Managing inherent risks in mutual fund service conversions

Best practice expertise and processes for successful mutual fund service conversions

Service conversion risks defined

The transition of administration, portfolio accounting, transfer agent, custody and distribution services from one mutual fund provider to another firm can be the most risky endeavor undertaken by a mutual fund company. The investment manager and fund board are trusting that the successor service provider will both successfully own and manage the entire process, with minimal impact to fund operations and investor servicing. In today's mutual fund regulatory and governance environment, the mutual fund trustees and chief compliance officer will likely face accountability for both the success and risks of the service transition, including risks such as:

Potential Service Conversion Risks

1. Data integrity
2. Fund complex reputational risk
3. Investor services disruption
4. NAV accuracy
5. Portfolio compliance
6. Pending portfolio, investor transactions, financial reporting

Service conversion methodology

A successful conversion of mutual fund services depends entirely upon the thoughtful, careful planning and expertise of your successor service team and a dedicated project manager. In addition to having significant experience converting similar funds and services, you should consider the tenure of the conversion team and conversion management methodology employed by the service provider. A well-established conversion program will use a project management methodology to coordinate the significant number of concurrent conversion tasks and interdependencies involved in major conversions occurring in generally a short 120-180 day time frame.

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“Expert planning and communication are your biggest conversion risks – the success of a 4-6 month conversion project depends on the first 30 days. Success also depends on the service team expertise to completely and accurately define each customer segment service and conversion requirements at the start of the project.”

Bob Kern
Executive Vice President
U.S. Bancorp Fund Services

Service implementation planning

The fund sponsor and fund board should be aware of two distinct aspects of their service migration – service implementation process distinct from the data conversion. The conversion of investor and portfolio data is only a part of the service implementation, which includes many other items, such as building your service team, communication protocols, establishing ongoing service performance measurement and reporting, daily reporting data and delivery. Key components of the project management process include the following critical items to ensure successful service implementation:

Service Implementation Plan – The successor administrator owns the service conversion process and will create a conversion plan document to cover all project management office items:

- Conversion contact list – All individuals, contact details, escalation protocol for each task.
- Detailed task list with milestones – Conversion tasks, dependencies, specific task owner and associated task deadline(s).
- Communication plan – Key contacts at each service provider and fund complex, including a plan for regular formal conversion dialogue regarding plan expectations, task progress against goal, dates and issue resolution.
- Customer segment notification – The plan should include both consideration and potential involvement of all customer segments within the mutual fund complex:

Mutual Fund Customer Segments		
Investors	Fund adviser	Fund board
Intermediary firms	Sub-advisers	Fund officers
Trading firms	Independent audit firm	Fund CCO

Service Requirements Definition – One of the most critical success criteria for each implementation is the discovery, validation and documentation of service goals and objectives required of each of the above customer segments – each of these parties has specific, unique requirements that must be included in the implementation plan. In order to meet these goals, the service provider should drive the process to identify and document the target service model regarding such items as investor services, communications, customization, reporting, board communications and compliance.

Data Conversion – A fund accounting conversion will typically entail conversion of security masters, tax lots, income/expense accruals and capital stock, with parallel NAV processing for 1-2 weeks. The transfer agent conversion will generally entail a conversion point, typically a weekend, with planned 1-2 mock conversions and associated remediation from each “dry run”. Both investor and portfolio data files are required early in the process to analyze the source data, map to successor systems, validate data and plan the process, including signoff by both parties.

Service Implementation Validation – Throughout the 4-6 month service implementation process, the successor service provider will continually validate the service and conversion requirements as well as task goals, to confirm the target service environment. Audit processes should be built into each conversion task to identify exceptions and confirm success.

Service conversion risk considerations

The table below outlines some of the critical risk areas when converting mutual fund accounting, administration, shareholder services, custody and distributor services.

Mutual Fund Service Conversion Potential Areas for Risk Consideration	
Risk	**Risk Mitigation Measure**
Fund administration and fund accounting services	
• Portfolio securities reconciliation • Income/expense accrual reconciliation • Portfolio transactions and financial reporting pending over conversion date • Reconciliation with custodian, transfer agent • Portfolio compliance	• Secure (proxy) asset list early in project; automate exception process • Securities accounting validation/expertise • Identify/plan/account for pending transactions, financial statements • Planned coordination of exception process • Audit all data received and prior compliance testing process/reporting; validate compliance with RIC SEC, IRC, prospectus, SAI at conversion
Custody services	
• Pending trade settlement over conversion • Income collection over conversion • Foreign market setup timing • Collateral management/RIC compliance conversion	• Plan for/identify/account for pending settlements, corporate actions • Identify securities/income source and track/account for pending receipt • Complete country setup documentation early in process (2-3 months) • Security/credit/collateral identification and segregation prior to conversion
Transfer agent and shareholder services	
• Pending NSCC trades over conversion • Intermediary platform trade support • Contact center preparedness • Shareholder services compliance; timely, accurate notification • Investor tax reporting for year of conversion	• Plan for/identify/adjust for pending NSCC trade/cash settlements • Intermediary communication and NSCC testing • Early contact center participation; training close to conversion date • Audit all data received; validate data vs prospectus, SAI, fund sponsor and customer segement service requirements • Successor firm coordination of specific responsibilities by specific parties to provide investor tax reporting
Distribution services	
• Dealer agreement conversion • Timely sales literature review/revision	• Early identification/communication with each intermediary for repapering • Inventory all fund materials/Web pages; compliance review

Conclusion

The ultimate success of a conversion of billions of dollars of mutual fund assets and hundreds of thousands of investor accounts depends on the expertise of the successor service team. This expertise drives the successful project management process, all stakeholder requirements analysis, the audit of data and processes, and the validation of service implementation results. The conversion team talent and project management process minimizes inherent process, exception, financial, operational and reputational risks associated with large service implementations.

“Over the past 10 years, we have managed the successful conversion of services for both large and small mutual fund families comprising over 85 fund complexes, 1,384 CUSIPS, 1.1 million shareholders and $395 billion in assets.”

About the author

Bob Kern is a managing director and executive vice president of U.S. Bancorp Fund Services. He began his career with U.S. Bancorp in 1982 and has served as a manager within the fund services subsidiary since 1984. From 1984 to 1994, Bob managed business development efforts as well as the mutual fund Transfer Agent operation including the Investor Services group, Account Services, Legal Compliance, Document Processing and Systems Support divisions. During that time, Bob assisted in the management and implementation of both services and technologies related to transfer agent and shareholder services, fund accounting, fund administration, literature fulfillment and fund distribution services.

Education and credentials

Bob received his undergraduate degree from Marquette University in business administration with specializations in finance and marketing. Bob serves as a board member of U.S. Bancorp Fund Services, Quasar Distributors, and interested trustee and chair of Managed Portfolio Series, an open-end mutual fund multiple series trust.

About us

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