

# Portability of Mutual Fund Shares

## *Survey Results – Final Report*

December 2006



## INTRODUCTION

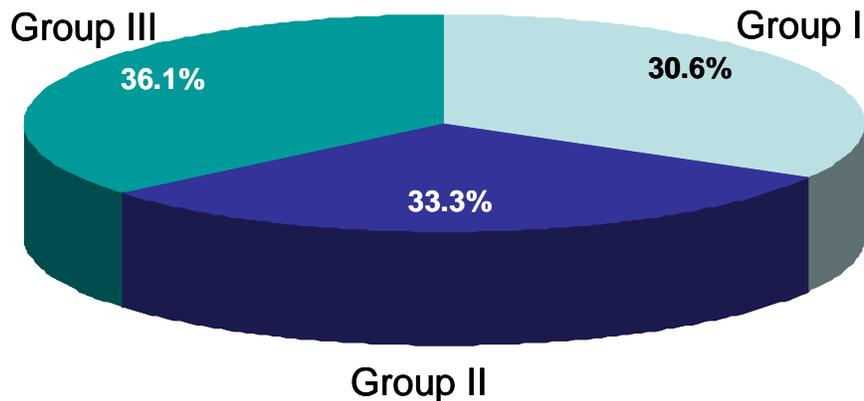
This survey was undertaken to measure the extent that mutual fund shares are currently portable and the degree to which portability of mutual fund shares has changed over the past five years. It also provided an opportunity to assess some relatively new initiatives such as Servicing Agreements and the ability of firms to reflect client assets not held at the firm on customer statements. The issue of mutual fund share portability is important to industry firms and to the SEC, which has monitored this issue for several years.

Responses to the survey were received from thirty-six firms, representing a cross-section of SIFMA's membership. It is important to note that many SIFMA member firms are not impacted by this issue and, therefore, did not respond to the survey.

For the purposes of the study, firms were segmented into three firm-size categories: **Group I** (firms that distribute fewer than 1,000 mutual funds); **Group II** (firms that distribute between 1,000 and 5,000 funds); **Group III** (firms that distribute more than 5,000 funds).

Most respondents indicated that the portability of mutual fund shares was a serious issue that deserved, and was getting, focus and attention.

### Distribution of Participating Firms



## CONCLUSIONS

SIFMA's Survey on the Portability of Mutual Fund Shares points to several conclusions, including:

- Survey respondents clearly believe that mutual fund shares are more portable today than five years ago.
- Participation in FundServ and/or Client Data Share is very relevant to firms' decisions to enter into Selling or Servicing Agreements with fund families.
- Non-affiliated funds account for the vast majority (91%) of the funds distributed by participating firms and are the most portable.
- Customers raise the issue of portability relatively infrequently.
- For most firms, the situation where a client wants to transfer shares but the receiving firm is unable to accept those shares is relatively infrequent. However, it appears to be somewhat more frequent for larger firms.
- Key impediments to entering into Selling Agreements include limited client demand and liability issues, among several other issues.
- Half the participating firms reported having Servicing Agreements with some fund families. The average number of agreements per firm is 45.

## HIGHLIGHTS

- Greater Portability: A considerable majority of firms reported that mutual fund shares are now as portable or more portable than five years ago. This varied only slightly by fund type.
- FundServ and Client Data Share: Overwhelmingly, participants indicated that a fund's participation in FundServ and/or Client Data Share are very relevant to their decision about whether or not to enter into Selling or Servicing Agreements.
- How Often Customers Raise the Issue: Fully half of the participating firms (50.0%) indicated that their customers raised the issue of mutual fund portability rather infrequently (1 or 2 on a five-point scale where 1=very infrequently). Slightly over one third (38.1%) indicated their customers raised this issue somewhat frequently or very frequently (4 or 5 on a five-point scale where 5=very frequently).
- Transfer of fund shares: The extent to which clients want to transfer fund shares, but the receiving firm is unable to accept such shares, varies. For all firms responding, 44.5% indicated that this happened very infrequently or never ("2" or "1" on a five-point scale where 1 = never). This proportion grew to 66.6% for Group I firms and to 54.6% for Group II. Group III firms, perhaps due to their more complex relationships, had a somewhat lower proportion of firms responding "1" or "2" and a slightly higher proportion responding "4" or "5" (on a five-point scale where 5=quite frequently).
- Selling Agreement Impediments: For both Brokerage Firms and Fund Families there are numerous impediments to entering into Selling Agreements. The two most frequently cited are limited client demand and liability issues.
- Extent of Servicing Agreements: Half of the responding firms (50.0%) indicated that they had Servicing Agreements with some Fund Families.
- Influences on decision to enter into Selling or Servicing Agreements: The extent to which due diligence, risk management, compliance and other considerations affect firms' decisions about entering into either Selling Agreements or Servicing Agreements is significant, with 94.4% and 63.0% of respondents saying "Yes," respectively.
- Special Compliance issues: Slightly more than one-third of respondents (34.8%) indicated that Servicing Agreements, in the absence of Selling Agreements, present special compliance issues.

## ANALYSIS OF SURVEY RESULTS

**Question 1: What is the total number of active customer accounts at your firm?**

### Average Number of Customer Accounts per Firm

<u>All Firms</u>	<u>Group I</u>	<u>Group II</u>	<u>Group III</u>
1,077,435	264,173	202,514	1,780,516

**Question 2: What percent of customer accounts hold mutual funds?**

### Percent of Accounts Holding Mutual Funds

<u>All Firms</u>	<u>Group I</u>	<u>Group II</u>	<u>Group III</u>
69.6%	86.5%	50.9%	64.2%

**Question 3: Approximately how many individual mutual funds does your firm offer to its customers?**

### Average Number of Mutual Funds per Firm

<u>All Firms</u>	<u>Group I</u>	<u>Group II</u>	<u>Group III</u>
4,299	274	2,111	10,330

**Of the total number of individual mutual funds offered, what proportion is in each of the following categories?**

### Proportion of Mutual Funds in Each Category

	<u>All Firms</u>	<u>Group I</u>	<u>Group II</u>	<u>Group III</u>
	-----( <i>percent of responses</i> )-----			
Affiliated Load Funds	4.2	32.1	1.0	4.0
Affiliated No-Load Funds	1.6	0.1	8.7	0.1
Non-Affiliated Load Funds	75.9	49.7	71.1	77.8
Non-Affiliated No-Load Funds	18.2	18.0	19.2	18.0
Total	100.0%	100.0%	100.0%	100.0%

**Question 4: To what extent are mutual fund shares more portable at your firm today compared with 5 years ago?**

	<b>Extent to Which Mutual Fund Shares are More Portable Compared with 5 Years Ago</b>			
	<b>Affiliated</b>		<b>Non-Affiliated</b>	
	<b>Load</b>	<b>No-Load</b>	<b>Load</b>	<b>No-Load</b>
	-----( <i>percent of responses</i> )-----			
More Portable 5	9.5	5.9	14.3	6.3
4	28.6	23.5	40.0	43.8
Same 3	57.1	64.7	31.4	34.4
2	-	-	5.7	9.4
Less Portable 1	4.8	5.9	8.6	6.3
Total	100.0%	100.0%	100.0%	100.0%

**Question 5: To what extent have your customers raised the issue of mutual fund share portability during the past year?**

	<b>Extent to Which Customers Have Raised Issue of Mutual Fund Portability</b>			
	<b>All Firms</b>	<b>Group I</b>	<b>Group II</b>	<b>Group III</b>
	-----( <i>percent of responses</i> )-----			
Very Frequently 5	2.8	8.3	-	-
4	25.0	8.3	45.5	23.1
3	22.2	-	9.1	53.8
2	19.4	33.3	27.3	-
Very Infrequently 1	30.6	50.0	18.2	23.1
Total	100.0%	100.0%	100.0%	100.0%

**What issues do your customers typically raise regarding share portability?**

Responding firms indicated that their clients typically raised issues similar to the following:

- Whether or not the firm can hold no-load and proprietary funds
- Can certain share classes (e.g., B and C shares) be held
- How will account/transaction history be affected
- Can funds in 401(k) be held in rollover IRA

**Question 6: How often has your firm experienced the situation where a client wants to transfer mutual fund shares to or from your firm, but the receiving firm is unable to accept such shares?**

	<b><u>Extent to Which Firms Have Experienced this Situation</u></b>			
	<b><u>All Firms</u></b>	<b><u>Group I</u></b>	<b><u>Group II</u></b>	<b><u>Group III</u></b>
	-----( <i>percent of responses</i> )-----			
Quite Frequently 5	5.6	-	-	15.4
4	22.2	25.0	18.2	23.1
3	27.8	8.3	27.3	46.2
2	38.9	58.3	45.5	15.4
Never 1	5.6	8.3	9.1	-
Total	100.0%	100.0%	100.0%	100.0%

**What are the key reasons firms are unable to accept such shares?**

Responding firms indicated that their clients typically raised issues similar to the following:

- Funds are Proprietary
- Minimum investment too high
- Lack of sales agreement
- No-load funds not held
- Paperwork requirements/due diligence
- Share class is ineligible

**Question 7: If a client at your firm holds Mutual Funds or other assets at another financial institution can you reflect those assets on your firm's customer statement?**

	<b><u>Whether Firms Can Reflect Client Assets Held Outside the Firm on Customer Statements</u></b>			
	<b><u>All Firms</u></b>	<b><u>Group I</u></b>	<b><u>Group II</u></b>	<b><u>Group III</u></b>
Yes	19.4	16.7	9.1	30.8
No	80.6	83.3	90.9	69.2
Total	100.0%	100.0%	100.0%	100.0%

Approximately 20% of firms reported that they can reflect assets held by a client at another financial services firm on their customer statements. Of those who are able to do so, they may not be able to reflect all client assets, however.

**Question 8: Approximately how many Fund Families have selling agreements with your firm?**

**Average Number of Selling Agreements per Firm**

<u>All Firms</u>	<u>Group I</u>	<u>Group II</u>	<u>Group III</u>
203	90	140	224

**Question 9: What are the key impediments (experienced by your firm or cited by Fund Families) to entering into Selling Agreements for Brokerage Firms and Fund Families?**

**Extent to Which Firms Identified Certain Impediments to Entering Into Selling Agreements**

	<u>All Firms</u>	<u>Group I</u>	<u>Group II</u>	<u>Group III</u>
	-----( <i>percent of responses</i> )-----			
<b><u>FOR BROKERAGE FIRMS</u></b>				
Costs	12.3	5.3	22.7	10.0
Compensation/Cost Reimbursement	11.1	5.3	9.1	15.0
Transparency of Data	13.6	26.3	13.6	7.5
22(c) issues	6.2	5.3	4.5	7.5
Limited Client Demand	28.4	26.3	31.8	27.5
Liability Issues	14.8	10.5	13.6	17.5
Other	13.6	21.1	4.5	15.0
Total	100.0%	100.0%	100.0%	100.0%
<b><u>FOR FUND FAMILIES</u></b>				
Costs	15.9	14.3	17.6	15.9
Compensation/Cost Reimbursement	9.1	11.9	8.8	11.4
Transparency of Data	6.8	7.1	5.9	11.4
22(c) issues	9.1	9.5	8.8	11.4
Limited Client Demand	25.0	28.6	29.4	15.9
Liability Issues	15.9	11.9	11.8	18.2
Other	18.2	16.7	17.6	15.9
Total	100.0%	100.0%	100.0%	100.0%

In addition to the reasons cited above, firms offered the following reasons:

- Not FundServ compatible
- Due diligence issues
- Operational compatibility
- Indemnity issues

**Question 10: Are there due diligence, risk management, compliance or other considerations that affect your decision about whether or not to enter into a selling agreement?**

**Whether Due Diligence, Risk Management, Compliance and Other Factors Affect Firms' Decision to Enter Into Selling Agreements**

	<u>All Firms</u>	<u>Group I</u>	<u>Group II</u>	<u>Group III</u>
Yes	94.4	83.3	100.0	100.0
No	5.6	16.7	-	-
Total	100.0%	100.0%	100.0%	100.0%

With respect to the reasons cited above, firms offered the following factors:

- ❖ Front/back office considerations
- ❖ Operational compatibility
- ❖ Ability to meet due diligence criteria
- ❖ Sufficient demand to justify risks

**Question 11: Does your firm have servicing agreements with Fund Families?**

**Whether Firms Have Servicing Agreements With Fund Families**

	<u>All Firms</u>	<u>Group I</u>	<u>Group II</u>	<u>Group III</u>
Yes	50.0	41.7	45.5	61.5
No	50.0	58.3	54.5	38.5
Total	100.0%	100.0%	100.0%	100.0%

**Approximately how many Fund Families have servicing agreements with your firm?**

**Average Number of Servicing Agreements per Firm**

<u>All Firms</u>	<u>Group I</u>	<u>Group II</u>	<u>Group III</u>
45	101	21	25

**Actions Typically Covered by Servicing Agreements**

	<u>All Firms</u>	<u>Group I</u>	<u>Group II</u>	<u>Group III</u>
	-----( <i>percent of responses</i> )-----			
Maintain Existing Position	23.1	20.0	20.8	26.9
Reinvestment of Dividends	18.5	20.0	16.7	19.2
Reinvestment of Capital Gains	18.5	20.0	16.7	19.2
Process Redemptions	20.0	13.3	20.8	23.1
Receive trails/other revenue	15.4	13.3	20.8	11.5
Other	4.6	13.3	4.2	-
Total	100.0%	100.0%	100.0%	100.0%

**Question 12: If you are a party to any servicing agreements that do not permit you to reinvest dividends and capital gains on behalf of the account holder, please explain how you handle reinvestment?**

Respondents typically indicated that in this type of situation, dividends and capital gains are paid to clients in cash.

**Question 13: What are the key impediments (experienced by your firm or cited by Fund Families) to entering into Servicing Agreements for Brokerage Firms and Fund Families?**

**Extent to Which Firms  
Identified Certain Impediments to Entering Into Servicing Agreements**

	<u>All Firms</u>	<u>Group I</u>	<u>Group II</u>	<u>Group III</u>
	-----( <i>percent of responses</i> )-----			
<b><u>FOR BROKERAGE FIRMS</u></b>				
Costs	15.6	14.3	20.0	13.0
Compensation/Cost Reimbursement	11.1	14.3	6.7	13.0
Transparency of Data	11.1	14.3	13.3	8.7
22(c) issues	6.7	-	13.3	4.3
Limited Client Demand	17.8	28.6	6.7	21.7
Liability Issues	17.8	14.3	26.7	13.0
Other	20.0	14.3	13.3	26.1
Total	100.0%	100.0%	100.0%	100.0%
<b><u>FOR FUND FAMILIES</u></b>				
Costs	18.5	25.0	20.0	14.3
Compensation/Cost Reimbursement	14.8	12.5	-	21.4
Transparency of Data	14.8	12.5	40.0	7.1
22(c) issues	3.7	-	-	7.1
Limited Client Demand	14.8	25.0	-	14.3
Liability Issues	18.5	12.5	40.0	14.3
Other	14.8	12.5	-	21.4
Total	100.0%	100.0%	100.0%	100.0%

In addition to the reasons cited above, firms offered the following:

- Firm's policy is to only sign Selling Agreements
- Administrative burdens overseeing a large number of relationships

**Question 14: Are there due diligence, risk management, compliance or other considerations that affect your decision about whether or not to enter into a servicing agreement?**

**Whether Due Diligence, Risk Management, Compliance and Other Factors Affect Firms' Decision to Enter Into Servicing Agreements**

	<u>All Firms</u>	<u>Group I</u>	<u>Group II</u>	<u>Group III</u>
Yes	63.0	44.4	62.5	80.0
No	37.0	55.6	37.5	20.0
Total	100.0%	100.0%	100.0%	100.0%

Responding firms that indicated "Yes" offered the following additional insights:

- Must meet minimum due diligence criteria/requirements
- Tradeoff between liability concerns and client demand

**Question 15: Do Servicing Agreements, in the absence of Selling Agreements, present any special compliance issues?**

**Whether Servicing Agreements, in the absence of Selling Agreements Present any Special Compliance Issues**

	<u>All Firms</u>	<u>Group I</u>	<u>Group II</u>	<u>Group III</u>
Yes	34.8	30.0	75.0	22.2
No	65.2	70.0	25.0	77.8
Total	100.0%	100.0%	100.0%	100.0%

Of the firms that responded "Yes" the following reasons were offered:

- Suitability concerns if product was not originally sold by firm
- Compensation and liability issues
- Annual review requirement

**Question 16: To what extent is a fund’s participation in FundServ or Client Data Share relevant to your decision whether to enter into a selling or servicing agreement with that fund family?**

	<b><u>Extent to Which Firms Have Experienced this Situation</u></b>			
	<b><u>All Firms</u></b>	<b><u>Group I</u></b>	<b><u>Group II</u></b>	<b><u>Group III</u></b>
	-----( <i>percent of responses</i> )-----			
Very relevant 5	51.4	33.3	60.0	61.5
4	22.9	41.7	20.0	7.7
3	11.4	8.3	10.0	15.4
2	5.7	16.7	-	-
Not relevant 1	8.6	-	10.0	15.4
Total	100.0%	100.0%	100.0%	100.0%

If you responded “5” or “4” please explain why it is relevant. Responses fell into the following general categories:

- Efficiency/ease of transferring customer data
- Policy to only deal with funds that participate in FundServ
- Infrastructure for standard industry interfaces
- Data transparency

If you responded “2” or “1” please explain why it is relevant. Very few firms responded in these categories and most indicated that it was not relevant because trades go through their clearing broker or clearing firm.