

MEMO# 27694

November 12, 2013

Status of ICI Committee Work on Business Continuity and Unscheduled Market Closures

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TO: BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 39-13
BROKER/DEALER ADVISORY COMMITTEE No. 51-13
OPERATIONS COMMITTEE No. 52-13
TRANSFER AGENT ADVISORY COMMITTEE No. 80-13 RE: STATUS OF ICI COMMITTEE WORK
ON BUSINESS CONTINUITY AND UNSCHEDULED MARKET CLOSURES

BACKGROUND

During the Superstorm Sandy weather event in October 2012, ICI engaged with Institute members, intermediaries, service providers, and the Depository Trust & Clearing Corporation (DTCC) [\[1\]](#) to discuss operational issues and processing needs that confronted the industry throughout the event. These discussions highlighted a variety of issues that require special consideration when there is a disruption to normal market activity. To address these and future concerns, a permanent committee was formed – the Business Continuity Planning Steering Committee (BCPSC) - that consists of members of the Broker/Dealer Advisory Committee (BDAC) and Bank, Trust and Retirement Advisory Committee (BTRAC). The BCPSC's goal is to develop common practices for industry participants that can be utilized to improve operational processing as part of BCP plans for future events.

The Institute's Transfer Agent Advisory Committee (TAAC) also engaged its Unscheduled Market Close Task Force (UMCTF) post Sandy. The group was tasked with updating transfer agent documentation established and shared with the industry in 2008, following an unscheduled market closure due to a presidential day of mourning.

Both the BCPSC and the UMCTF began conducting conference calls in December 2012 to develop and revise documentation to aid industry stakeholders with operational issues during unscheduled market closures as a result of lessons learned during Hurricane Sandy.

STATUS OF BCPSC AND UMCTF WORK

BCPSC

Several operational processing issues were raised during the October weather event that affected funds, intermediaries, service providers, and the DTCC. In order to organize the committee's work, a post mortem assessment was conducted by the mutual funds and, separately, by intermediaries. Those assessments were then reconciled by the BCPSC and the issues identified were categorized into four areas: NAV Pricing/Dividends, Transfers, Trading, and Output. To address the issues identified for each area, subgroups were formed representing a cross-section of BCPSC members and supplemented with subject matter experts from representative firms. The subgroups began conference calls in March 2013 to vet the following issues, and develop recommendations on industry best practices and potential enhancements for operational processing with intermediaries occurring primarily through the industry's utility ("the DTCC") during and after unscheduled market closure events:

NAV Pricing/Dividends

Practices regarding NAV pricing should include:

1. Distribution of Net Asset Values upon reopening of markets after an unscheduled close. The practices also should address the communication of corrected NAVs.
2. Expectations for communication of open/close status of funds. The assessment should include what information intermediaries expect to receive from funds and what communication protocols will be used.
3. Implications for compensation. Depending on the timing of the event, the processing of intermediary fees may be affected by the inability of fund transfer agents to run normal processing routines during the market closure. Generally transfer agent systems execute many processes in a set sequence as part of their nightly cycles beginning with trade processing. During an unscheduled market close, full nightly processing cycles are not typically running. This impacts the execution of routines such as processing of intermediary compensation which normally follow completion of trade processing within the nightly processing cycle. As a result, compensation processing is delayed until the next business day the market is open.

Considerations regarding the passing of dividend rates should include:

1. The delivery of single day vs. bulk (multiday) rates. Intermediaries prefer that single day rate information is provided by funds for each day the market is closed.
2. Communications and processing impacts for corrections to the daily rates calculated for each of the days during the unscheduled closure, if changes are required after their release once the markets have reopened.
3. Effect of an unscheduled close if the Record Date and/or Ex-Date/Reinvestment date falls during the unscheduled closure.

Transfers

Three types of transfers were examined within the context of the unscheduled

close: (1) DTCC ACATS-Fund/SERV [2], (2) NSCC Networking [3], and (3) Manual. However, the group agreed to focus primarily on ACATS-Fund/SERV transfers to resolve timing issues and address settlement considerations for firms.

ACATS-Fund/SERV transactions have unique timing considerations because firms use a single system (ACATS) for transferring multiple security types that must sync with mutual fund processing (Fund/SERV), thereby limiting transfer flexibility during unscheduled closures:

- ACATS transfers are initiated by intermediaries 1-2 business days prior to receipt by funds. Therefore, unlike other trading files, these transactions are already ‘in flight’ for processing prior to an unscheduled closure;
- ACATS transfers must be acknowledged as received by funds within two nightly processing cycles. Failure of the fund to do so will cause the ACATS transfer to fail and require the intermediary firms involved with the transfer to manually complete the transfer outside of the NSCC system;
- Because most fund transfer agent systems typically acknowledge and process transfers with other price-dependent transactions as part of normal processing cycles, and since those cycles are not typically run during an unscheduled closure, corresponding transfers were not acknowledged or processed. The result was significant post-event coordination and manual processing between the intermediary firms and funds that could not acknowledge and complete ACATS-Fund/SERV transfers.

To alleviate future problems, this subgroup explored the transfer processing issues identified above and conducted a BCPSC fund survey on current and future ACATS-Fund/SERV practices that revealed additional considerations:

1. Altering the processing cycle of an ACATS transfer is not a viable option as the system is also utilized by firms to transfer other security types. In addition, the ability to complete an ACATS-Fund/SERV transfer “on time” is critically important to the overall transfer process.
2. Long term, fund transfer agent systems will need enhanced capabilities that will allow funds to acknowledge receipt of ACATS-Fund/SERV transfers within two nightly processing cycles of receipt during an unscheduled close.
3. Short-term recommended practices will need to be developed for communicating transfer acknowledgements outside of the NSCC, for those fund transfer agents that do not have automated acknowledgement capability during unscheduled closures.
4. Fund practices also should include providing single-day dividend rates for transfers processed, where possible, to reduce breakage on ACATS-Fund/SERV transfers that are due to settle during an unscheduled closure.

Trading

Operational processing issues for trading include:

1. Practices for funds and intermediaries that address trade delivery from intermediaries for transactions submitted by their clients that were received in good order during an unscheduled close.
2. Effect of an unscheduled close on NSCC Defined Contribution Clearance & Settlement trading.
3. Considerations for settlement cycles that will continue during unscheduled market closures when the DTCC is open.
4. Special circumstances surrounding money market fund share trading conducted directly with funds. Since the majority of the money market fund activity does not transact through the NSCC, each fund will need to clearly communicate to intermediaries their requirements for trading of any money market or fixed income funds open during a general market closure.

Output

Processing issues related to file output include:

1. Review of the primary files exchanged through DTCC by funds and intermediaries.
2. Classification of files into two categories: critical settlement files (position and activity) used for reconciliation and secondary data files (non-critical) which primarily are used for analysis and oversight but are not time sensitive.
3. Considerations and delivery timeframes for critical and secondary files sent by both funds and intermediaries.

UMCTF

In addition, the TAAC's task force began a comprehensive review of the 2008 industry documentation in light of the 2012 weather event. Their focus centered on many of the same issues the BCPSC identified, but related to fund transfer agent operations only. The UMCTF completed their review and agreed on recommended changes to the unscheduled market close documentation in August 2013.

NEXT STEPS

Each subgroup has produced a draft industry practices document that addresses most of the issues identified above, which has been reviewed by the BCPSC. [\[4\]](#) Those drafts are now being distributed to BDAC and BTRAC for broader member review. Once all comments are received and incorporated, the BCPSC documentation will be harmonized with the UMCTF documentation by a joint working group. The goal is to provide a single reference source on operational processing issues and common practices for Institute members and industry stakeholders to utilize in their BCP planning for unscheduled market closures. The final draft document will be reviewed by ICI and antitrust counsel prior to release. The target delivery date for the final documentation is year-end 2013. These ICI groups will continue to address BCP issues and refine the industry documentation as issues arise or are identified to improve operational processing for future events.

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endnotes

[1] As the securities industry utility, DTCC's subsidiary - the National Securities Clearing Corporation (NSCC) provides critical services for trading and settlement (Fund/SERV), and data exchange (Networking), which facilitate automated activity between mutual funds and intermediaries.

[2] Intermediary firms (e.g., banks, broker/dealers) utilize the DTCC's Automated Customer Account Transfer System to move customer securities positions, including those held in mutual funds, between firms. ACATS interfaces with NSCC's Fund/SERV platform to facilitate the re-registration of mutual fund shares between broker accounts on the fund's primary transfer agent system. The successful ACATS transaction creates a settlement obligation and expectation that shares move between the intermediary firms..

[3] Networking transfers are primarily utilized to re-register shares within an intermediary firm's accounts held on the fund's primary transfer agent system.

[4] To date only industry practices and not DTCC system enhancements have been recommended by the subgroups. Transfer agent service providers (both proprietary and external) are in the process of determining whether their own systems require enhancements to meet recommended industry practices.