INVESTMENT COMPANY INSTITUTE

MEMO# 8723

March 17, 1997

OPERATIONAL CONSIDERATIONS OF INDUSTRY GROWTH AND CHANGE

March 17, 1997 TO: BOARD OF GOVERNORS No. 20-97 OPERATIONS COMMITTEE No. 7-97 PRIMARY CONTACTS - MEMBER COMPLEX (MEMBERS - ONE PER COMPLEX) No. 18-97 RE: Operational Considerations of Industry Growth and Change ____ I. BACKGROUND Steady growth of mutual fund assets and shareholder accounts combined with the growing prominence of newer distribution intermediaries, such as mutual fund marketplaces, retirement plans and financial planners, have contributed to the complexity of the mutual fund business and require continued improvements in the servicing environment. Because shareholder trust and confidence in the industry depends in large measure upon the industrys ability to provide investors with precise, timely and uninterrupted information, as well as access to their investments, it is important that the industry continue its ongoing service improvement programs and evaluations of its ability to provide high quality service to shareholders. Of particular importance is the industrys ability to respond to changes in peak capacity demands. An example of capacity planning is described in the attached article from Securities Industry News which describes steps being taken by the New York Stock Exchange to assess existing operational capacity and to increase its ability to meet peak demand by providing capacity to accommodate five times its average daily volume. The NYSEs decision is part of a regular review of its ability to execute transactions within comfortable thresholds, with "room to spare." The Institute has consulted with a number of members from different segments of the industry to identify practices used in assessing capacity needs. Based on these discussions, we have developed for your consideration the following factors and questions relevant to assessing operational infrastructure and peak demand capability. While every factor will not be relevant to each members, we hope you find it to be a helpful tool. II. SERVICING CAPABILITIES As the NYSE has done, members may wish to evaluate operational capacity in light of current average daily transaction volume and historical peak demand. Of course, capacity needs will vary among fund groups due to different distribution methods and organizational structures. Specific factors for your consideration are identified below. A. Technological Resources 1. Telephone line capacity into call distribution and voice response systems. 2. The ability of call distribution and voice response systems to absorb additional call volume, maintain calls in queue and the resulting impact an increase in volume will have on response time and abandoned call targets. In assessing telephone capacity, members may wish to consider both an increase in the number of calls and in the average length of phone calls. 3. The capacity of transaction processing workstations, imaging systems, automated work distributors, web sites, and either local or wide area networks to absorb a substantial increase in volume. 4. The availability of extra telephone, service, and transaction processing stations to absorb an increase in peak demand quickly. 5. The capabilities of any third-party call vendors and remote call centers to accommodate peak demand. 6. The ability of transfer agent systems to remain operational beyond standard cutoff times and still meet traditional nightly processing cycles. 7. The use of centralized automated transaction and information exchange systems, such as NSCCs FundSERV and Networking Services, to reduce reliance on manual processing. 8. The capabilities of distribution intermediaries to accommodate growth and changes in peak demand within the established time frames and their ability to provide periodic reports of transaction volume throughout the day. 9. The ability of output and mailing facilities to accommodate a surge in the volume of confirmations, checks, correspondence and requests for fulfillment materials. 10. The ability to place special messages on telecommunications systems (such as voice response units, automated call distributors and web sites) quickly. B. Human Resources 1. The availability and training of staff, in both call centers and transaction processing departments, to accommodate fluctuations in peak demand. 2. The training of staff to respond to more complex and longer calls due to changes in the markets. 3. The flexibility of staff to accommodate extensions of service hours during peak capacity periods, should an increase in customer activity indicate a need to extend service hours. C. Third-Party Service Agents and Vendors Members also may wish to consider evaluating the capabilities of third party providers to accommodate an increase in servicing demands, particularly during periods when demands from their other clients may also be increasing. Most of the items described above could apply to third party providers. One technique that may be useful to consider is the use of third party telecommunications firms to absorb overflow telephone calls and inquiries. D. Short-Term Funding Needs Many distribution intermediaries aggregate investors fund share transactions and report a net settlement amount for a fund to receive or pay well past the close of trading on the New York Stock Exchange. These channels of distribution, which frequently require next day settlement, may have reduced the time frame to meet next day settlement expectations. Cash on hand, new fund sales, income collections, maturing obligations, and sales of portfolio securities have provided the traditional source of funds to meet settlement obligations. Because of the natural time delay between T + 3 settlement of portfolio transactions and the next day settlement of shareholder transactions, many mutual funds have chosen to establish lines of credit to supplement short-term funding needs. If additional sources of short term funds are determined to be advisable, it may be appropriate to consider establishing either "committed" or "uncommitted" lines of credit with multiple institutions in order to reduce exposure to funding demands of one bank. We understand this segment of the credit market has recently become increasingly competitive. Any evaluation resulting in the establishment of borrowing arrangements should include a review of the requirements of Section 18(f) of the Investment Company Act, as well as any prospectus limitations governing the amount of borrowing. It should be noted that borrowing can increase a funds risk profile due to the leverage inherent in the transaction. E. Regulatory Considerations The Investment Company Act generally requires mutual funds to price portfolios and process investor orders every business day. There are limited exceptions, such as when the New York Stock Exchange is closed or the SEC grants relief. The SEC has granted relief on specific occasions when markets have closed or in the case of external emergencies such as weather. The SEC has never granted relief due to limitations in a mutual funds operational capacity. ******************************** If you have any questions regarding these recommendations please call Donald Boteler at (202) 326-5845 or the undersigned at (202) 326-5857. Lawrence R. Maffia Senior Vice President - Management