

The Growing Problem of Managing Omnibus Distribution

Balancing asset distribution with expense is getting harder, and why you should care.

Introduction

Assets within the mutual fund distribution channel are migrating away from accounts that trade directly with the fund company and toward larger omnibus accounts at intermediaries. With this fundamental shift in distribution come several growing fiduciary risks, which have historically been hidden from view and frequently ignored as just “the cost of doing business”.

As the market softens and becomes more competitive, fund company directors and executives can no longer ignore these risks, and must scrutinize whether the distribution expense associated with these complex omnibus fee relationships justify the revenue they generate.

Relationship managers increase distribution

As they are tasked to do, fund company **relationship managers increase revenue** by increasing the volume of assets in the distribution channel. They frequently **establish unique fee agreements** to incentivize distributors to carry their products, thereby increasing fund company revenue.

Fee agreements generate invoices

Fee agreements translate into invoices sent from the distributor to the fund company. Each distributor sends their invoices in a unique format. Some distributors still send pdf or paper bills. Each distributor has unique fee agreements.

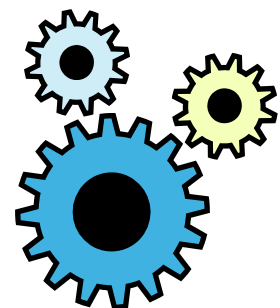
As the **agreements become more complex, so do the invoices**. Omnibus billing involves multiple relationships on the same set of assets, including 12b-1 fees, network fees, sub-TA and service fees (among others). Distributors do typically provide detailed asset and account breakdowns on each invoice line item.

Operations handles the invoices

Invoice handling falls in the domain of operations personnel, typically within the fund company’s finance group. The staff need to decipher the incoming invoices, validate the bills against the most recent fee agreements, make sure that all invoices are received and paid, and that there are no double bills.

The **mechanics of processing invoices today are completely manual**. Each invoice must be handled “one-at-a-time” using Excel.

Processing demands highly specialized knowledge regarding each distributors invoice. There is no standard for storing, organizing or accessing fee agreements. It is not possible for operations to validate every line item of long and complex invoices against the correct version of each fee agreement. Fee agreements



change over time, increasing the likelihood of errors between the distributor and the fund company. Manual allocation of fees to either the fund or the investment manager reduces accuracy even further.

Without proper tools, operations executives **must hire additional staff** to manage these invoices. The difficulty, expense and risk of managing these invoices grow as assets shift toward omnibus relationships. As a director or finance executive, you may want the challenge of handling invoices and payments to simply go away.

Although managing invoices is complicated, risky and expensive, the **real problem for executives and directors is much larger**. Even though operations staff labor to assemble some type of summary data from the myriad of underlying spreadsheets, visibility into the business is severely limited.

Omnibus assets and their distribution expense are a black box

Once relationship managers establish fee agreements, they have **no visibility into the assets at the distributors**, or the flows into and out of those distributors over time. Finance executives ride herd on distribution expenses associated with those assets that have been lumped into a large “black box” and considered the “cost of doing business”.

The fact that relationship managers can't see their assets, and that finance executives can't see distribution expenses associated with them can no longer be ignored.

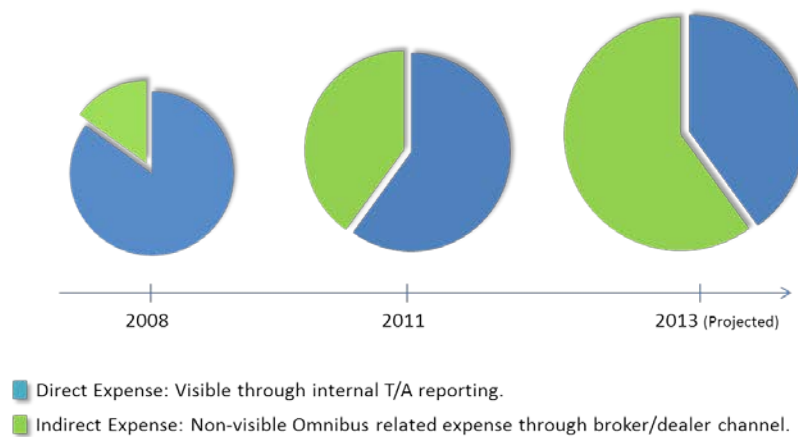
Starting to ask questions

Directors and executives at forward looking fund companies are beginning to **ask deeper questions** and **search for visibility** inside the black box.

Relationship managers want to see the level of **assets at specific distributors**, how they **break down by fund**, and **how the asset levels change over time**.

Finance executives want to break down total distribution expense into **indirect expense** (where intermediaries roll up investor assets into omnibus accounts) and **direct expense** (where investors maintain direct trading accounts with the fund company).

Fund Distribution Expenses Over Time



The **sum** of indirect and direct distribution expenses, as well as the **ratio** between indirect and direct expense **have grown over time**. The above graphic describes the impact omnibus related expense has on overall expense ratios for an actual mid-sized fund company. This trend toward complex indirect distribution expense will only continue to accelerate.

Directors want to rationalize how to **allocate distribution expenses** to either the funds or to the corporation, and need more detailed understanding. Ultimately, they want to answer shareholders' questions about **the effect of distribution expense on profitability**.

Without tools to "see inside the black box", it's difficult for executives and directors to make intelligent decisions about how distribution fees should be structured and rationalized with the distributors.

The Solution: Modern invoice processing

Modern data processing services provide a solution that covers two major categories: **'straight-through' invoice processing** and **business intelligence**.

It is now possible for modern service providers to **validate each line item** of each invoice against the correct fee parameters, flagging only exceptions for internal review and resolution. Using highly sophisticated and flexible technology, service providers can now automatically **allocate each distribution expense** to the appropriate cost center according to custom configured rules, eliminating the labor and risk of manual calculation errors. Automated calculations improve the bottom line by **reducing labor, eliminating wasted expense of overpayments**, while simultaneously protecting your future cash flow from the **liability of underpayments**.

Clean and relevant analytics data

Modern service providers can now give you direct access to clean, organized, and immediately accessible **analytics data about the assets** in your distribution channel **and expenses** required to support them. Modern technologies provide you with a clear view of where your assets are in the distribution channel and the cost involved in supporting that distribution.

New visibility leads to effective decisions

Distribution relationships are a fund company's **lifeline to the marketplace**. Executive's ability to manage their company hinges on having all distribution data in one place, including where assets are in the distribution channel as well as the distribution expense associated with those assets.

Today, **relationship managers can see assets** by distributor, fund type, and share class, including the dynamics of asset shifts in their distribution channel over time. **Compliance and operations executives** have independent and completely transparent access to actual results of invoice processing, assured compliance between payments and contracts, (with immediate awareness of any exceptions), simplifying audits and avoiding potential corporate embarrassment.

Finance executives can see the distribution expense load required to support those assets. Automated tools produce true business intelligence, allowing fund company executives to work together and make intelligent decisions about the **fee agreements** that lie at the sensitive intersection between revenue and asset distribution expense.

Executives and directors can more effectively carry out their **fiduciary responsibilities** to their shareholders by fully understanding the contents of what had previously been a black box, and making **effective decisions** based on the latest in business intelligence.

*Written by **Charlie Pepler**, CEO of Capnetix.*

Capnetix provides intermediary invoice handling services for the mutual fund industry, using the latest in record keeping, systems integration and process technologies. Visit our website at <http://www.capnetix.com>. Follow us on Twitter @Capnetix.

