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## In European Investment Fund Settlement

**The post-trade processing and settlement infrastructure of the European investment funds marketplace is even more fragmented than the securities market equivalent, and it is getting more complicated rather than less. But there is a way to bypass the complexity.**

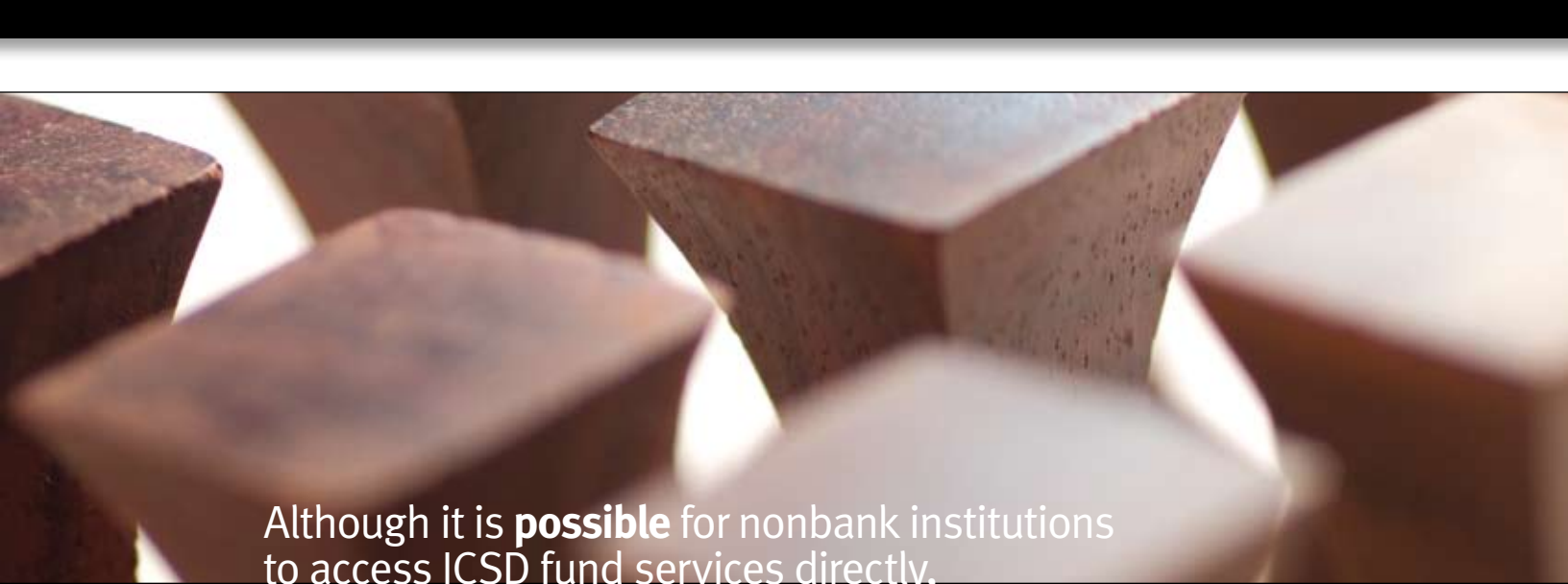
European fund managers aim to distribute their investment funds in as many markets as possible. To achieve this, they have had to build complicated networks of banks, private wealth managers, brokers, private banks and IFAs to act as fund distributors. Those distributors must, in turn, be supported by an even more complicated infrastructure of transfer agents, order-routing platforms and settlement systems to complete the subscription, redemption and switching transactions they initiate on behalf of clients in each market.

Distribution networks are typically domestic in nature, and peculiar to a particular market. Supporting infrastructure is usually domestic, too; although in Europe the rise of Dublin and Luxembourg as specialist fund administration centers, and of Clearstream and Euroclear as international centralized securities depositories (ICSDs), means domestic distributors can be serviced remotely. The result is a complex mosaic of commercial transfer agents, domestic and cross-border settlement utilities, bank intermediaries, order-routing systems, legal, regulatory and tax jurisdictions, and market-specific procedures and methods of communication. The picture it presents is of a bewildering array of choices, challenges and charges.

Efforts to impose order on this chaos have made limited progress. The consolidation of banks, which still dominate distribution in continental Europe, has barely begun. Fund managers cannot agree on pan-European distribution contracts, and appoint a separate transfer agent in each market. Mergers between central securities depositories (CSDs) have stalled, leading to closed systems offering limited access to counterparts. Unlike the United States, where a single CSD-owned order-routing network connects fund distributors and fund managers throughout the country, Europe also has a medley of domestic order-routing networks and two cross-border alternatives. The adoption of SWIFT message standards is far from universal, and fax remains the preferred method of communication for many.

So what are fund managers to do? The answer lies in a modification of a banking service invented to overcome the fragmentation of the European marketplace long before its consolidation, harmonization and standardization was even considered. Eurobond issuers have for many years deposited a single “global” bond or note in Euroclear and Clearstream. This enables the custodian banks appointed as “common depositories” to issue bonds to investors in multiple markets and settle transactions in them via their accounts at Euroclear and Clearstream, and indeed between accounts at either CSD over the electronic bridge that links them. This method proved so convenient that banks adapted it to new purposes. Fund managers can issue a “global” fund certificate into either or both ICSDs, enabling the same common depository banks to use their accounts at Clearstream and Euroclear to create units in the fund for investors as they are purchased, and redeem them as they are sold.

By this means, thousands of individual investments in a fund by investors located in multiple markets are reduced to a single aggregate holding in a single account



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operated by a single bank on behalf of a single fund manager. Investors that use their custodians to settle equity and fixed income transactions on their behalf in the ICSDs already find it a convenient method of settling funds business, as an account exists already, and their custodian bank has the connectivity to operate it. Distributors value the approach too, because they retain control of the relationship with the underlying investors, but do not have to invest in connections to multiple settlement venues. They can also collect and redeem large-value subscriptions and redemptions without concerns about their creditworthiness, because the transactions are intermediated by a bank. Bank intermediation is an important consideration for managers, too, because the ICSD fund services are used not only by banks, but also by major brokers and fund promoters globally.

This is why, although it is possible for nonbank institutions to access ICSD fund services directly, few have chosen to do so. Access to counterparties can be an issue where a segregated rather than a main platform is made available. Furthermore, even when they can access a main platform at an attractive price, most fund managers and their transfer agents and distributors prefer to settle transactions between accounts at the ICSDs via intermediaries. Managers and agents may struggle to support their own high value, institutional-scale fund transactions in terms of credit rating and access to liquidity and connectivity. Most also prefer not to perform the functions currently performed by settlement agents and common depository banks.

Even with low fees for direct access, the savings from eliminating banks from the chain are unlikely to cover the costs of replicating these functions, plus the costs of the connectivity and account operating overheads the

banks are incurring at both ICSDs. Therefore, the main effect of greater openness to nonbanks is increased complexity as well as choice in the post-trade processing of European fund transactions. It is now possible to settle fund transactions in Euroclear and Clearstream by no less than six different methods. And those are just the options for fund settlement at the ICSDs. There are other order-routing systems and settlement platforms in all of the domestic funds markets of Europe.

This fragmentation is why JPMorgan is experiencing considerable growth in its Investment Fund Clearance (IFC) service, in which the bank acts as a settlement agent for global fund certificate programs at the ICSDs. In a market where the options for settling institutional mutual fund transactions are increasing, and there is neither a single place nor a single method of settlement, IFC offers managers and distributors a convenient means of overcoming the fragmentation of the post-trade infrastructure. Many fund managers are already using the service. Thirteen of the top 20 global fund managers serviced by JPMorgan have global note programs — and the volume of transactions settled by IFC is equivalent to nearly two thirds of the daily fund transaction volumes at the two ICSDs. In the same way as it insulates clients from the complexity of the European securities trading, clearing and settlement infrastructure through its GlobeClear service, JPMorgan is able to help fund managers and distributors transact business efficiently despite the fragmentation of the funds industry infrastructure in Europe. IFC offers managers and distributors an invaluable combination: any route to settlement, via a single point of entry. ○○○

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