



enable the industry to address this. However, there has been very little interest in master-feeder arrangements or mergers because many obstacles remain. The fund industry is just one part of the financial services landscape. Other sectors, banks, broker-dealers, insurers and others are all subject to the increasing regulatory burden. In particular there are more stringent capital and/or solvency requirements as well as much higher compliance costs to be addressed. These are likely to play a part in reshaping the industry, shaking out the weak and offering opportunities for growth. This may be the catalyst that begins to remove

large numbers of essentially moribund funds from the market and lays the groundwork for scale—a better deal all round for the investor. ■

<sup>1</sup> Source: Lipper

<sup>2</sup> Global Financial Stability Report, April 2011

<sup>3</sup> BIS Working Papers no. 343, "Market structures and systemic risks of exchange-traded funds," April 2011

<sup>4</sup> "Potential financial stability issues arising from recent trends in Exchange-Traded Funds (ETFs)," April 2011

<sup>5</sup> IRS Notices: 2010-60: <http://www.irs.gov/pub/irs-drop/n-10-60.pdf>, 2011-34: <http://www.irs.gov/pub/irs-drop/n-11-34.pdf>, 2011-53: <http://www.irs.gov/pub/irs-drop/n-11-53.pdf>

<sup>6</sup> In respect of dividends, interest and certain other U.S. source payments

## And How Will the Resulting Regulations Impact Global Fund Distribution?

The key to the success of UCITS is its ability to passport freely cross-border within the EU and to distribute globally from recognised and specialist domiciles such as Ireland and Luxembourg.

The turmoil created by the global financial crisis in 2008 has expedited a raft of regulatory reform and change. One of the questions outstanding is how these regulatory changes will impact the current UCITS fund distribution model and what will the impact be to investors?

### Upcoming changes

Luxembourg and Ireland are the two main domiciles of choice for fund promoters seeking to establish UCITS funds that will be marketed cross-border, i.e., mutual funds that will offer more than just domestic distribution. Over the years, these two fund centres have developed the necessary infrastructure and skilled workforce to service UCITS funds for international investors.

The distribution model facilitating this growth has evolved over the last 25 years with new markets opening up, new developments in fund structures and greatly enhanced technology. As a result, the concept of global distribution can be confusing and often hard to navigate. Identifying a single distribution model that can accommodate a diverse range of regional

requirements and local buying behaviours via distributors, banks or platforms can present many challenges.

The fragmented nature of the distribution model is evidenced by key elements, including local country tax reporting as well as varied commission structures and share class hedging. This highlights the ineffectiveness of attempting to compare the structure of a local market such as the U.S. or UK with one that tries to accommodate cross-border variations and client requirements.

### Challenges

The global distribution opportunities presented by a UCITS fund also represent its greatest challenge—namely the ability to market into many jurisdictions and to different types of investors worldwide.

The key drivers of change that we have observed in the past few years are far from temporary. Regulation and change are set to cause a significant shift in our thinking and our servicing strategies and have the potential to disrupt global distribution models.

The uncertainty of these changes and their impact dominate our thinking and the strategies of our clients. It is more important than ever for securities services providers to remain at the forefront of regulatory change, to understand the complexities of distribution



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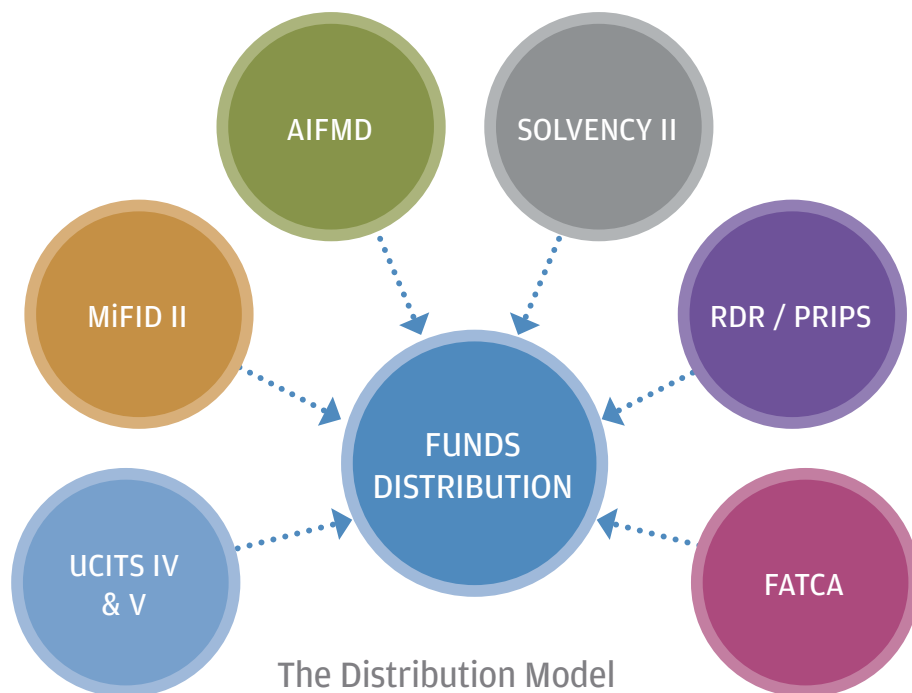
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and to help prepare their clients for the challenges ahead.

The UCITS directive has its own legal framework, which has recently been amended under UCITS IV. This provides more stringent rules but also provides opportunities for efficient fund consolidation and a more effective cross-border registration process.

One of the challenges facing fund promoters under UCITS IV is the introduction of the new and obligatory Key Investor Information Document (KIID). This mandatory one-page document is a sound objective although its practical implementation is not straightforward. It will help maintain transparency by providing the investor with key information on the fund in a consistent format. However, the KIID presents an additional reporting burden on distributors/fund managers, as production is complicated by translation requirements and the cost of disseminating the material. It is precisely the practical implementation that needs to be addressed when considering all the proposed regulations that will undoubtedly impact the current distribution model. Who will be held accountable for implementing the changes and where is the burden being placed—on the asset managers or the distributors?

Whilst not always straightforward, the current distribution model works well and allows asset managers to reach their investors by selecting appropriate fund features, platforms or distribution channels. Whether the intention is to protect the investor base or to provide further transparency, we need to understand how the adoption and implementation of regulatory change will alter existing access points and, fundamentally, what cost will the funds industry incur by facilitating these new demands. Investor requirements will essentially remain the same—they will continue to seek returns on investment products that they can access and understand. However, additional reporting requirements may negatively impact the total expense ratio (TER), and the returns could ultimately make



the products undesirable. Therefore, creating an efficient future model to accommodate these requirements is critical to the continued asset growth and appeal of the UCITS domiciles.

### What next?

The increase in regulatory initiatives will require specific technology development efforts, i.e., to accommodate reporting for Solvency II or FATCA. Many service providers are already preparing for the combined impact of the changes and the effect the new regulatory environment will have on the fund features, structures and distribution channels.

UCITS V is awaiting the final scope of upcoming reforms, including MiFID II and AIFMD, before it takes shape. RDR (Retail Distribution Review), PRIIPs (Packaged Retail Investment Products) and Dodd-Frank will all necessitate changes to the core infrastructure of the fund administrator in order to cater for new share classes, commission and distribution capabilities, and enhanced reporting. There is little doubt the distribution model will change; the ability to understand and anticipate these changes will set the market leaders apart in the coming years. Leveraging a partner with a global footprint, experience, ongoing investment and tacit knowledge on the fundamentals of this distribution model will provide clients with the confidence to design these solutions and continue to prosper in the face of this constantly evolving landscape. ■

### The Distribution Value Chain



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