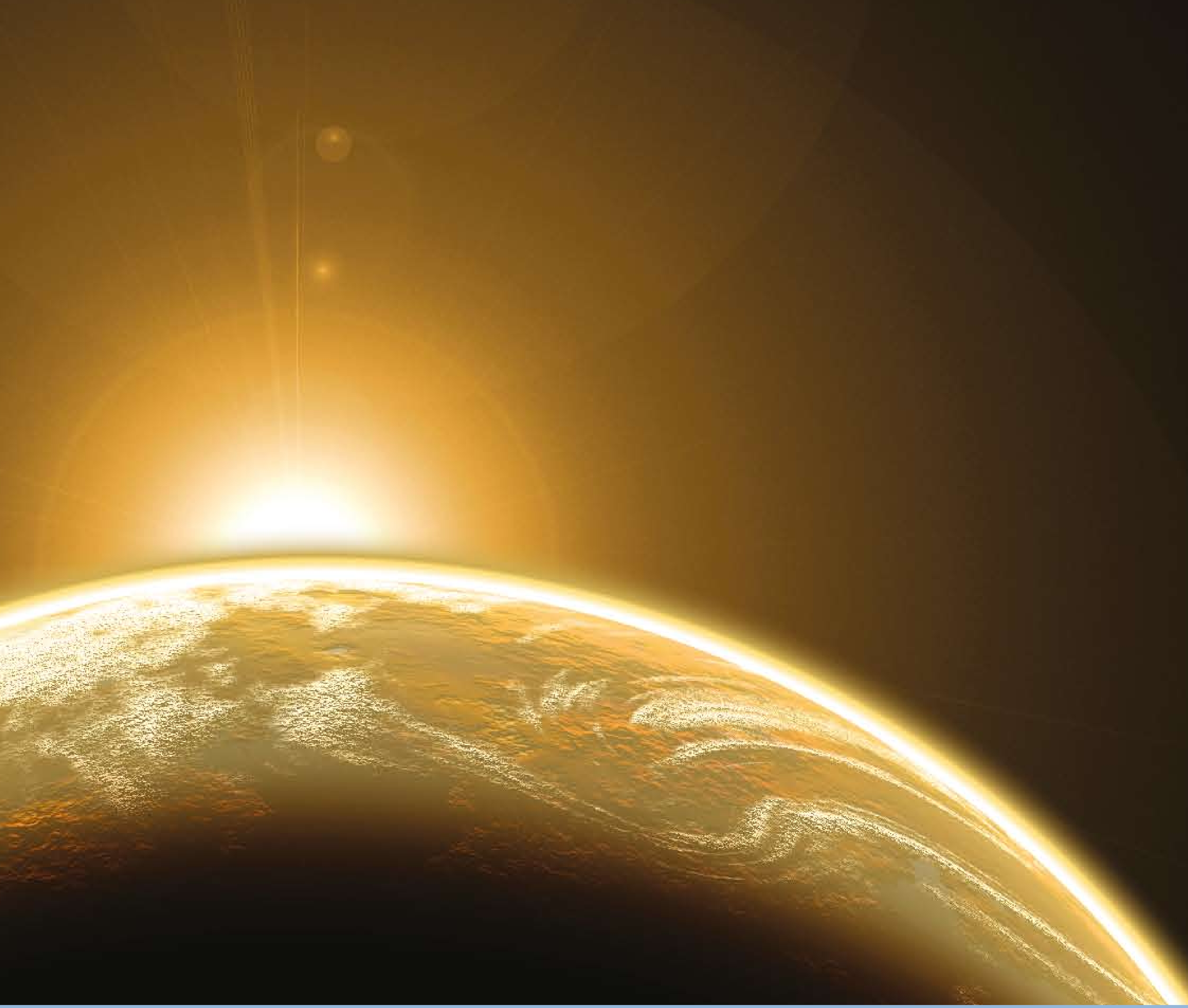

The Rise of the Distributors:
A Practical Guide to Effective Distribution

The Future of Asset Management: Exploring New Frontiers

WORLDWIDE SECURITIES SERVICES

J.P.Morgan

J.P. Morgan is committed to helping our clients mitigate risks, enhance revenues and increase efficiencies.

New challenges, New answers

Regulated funds in Europe have experienced an explosion of growth with new funds launched by fund managers from outside the region as well as by alternative managers. Both of these groups are coming to the European regulated fund market with different levels of experience with high net worth and retail investors, and each faces a similar challenge: finding ways to reach investors and growing these new funds successfully.

This challenge is not straightforward, and for newcomers to the market with little experience of marketing to private wealth and retail investors in Europe it can seem daunting. Hedge fund managers used to dealing with institutional investors will discover it has to work with high street and private banks across the continent, which control the majority of distribution, in order for their hedge-like UCITS to succeed. A fund manager from Asia that wants to sell funds governed by the UCITS framework will find it is responsible for a vast swathe of reporting in different currencies and compliance with a variety of tax regulations that vary by country of distribution.

Fund promoters see UCITS as a way to enter new markets in a cost efficient manner to grow assets and revenue, so coping with these challenges is unquestionably an essential pre-condition for success.

As a leading fund services provider to many of the world's most successful global fund managers, J.P. Morgan has long been dedicated to supporting you, our clients and your investors, through many of the industry's evolutions and revolutions. A strategic partner like J.P. Morgan can help support your fund distribution through our global transfer agency network, complemented by client service on the ground in multiple jurisdictions and local tax and regulatory knowledge, all supported by the most sophisticated technology solutions available.

We are committed to working with you to enable you to get the most from your cross-border UCITS funds, and ensure you have the best available support.

The rise of the distributor

Managers of regulated funds know that a well-executed distribution strategy is critical to their success. For new entrants to the regulated fund market, this may be a significant change to how they usually operate.

While the regulated environment was once dominated by traditional asset managers based in the same region or country as their investors, this is no longer the case. Today, hedge fund managers and traditional managers from as far afield as the US and the Asia Pacific region are creating and managing regulated funds in Europe in an effort to leverage the strength of the UCITS brand and its distribution potential.

Fund managers who are new to UCITS will need to consider the following issues:

1. Understanding what distributors need and expect from a fund manager
2. Navigating a new regulatory environment
3. Having access to the most up to date technology to build relationships with distributors

Fund managers entering the regulated UCITS market for the first time need to know what is required to launch and manage a successful regulated fund, who the top distributors are and how to get the most out of these distributors.

There is considerable advantage to be had in working with a strategic partner that understands local jurisdictions, can support the creation of funds for cross-border distribution, and has the local knowledge for reports to end investors and regulators, in short managing the end-to-end distribution chain.

Understand what distributors need and expect from you

With the increasing power of the distributor, it is important to understand the specific needs and expectations of each distributor or distribution channel, as there is significant variation between countries and continents.

Given a complex cross-continental value chain, the importance of clear communication is heightened. Promoters may wish to leverage their administrator's capacity to offer dedicated service personnel, to respond to the requirements of promoters and distributors in order to meet both client and location-centric needs.

Understanding regional and country-specific characteristics is essential to successfully implementing a cross-border strategy.

Typically fund promoters cover a mixture of four or five channels.

Distribution Channels

- Retail and private banks
- Financial Advisors (Independent, Tied) and Broker Dealers
- Fund Supermarkets
- Direct to consumer portals
- Institutional Investors including Insurers and Pension Schemes

Despite the varied requirements, there are a few points to consider when entering a new market or region, and engaging with local distributors

Points to Consider

- **Distribution Agreements –** An essential part of any cross-border strategy, agreed between Fund Promoters and distributors.
- **Operational Connectivity and Communication –** It is important to understand the distributor's expectations on the method, and frequency, of sending and receiving trades, confirmations and pricing information.
- **Commission Policy –** This is a key element to agree and understand the requirement for commission and retrocession payments to each distributor. Consideration might be given to local or distributor specific requirements, which can require flexible systems 'behind the scenes' to administer bespoke agreements.
- **Support in Multiple Languages and Time Zones –** Practical considerations such as the ability to offer support in the distributor's own language and time zone are a key consideration, as is the ability to do the same for end investors.
- **Real time enquiry and reporting functionality –** Distributors are likely to require ready access to information on transactions and holdings. In addition, distributors may wish to assess Fund Promoters, and their administrators, on key performance measures such as the percentage of business processed electronically.

Navigate a new regulatory environment

Regulatory change is a constant in the world of financial services. Now more than ever your chosen service provider needs to be able to respond quickly to changes and have the capability to monitor, analyse, respond to and communicate forthcoming regulatory change.

In Europe, changes such as UCITS IV and the Directive on Alternative Investment Fund Managers (AIFMD), extension of the EU Taxation of Savings Directive and the expected UCITS V will all have implications on how fund managers build their business models for the future.

Country-specific regulations such as the Retail Distribution Review (RDR) in the United Kingdom, and for tax reporting in a number of jurisdictions, can have a significant impact on distribution. The RDR envisions changing the way in which funds are bought and sold, with an end to commission arrangements and a move to fee-based distribution. This means the pattern of distribution may change as well as requiring technology adjustments to platforms and transfer agency systems.

UCITS IV – A Snapshot and the Impact on Distribution

The 'recast' UCITS directive offers a number of opportunities to fund promoters which have been heralded by commentators as another revolutionary step in the development of UCITS. In particular, the European Commission's objective is to make the fund industry more efficient – to provide a framework that will enable managers to streamline activities, contain costs, enhance their profitability and portfolio returns for investors.

UCITS IV may be the last pro-industry regulatory measure we shall see for some time and even before it has come into effect, UCITS V is already on the lips of many commentators. UCITS V is unlikely to specifically revoke any of the flexibilities delivered through UCITS III and IV, however the additional responsibilities that it may place on Depositaries and Administrators will undoubtedly lead to changes in the industry.

Under UCITS IV, master feeder arrangements should provide a way to enter markets which have hitherto been considered to have a 'domestic' bias. It is almost certain that existing cross-border fund centres such as Luxembourg and Ireland will continue to be the locations of choice for the establishment of Master Funds, and markets such as France which are largely 'untapped' in terms of cross-border penetration may prove to be a lucrative prospect for certain fund promoters.

Naturally, 'tax drag' could be an obstacle but it may be possible to overcome this by using a tax transparent vehicle as the Master.

Additionally, the replacement of the Simplified Prospectus by the Key Investor Information Document (KID) with its clearly defined content is welcome but clients could face a considerable challenge in assembling the prescribed information. For example, the KID introduces the SRRI (synthetic risk reward indicator). The level of data required to is substantial – the SRRI is effectively a number calculated with reference to volatility in the unit price over a period of 5 years. Most clients will look to outsource these type of activities.

UCITS IV offers fund promoters and asset managers the opportunity to be innovative in product development, but also introduces demanding compliance requirements. The capabilities of fund administrators will be a key differentiator in delivering on mandatory aspects whilst leveraging the opportunities that UCITS IV affords.

Access to the best possible technology support

Technology plays a big part in cross-border distribution as it enables all parties to engage in the buying and selling of investments with ever greater speed and ease. For a promoter to get the best from the technology available in each region, three simple steps may prove useful:

1. **Assess the local standards –** Significant differences exists between countries and continents, with some embracing electronic trading and Straight Through Processing, and others sticking to tried and tested methods such as fax and telephone dealing. Distributors have the power to mandate the use of an increasing range of connectivity methods, allowing more sophisticated methods of exchange, and more exacting timeliness and data requirements.

2. **Understand the costs and time to implement each option –** Establishing technical connections has cost implications, both up front and ongoing, and they vary between suppliers, often depending on volume of business. In addition, the time required to engage, build and test technical connections must be factored in to the overall time to market.

3. **Engage your supporters –** The partners you choose to support your cross-border strategy should already work with technology and the providers in the region, and should have existing relationships and tested connectivity. Leveraging the experience of your service provider can help to smooth your own market entry.

Local support

A strategic partner can help you to understand the potentially complex tax and reporting implications for each local market as follows:

Local fund registration

Filing for distribution in local markets requires care and accuracy in submitting documentation. For distribution in Europe, UCITS IV delivers a much more straightforward and faster process for cross-border marketing (the UCITS 'passport'). Outside the EU, requirements vary by market and can be onerous. Keeping up to date with these requirements is also very important as losing access to a market once obtained would be damaging. Fund promoters locating funds in the major cross-border fund centres of Luxembourg and Ireland need to ensure the proper administrative running of their management company and funds.

Understanding local reporting

Whilst the UCITS concept opens doors in terms of allowing access to new markets, the volume and complexity of local reporting requirements are significant challenges. Local financial and regulatory statements for funds registered and distributed globally will be required.

Tax Reporting

As cross-border distribution has increased, the ability to provide accurate and timely tax reporting has become increasingly important both to assist investors in minimising their tax liability and to enable funds to compete effectively with local products. This means a significant degree of flexibility is required to translate core fund data in multiple ways to accommodate the different tax reporting required in multiple markets.

Provision of tax reporting can be a challenging task for the fund administrator; it requires the interpretation of complex tax rules in numerous countries and then applying these different rules to the same fund to ensure tax regulations are correctly complied with in each market of distribution. This requires the administrator to have a deep understanding of these tax rules and also a technology system that can deal with the multiple countries and tax regimes that regularly change.

For example, in 2004, Germany introduced tax reporting requirements for foreign funds. The consequences of non-compliance may result in lump-sum taxation at investor level, making foreign fund investment unattractive. The German tax reporting requirements are onerous: daily calculation and publication of the interim profit (interest) and equity income, and annual reporting within four months of year end. Critically the calculations need to accord with German rules and be certified as compliant. Compliance with German tax reporting obligations is thus a critical prerequisite to successful distribution in Germany. Similar reporting requirements exist in other markets (such as UK and Austria) where funds are bought by investors in these countries.

Working with a strategic partner

With distribution models growing in complexity as fund promoters enter new markets and exploit developing distribution channels, there really is no 'go it alone' option. Working with a strategic partner with the right level of market knowledge, professional skills and experience means you can focus on realising your ambitions in the fast growing world of cross-border distribution.

What should you be thinking of **now**?

Checklist:

- [ ] Work with a strategic partner to manage the end-to-end distribution chain
- [ ] Understand what distributors need and expect from you
- [ ] Navigate a new regulatory environment
- [ ] Access to the best technology support
- [ ] Consult your adviser on tax

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