Eurofi 08 - Thursday 11/09/08: Session [4A] IMPROVING CROSS-BORDER FUND PROCESSING IN THE EU: Towards an industry roadmap for optimising cross-border processing and proposals for monitoring the progress.

The Panel

Moderator: **Wolf Klinz**, MEP, Committee on Economic and Monetary Affairs, European Parliament

Panellists: **Ivan Nicora**, Director, Head of Funds Department, Product Management, Euroclear;

Marc Raynaud, Global Head of Mutual Fund Distribution, BNP Paribas Investment Partners;

Josée-Lynda Denis, Vice-President, Global Fund Services, The Bank of New York Mellon;

Wolfgang Mansfeld, Member of the Executive Board, Union Asset Management Holding;

Niall Bohan, Head of Unit, Asset Management, DG Internal Market and Services, European Commission;

Bruno Prigent, Head of Investors Securities Services, Société Générale;

Dominique Valschaerts, Member of the Executive Committee, Luxembourg Stock Exchange

The Debate

Wolf Klinz, MEP, Committee on Economic and Monetary Affairs, European Parliament, prefaced the session by saying as a liberal he preferred not to introduce any more regulation, but to let the industry regulate itself. However, he acknowledged that little or no progress had been made on fund processing over the previous year, despite working groups at Efama and Eurofi having addressed the issue. "The fact is, 50 per cent of processing is still done manually, which is still too high," Mr Klinz said.

The delays were to some extent understandable, said **Ivan Nicora**, Director, Head of Funds Department, Product Management, Euroclear, given that funds were different from other instruments in financial markets and so required tailored treatment. It was not possible to just re-use techniques and structures from other parts of the financial services industry. Open architecture was driving automated fund processing, but this had only really started in the last decade and still only represented 20-25 per cent of volumes. In 75-80 per cent of cases, the distributor and the manufacturer were still one and the same so the operational burden was less acute. "The need for automation will increase as third-party distribution continues to grow," said Mr Nicora.

It had plenty of scope to grow since third-party distribution represented 80 per cent of the US market. "If Europe evolves the same way, even without any growth in the underlying market the burden will rise by three or four times. Finding solutions is a must."

The issue was not that the market lacked solutions, but rather that the solutions needed to be more widely employed. Mr Nicora described trying to get participants to embrace automation as a "catch 22 situation". The problem was, Mr Nicora believed,that the beneficiaries of automation (the promoters) and the bearers of its costs (the distributors) were not necessarily the same. In fact, according to Mr Nicora, the two sides of the debate stood to benefit in the end. "The benefits of automation are far larger than the costs for the market," he said. "But individually, for each part of the investment chain, this is not so."

Many asset managers supported automation and committed to solutions but if counterparties – essentially the distributors – did not embrace the same solution, then automation was not possible. "Automation depends on getting the distributors to invest too." The choice was for them to invest in the solution themselves or use service providers.

It was not reasonable to make a straight comparison between the fund processing environment in the US and the environment in Europe, said **Marc Raynaud**, Global Head of Mutual Fund Distribution, BNP Paribas Investment Partners. Although there were a number of technological evolutions in Europe, there had as yet been no standardisation of settlement, order trading and so on and solutions were provided by multiple players. This contrasts with the US where the FundServ platform of the National Securities Clearing Corporation (NSCC) was the only way to distribute funds.

He argued that European funds should be more easy to distribute with a platform like FundServ. "At the moment we have many funds that cannot be distributed because of lack of standardization," said Mr Raynaud. He outlined the advantages of the FundServ platform, including a centralised order execution and settlement process with co-ordinated cut-off times for dealing. "But it would be difficult to copy and paste FundServ in Europe," he conceded. "Pre-existing organisations could be adapted but it would be difficult. We really need to take the best aspects of FundServ and adapt them to the European environment" starting with activities that are less harmonized or automated in the EU such as commission tracking and payments.

How to convince different actors to invest together in automation was the key question, according to **Josée-Lynda Denis**, Vice-President, Global Fund Services, The Bank of New York Mellon. The bigger ones were aware of the need but were unwilling to support the cost of models that would benefit also smaller and medium distributors. It was also clear to many that back offices should evolve to support global distribution, but not everyone was conscious of this.

A major issue, according to Ms Denis, was there was not sufficient education of distributors about solutions that existed particularly smaller ones or those making many transactions for low amounts. "We welcome measures such as Swift Alliance Lite," she added. This initiative was being trialled by 20 Swift clients, and was formally launched at Sibos 2008, in Vienna.

The US was far ahead not just because it was a single market, Ms Denis said. It was also a result of a market that had functioned for a lot longer than its European equivalent and under the auspices of the SEC, which had been created way back in 1976. By contrast, the European cross-border market had only existed for about 20 years. "We have had to grow up so quickly here, and we need so much more customisation here than in the US," said Ms Denis. "In the US it is all really local distribution, and mainly 401K investors pouring money into the markets."

In Europe, it was necessary to be more innovative and it was for that reason that UCITS III and UCITS IV came into being. And in customising, you incurred greater costs, she said. It was difficult to standardise costs across a myriad of local banks and, costs might well be still higher than $70 per transaction in some cases. It would be useful for the industry if some of the biggest players shared information on costs and sat together to look at these problems collectively.

Wolfgang Mansfeld, Member of the Executive Board, Union Asset Management Holding,

said a wake-up call had been sounded as long ago as 2002, at the Fund Forum conference held in Rome. He said this had led EFAMA, the fund management industry group of which Mr Mansfeld is a member and former chairman, to work on the subject. "We started the process from scratch," said Mr Mansfeld. "We wanted to create technical standards since a DTCC blue-sky solution would not be appropriate in Europe".

There had been some progress as a result of the initiative. About 100 institutions – fund managers and advisers – now used ISO 20022 as a messaging standard for fund processing. However, EFAMA's influence had its limitations. While it could develop standards and make recommendations, the ball was now in the court of fund managers and distributors who had to endorse them and make the investment to create standards for commission handling, for instance. This was likely to be the next important fund-processing project.

"Everyone asks what the cost benefit is," said Mr Mansfeld. "Many think it is limited because not enough firms use the standards yet. If that is the case, is the current approach sufficient? Maybe some actions need to move beyond EFAMA to involve distributors in a more stringent way." EFAMA would continue to work on the issue, but also on creating indicators that measure progress on it. Its ability to get a critical mass of firms involved was limited, however. Further effort was required.

The European Commission recognised that the fund management industry faced a "real challenge" over fund processing, according to Niall Bohan, Head of Unit, Asset Management, DG Internal Market and Services, European Commission.

Research had shown that the cost of a cross-border fund transaction in Europe could be as high as €62 compared to just 7.5 cents in the US. The reasons for this lay in legacy distribution systems in Europe. "We live in a changing world now," said Mr Bohan. "Inefficiency in processing and administration was coming to the fore with the advent of open-architecture." Although tax was a complicating factor, the issues were not regulatory. The main issues stemmed from the business models of the firms concerned and from "coordination problems" in the market. Because each had different incentives, it was clear there would be no quick fix for these problems and no easy transition to the optimal model.

However, the trend was moving in the right direction, Mr Bohan believed. Continuing consolidation between large fund managers would, hopefully, impose more efficiency on distribution systems. At the same time, Mr Bohan questioned whether it was the role of the Commission to try to break the logjam that existed. "The Commission tries to focus where there is a clear legislative dimension, such as in UCITS IV," he said. "We cannot help with all the competitive challenges that the industry faces." He believed that the industry should drive the process and not wait for the public sector to "ride to the rescue once again".

He added that Eurofi should be congratulated for taking the matter forward and that this kind of leadership was required where agreeing within the industry on issues that were of common interest was difficult. The Commission would risk imposing standards that were not necessarily up to the task, or were second-best solutions, if it were to impose them itself. However, he did not rule out some kind of intervention in the event that the logjam could not be broken within the industry itself.

The current levels of standardisation within the cross-border industry need to be improved, said **Bruno Prigent**, Head of Investors Securities Services, Société Générale, with low levels of STP and high operational risk. "It is easier to buy exotic equity instruments than it is to subscribe to or redeem from a European mutual fund," he said. It was a matter of some urgency to develop standards for processes such as cash settlement. There were presently two main models in the European market for dealing with orders: the Luxembourg/Dublin model, and the French CSD model. There was a case for trying to establish which combination of features existing in both systems was the best and implementing it across the continent, Mr Prigent argued. Both types of systems had strengths and weaknesses, and in the final analysis they could be complementary.

Eurofi's funds working group had drawn up a proposed road map enabling around 80% of cross-border exchanges to be automated within four years, proposing standards covering the whole range of activities in the value chain ie order execution, settlement and commission tracking and solutions to speed up automation and to better handle direct orders coming from distributors in CSD environments. The issue of trailer fees was also important. At the moment it was difficult to obtain reliable data and costly to find out. Because there was no standardisation of distribution agreements, it was a "like a nightmare" to determine fees. Formats were required to enable adequate identification of distribution. The chain of orders could be so long it was difficult to follow where orders originated.

Dominique Valschaerts, Member of the Executive Committee, Luxembourg Stock Exchange, referred to the present difficulty to access fund processing data. Fund processing data was available but there was no efficient way to access or distribute it across Europe. Players at present have to maintain links with different data bases which is complex and costly. Institutions were indeed acting in an ever more global context, so it was important to understand their needs to have a global view of information from a single access point. "We are convinced of the need for a true, dedicated hub with the appropriate organisation to ensure data consistency," said Mr Valschaerts. "We have to go beyond the FPP standards and add a new dimension by adding new technology and tools." The tools existed but the challenge for the industry was to use them fully and achieve standardisation and interconnectivity. In the US, the SEC was acting rapidly: Europe should adopt the same approach.

Reacting to Eurofi's proposal to establish a common funds market governance structure involving all the players concerned – asset managers, distributors, administrative agents and solution providers – Mr Nicora thought it was a promising idea, but that its objectives had to be clearly defined. "At Euroclear we try to operate like this, we try to operate a forum. The key is to get all players around the same table. This is powerful and allows dialogue and the creation of a roadmap."

The sticking point could be if members of such a group had different objectives. He asked whether the underlying idea would be to extend the scope of automation among those who already do it, or attract new participants to automation. He advocated trying to attract new participants rather than increasing automation for those who already had it. But the difficulty was attracting players – particularly distributors – who were not yet automated.

J. Denis explained that EU players had not taken the time to do this so far, confronted with the complexity and growth challenges of the market but this was now a priority.

Mr Raynaud said that if enough standardization and automation could be achieved, cost savings would necessarily pass down to the end client as market forces kicked in. This was especially true for "plain vanilla" funds for which there is much transparency on costs and which are increasingly challenged by commoditized products. As an example, ETFs had lower costs attached to them for the end investor bringing competitive pressure. However, for this to happen investments must first be made and the costs must be covered.

Co-operation was needed among market players to achieve efficiency. The immediate benefits of standardisation would be seen more in improvements in quality of service than in rapid cost savings to the investors. But cost reductions, nevertheless, would seep through eventually. "The problem is, we can quantify the cost of investments in technology but the benefits are not easy to anticipate for individual companies," said Mr Raynaud.

Some companies had been deterred by the high costs from investing in technology that would have helped standardise procedures. Mr Mansfeld said: "My company had planned to implement ISO 20022 messages. It was on our project list for 2004. But the cost of the total project was €1m-€2m so we decided not to go ahead because the perceived benefits were not great enough. It depended on a sufficient number of our counterparties making a similar investment. " However, Mr Mansfeld's firm reviewed the situation again in 2006 and decided to implement.

W. Mansfeld added that since the ROI of automation projects depended on the number of users, incentives, possibly mutualized across the different players, could help to accelerate the uptake but some kind of regulatory enforcement might be needed to implement such an option. Regulation was indeed a possible means of imposing obligations on different parties with the objective of the industry being better off as a whole.

Mr Bohan concluded the debate by pointing out that fund processing consisted of so many facets that it was hard to consider as a single concept. He mentioned straight-through processing, trading protocols, commission handling and tax issues. There was also the question of overall infrastructure and which type of structure would win out and become the heart of a centralised system. He said the Commission " placed faith in the industry to raise its own game and make progress".

N. Bohan was encouraged by on-going actions and considered that the objective put forward by Eurofi of achieving 80% automation by 2011 similar to the US was ambitious but was the right direction to go towards. He agreed that the EU market needed vision and leadership, a roadmap and that a governance structure may help to develop the engagement of the different market players and encouraged Eurofi to continue specifying what was required to achieve this.

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