Regulatory Reform: The 'New Normal' is Here to Stay. Adapt, Innovate or...?

By Barbara Nelligan and Ryan Dargis

Dodd Frank, Money Market reform, Cost Basis reporting, Form PF, CFTC, AIFMD and UCITS IV are just a few of the terms you will hear in almost any conversation in the investment management industry. Regulatory scrutiny and its administrative demands are at an all time high and investor demand for transparency is increasing. All of this is happening amid an economic cycle that is putting continued pressure on investment managers to do more with less. How does one survive? Is this a challenge or, maybe, an opportunity?

In the post financial crisis, the need to more closely manage financial cost and risk is encouraging investment managers and fund sponsors to examine and potentially consolidate their legacy funds and separate accounts. It is also forcing investment managers to maintain a clear and disciplined strategic plan to support new target markets and investors as well as have the appropriate types of products to support those plans. Managers and fund sponsors are increasingly looking to strategic partners to help meet these objectives and, as a result, the relationship between service providers and fund sponsors is changing. As such, we've seen increasing interest in the use of service provider sponsored "platforms" such as Series Trust for registered mutual funds, UCITS Fund hosting solutions and Bank Collective Trust Funds.

Utilizing a platform is a way for investment managers to shift the administrative and business governance responsibilities of managing a fund vehicle to a third party. Outsourcing these functions is not only cost effective but it also allows managers to focus on what they do best. Platforms offer the jurisdictional expertise of a service provider with robust regulatory compliance programs that managers may find difficult to support. For example, let's consider the Series Trust. This concept was developed in the 1980's so that smaller registered investment advisers could cost effectively enter the mutual fund business. More recently, the Series Trust model has become increasingly popular with:

- Previously non-registered domestic U.S. investment advisers;
- Non-U.S. domiciled investment advisers entering the U.S. mutual fund business; and
- Well-established U.S. investment advisers that do not want the administrative burden of a registered investment company.

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Typically, investment managers in these categories have global distribution and manage their assets across multiple vehicles. The Series Trust offers an efficient, cost effective solution and speed to market, which are both important attributes in a fast paced world. In addition, a series trust solution from a service provider with a large global presence and jurisdictional expertise offers a unique opportunity. It presents a mechanism for the investment manager to distribute its strategy via a U.S. registered vehicle as well as a consistent back office experience next to their other funds.

Similarly, the UCITS fund hosting platform provides asset managers with the European passport for distribution that is accepted by regulators worldwide. The UCITS platform provides management company services, fund administration, global custody, regulatory compliance and tax-transparent fund services, allowing asset managers to focus on managing assets and expanding their investor base. Structured as a UCITS **Irish Common Contractual Fund** umbrella, managers can create compartments or sub funds. Similar to the Series Trust, the UCITS platform offers speed to market and regulatory compliance but also a feature important to cross border distribution…tax transparency. Tax transparent funds allow investors to access their reduced double tax treaty rates on income entitlements, which may enhance returns compared to other collective investment vehicles.

Another vehicle to consider is the Bank Collective Trust Fund. These funds have seen a revival of interest by managers wishing to penetrate the U.S. retirement market. The vehicle's robust yet streamlined regulatory regime, attractive cost structure as compared to traditional mutual funds and ability to function in the Defined Contribution retirement market like a mutual fund have all fostered increased interest. Overseen through banking regulators and, therefore, only available for banks to own and sponsor, Collective Funds are exempt from the **SEC** registration requirements associated with mutual funds. As such, the number of sponsoring entities is limited to banks willing to create the necessary oversight structure to own and operate sub-advised funds. Doing so allows qualified investment managers to focus on their specialty, executing their investment strategy, while leaving the governance and oversight of the fund and the sub-advisor to the Bank.

The common thread through all of these vehicles is that the service provider has the scale to support the larger back office operation coupled with the jurisdictional expertise to govern much of the daily business activities. In the face of the "new normal", the investment manager's traditional view of the third party provider as processor should change to one of partner. The service provider, for its part, needs to continue to evaluate its value proposition, including solutions to help the investment manager expand its investor base. Together, the intended and unintended consequences of regulatory reform can be more efficiently managed through long standing products packaged into new solutions. Adapt, innovate and grow!

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