Who wants to collect millions?

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With more than 3,200 management companies in Europe and at least 55,000 funds (EFAMA—June 2013), places in the sun come at a great cost for those who want to collect millions. Domestic markets have become too narrow and local investors, whether private or institutional, are no longer able to support asset management players.

In France—the second largest collective management market in Europe (behind the UK)—the lacklustre collection (historical outflow phase that began in 2007) is the result of various factors:

- Cultural risk aversion (-40% of individual shareholders from December 2008 to September 2012. Source: TNS Sofres)
- Institutional investors seeking a credit balance position (in 2012, -22% decrease in the volume of calls for tenders to select asset managers. Source: BFinance)
- Competition in terms of regulated savings (€49.2 billion invested in the Livret A and LDD in 2012, compared to €17.5 billion in 2011 and €5.6 billion in 2010. Sources: FFSA, Caisse des Dépôts, Banque de France, Eurostat)

In this context, where few forward-looking indicators are positive, the only alternative is to turn to export. However, the sale of products abroad by management SMEs is not as easy as it looks. Some of the obstacles for management companies will be the learning curve (owing to the length of the learning phase), tailoring of the offer to the expectations of international targets and adapting sales teams and support services.

Together with the substantial investment required to win new customers, optimising all processes and streamlining expertise are key to securing margins. One of the paths that may be followed in connection with these objectives would be to streamline the organisational system of existing management group structures in Europe.

Currently, a firm comprises a set of local subsidiaries that are authorised to conduct the primary management activity on their domestic market, and single entities (without authorisation) whose purpose is to promote sales.

Current regulatory measures now facilitate the set-up of cross-border structures:

- Since the UCITS IV directive came into force in July 2011, the introduction of a management company passport has enabled authorised management companies in a member state to act as management companies of UCITS in another member state.
  The management company passport allows asset managers greater flexibility with regard to the place of domiciliation and administration for their funds.
- During the entry into force of the AIFM directive in July 2013, an intra-European passport was set-up for European managers in charge of European AIFs. This passport will authorise any AIFM in charge of AIFs to sell the funds that it manages to professional investors in Europe, in return for authorisation from the relevant European authority.

Revamping an organisation requires thought as to what are its priorities (collection and/or efficiency), while taking into account the firm's current set-up and its background (organisation, international presence, type of expertise and products, type of clients, etc.).

However, at least five critical aspects must be taken into account in this utopian table:

- Location of the structure
- Management of human resources
- Implementation trajectory
- Tax implications
- Management of delegations

PHASE	ALTERNATIVES	RELATED ISSUES
Regulatory	A single portfolio management company with all the authorisations or several regulated structures	Level of relationship with the supervisory authority and qualification of the substance
Vehicles	Selling restricted to Europe or worldwide	Appeal/positioning Vehicle size Loan transfer strategy Sales agreement (between the supervisory authorities and the distribution country)
Management centers	Location of expertise based on the current set-up (or ability to find experienced resources), organisation of delegations	Adaptation of expertise to expectations, transfer pricing management
Central administration	Detailed breakdown of functions, concentration (Hub) and optimisation of process fluidity	Management of resources, Automation, role synergy
Sales teams	Proximity of collection points or concentration of sales teams, support of an operational marketing department and centralised client services, management using dedicated and interfacing tools (CRM), loyalty and prospection system	Phased management of client/channel penetrations

RISK MANAGEMENT

OPTIMISATION MANAGEMENT

The ‘Universal ManCo’ model (see Performance 2013 article) is now the subject of in-depth study. The creation of a regulatory holding company naturally generates substantial economies of scale compared to locally regulated management structures.

Illustration of an organisation for a management firm with locally regulated management structures

Universal ManCo

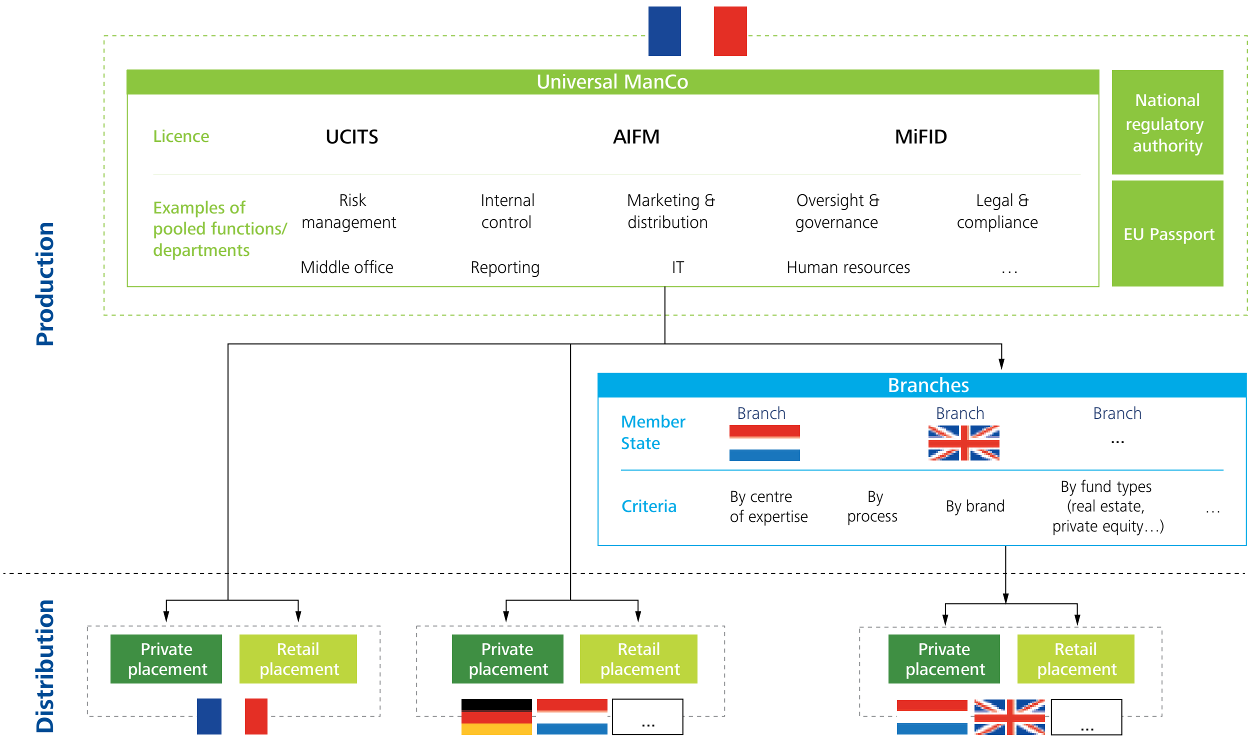
Advantages

- A single structure: relationship with a single supervisory authority
- Single contact point for service providers and investors
- Legal and compliance simplification
- Centralisation of process and control resources
- Generation of synergies

Disadvantages

- Pooling of dissimilar activities or functions
- System that must comply with the strictest regulation

Illustration of a ‘Universal ManCo’ model covering all group licenses



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Location of the structure

The implementation of the ManCo model is a genuine regulatory, organisational and fiscal challenge. The characteristics and sensitivity of a supervisory authority vary from one country to another.

Certain authorities are considered as business friendly with a pragmatic treatment of requests from portfolio management companies, whereas others demonstrate vigilance at all times in order to protect investors. The responsiveness and experience of the counterparties are also critical components. The monitoring system and sanction policy should not be underestimated when it comes to making a choice.

The interpretations of the definition of substance and the proportionality rule may be clearly expressed in a circular, or fall within the jurisdiction of the counterparties or case-law. Finally, a fiscal union has not been established and discrepancies (prior to negotiations with the tax authorities) are apparent for both direct and indirect taxation. Country ratings are also to be considered given their impact on the ratings of local custodians.

Management of human resources

Three points are to be taken into account: mobility, ability to recruit, appeal of the target country. The absence of mobility for key individuals and the difficulties in identifying local resources for management, risk, and middle office represent hidden obstacles when looking for a foreign place of establishment.

Compensation plans, individual tax status, different living standards, and infrastructures among other aspects, should be included in the selection criteria matrix.

Implementation trajectory

Removing the substance of a regulated entity or transforming this structure into a financial service provider needs to be handled with the greatest of care. The adoption of a Universal ManCo approach results in a transition during which the various regulated structures will co-exist pending the standardised operation of the target entity.

Tax implications

When setting up abroad, certain countries have a tax ruling process that commits the tax authorities to the early consideration of transactions that have repercussions for the level of taxation. Moreover, certain countries have not adopted the financial transaction tax process.

Management of delegations

The possibilities of delegating the primary activities can be analysed with regard to the definition/interpretation of the substance ('letter-box' notion).
There are two variants:

- A quantitative vision (weight of delegated activities < weight of non-delegated activities)
- A qualitative vision (delegation possible if able to carry out controls).

Another factor to be considered is the service provider's status and location which, in certain transpositions and for certain activities, must have a specific authorisation. Transfer prices will have to be determined taking into account the practices of the local tax authorities (whether or not the 'arm's length principle' is applied).

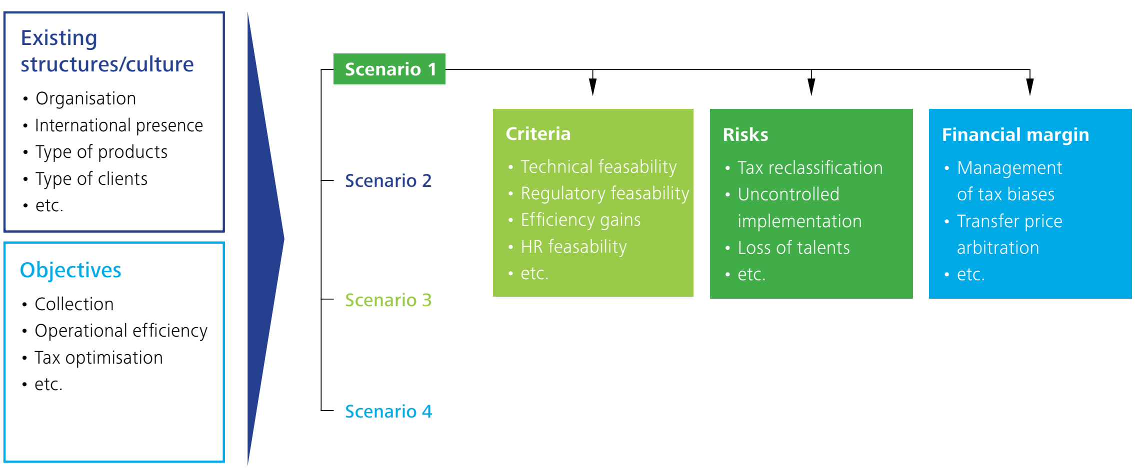
In addition to fund structuring decisions, the Universal ManCo requires careful consideration from an operational point of view. Asset managers must thoroughly examine a range of aspects including overall administrative organisation as well as local practices in the chosen domicile.

We see two cases commonly emerging. The most common scenario relates to large asset managers who choose to centralise multiple structures under one Universal ManCo in order to rationalise their operations and comply with AIFMD. The attention of small to medium-sized firms and non-European asset managers, meanwhile, is focused on selecting a management company domicile for distribution in Europe. Asset managers stand to gain in terms of operational efficiency, as the Universal ManCo service model entails the consolidation of information in a centralised structure.

From an operational perspective, the asset manager will require light local infrastructure and a robust global architecture. Among the challenges they must come to terms with are:

- Reinforcing distribution services across Europe and beyond European borders. This requires registration in new distribution domiciles and the development of related reporting and efficient fund registration processes
- Adapting governance, which can involve fund hosting services and consolidated risk monitoring across various countries
- Reviewing the operational model. This entails examining the middle office to back office value chain and how it will be influenced by the new local/global service model

Finally, the range of asset classes and fund structures that are managed—whether they are UCITS products, retail funds and private equity or structured products—will clearly influence the approach and the operational solution chosen. On the whole, streamlining a firm's management structures requires a set of multiple and differing parameters to be taken into account according to a structured yet recurring approach. The potential economies and synergies are clearly evident, but the path to reach the target does not appear entirely straightforward.



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To the **point**:

- Extending the application of the European passport to all collective investment products gives pause for thought regarding the operating systems of European management companies
- The model is of particular interest to management entities with multiple locations in Europe, as well as non-European establishments that wish to obtain a European license for their management activities
- Implementation of the Universal ManCo model requires a detailed analysis of the critical issues (location of the entity, human resources management, implementation process, tax implications, delegation management, etc.)
- The Universal ManCo model meets operating efficiency objectives