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## Investment Funds Processing in Europe

The European investment fund market continues to experience strong growth. Assets invested in UCITS funds doubled since 2002. Despite the current setback that affects all asset classes, the long term upwards trend continues.

Behind the invested assets, there are individual transactions, and associated transaction costs. Currently some 50 million fund transactions are processed annually in Europe, at a cost per trade that is many times higher than in the equity market.

The seamless, pan-European capital market is still many years away. While progress is being made in various fields, European funds processing remains fragmented in many ways. Cross-border consolidation and convergence of market practice is still slow. The next fundamental step for the European funds industry is the implementation of UCITS IV with the improvement of the passports for funds and for the fund management companies. Distribution will become key. The technical preconditions must be ready to accompany this major evolution and to help the industry to leverage its outcomes for the investors. The ISSA Fund Working Group aims to expedite this process, by highlighting in its report existing best practice used locally that should be shared and implemented over time on a pan-European level.

In its analysis, the group pursued and recommends a bottom-up approach: start on the domestic market level, work up to a European level while bearing in mind that European solutions must ultimately be compatible with global ones. Know-how gained locally should be used to cross-fertilize the industry as it has the potential to be re-used elsewhere without the need for reinventing the wheel. A guiding principle was to abstain from promoting radical changes to the market but address its inefficiencies, step by step. A pragmatic approach was favored, recommending the re-use of solutions that already exist, either at the level of the transfer agents or the central depositories, including potentially TARGET2 Securities, and therefore have a realistic chance for adoption on a wider scale. The focus was on drafting recommendation that facilitate interoperability between the existing operating models, rather than seeking to design a new green field solution.

The group remained neutral towards commercial service offerings. The critical elements are the individual functions comprising the overall process. Those generic functions can be handled in different ways in a variety of operating models. Market forces decide to which solution the critical mass will flow. The report covers these functions:

- Messaging standards and reference data
- Account opening
- Order placement
- Order execution
- Settlement
- Transfer of holdings from one investor custodian to another
- Holding and transaction reporting
- Commission reporting
- Custody and asset servicing
- Distribution
- Miscellaneous additional issues

The scope of the analysis was limited to UCITS Funds distributed and safekept through the involvement of intermediaries such as custodian banks, order routing platforms and central securities depositories. The working group believes that all its recommendations are open enough to accommodate alternative funds.

### Ten guiding principles for tomorrow's fund processing infrastructure

Numerous detailed and often small-step recommendations can be found in the report. From them, ten higher level principles were derived to guide the way forward. The group is convinced that, if those were implemented consistently, the European funds processing infrastructure would benefit immensely in terms of efficiency gains, risk mitigation and cost savings. The ten principles are listed overleaf. The full report is available from ISSA's website [www.issanet.org](http://www.issanet.org)

## Ten guiding principles to achieve higher efficiency and convergence of market practice in European funds processing

- 1. Paperless processes, straight-through processing based on ISO standards**

Paper should be removed from all processing steps and replaced by STP processes. All transaction related communication from order processing through commission payment between professional market participants should be electronic and adhere to ISO standards.
- 2. Mitigation of operational risk**

Financial and operational risks should be mitigated, especially counterparty credit risk and those related to the payment process.
- 3. Clarity of account structures**

Distributors should agree with the fund management company prior to the first transaction how they will place orders, detailing the accounts in which their investments will be held and the accounts used for settlement. This should include details of any external third parties such as custodians or depositaries with whom the distributor has contracted for such services. The fund management company should in turn provide these details to their transfer agent.
- 4. Key identifiers**

Contractual agreements between a distributor and a fund management company should have a unique 'Agreement Identifier' and (where needed) a 'Local Identifier' which dictates the commercial terms to be applied in respect of all commission types. These identifiers should be quoted in all instructions relating to those agreements. The combined 'Agreement and Local Identifiers' and the relevant account numbers should be included in all fund orders.
- 5. Commission reporting**

Where omnibus accounts are used, order marking or equivalent standardized position reporting mechanisms should be in place to ensure correct commission calculation. A standard format for position reporting should be developed.
- 6. Fund Processing Passport**

Fund management companies should provide a complete Fund Processing Passport (FPP) for all funds. The fund prospectus must mention where the passport can be obtained. The industry should get organized to facilitate access to and distribution of FPPs.
- 7. Completeness of data throughout the intermediary chain**

The order issuer is responsible for completing the order with all information required by the transfer agent. Each intermediary must pass on complete information.
- 8. Acknowledgement of order receipt and confirmation of order execution**

Transfer agents should acknowledge the receipt of orders as soon as possible. They should also notify the execution of orders as soon as possible. Distributors and client side custodians should send execution confirmations to their clients only upon receipt of an execution confirmation from the transfer agent.
- 9. Flexibility of position reporting systems**

Position tracking and reporting systems used by client side and fund side intermediaries as well as central market infrastructures, should support both trade date based and settlement date based reporting.
- 10. Transfers of holdings**

Transfers of holdings should be automated and, where possible, the distributor identifiers (combined Agreement and Local Identifier) should be included in the transfer instruction message.

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ISSA provides leadership in the formulation and promotion of best practice to improve efficiency and risk management in the global asset servicing industry. ISSA is a private sector, non-profit association.