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MIFID II FUND PLATFORMS: It takes two to tango

Fund platforms, which could provide a route for cross-border distribution, face hurdles when MiFID II comes into effect. **Fiona Rintoul** looks at the challenges ahead, including data-sharing.

Distribution has always put a brake on the dream of a single European market for investment funds. Funds may be harmonised. They may have European passports. But how do you get them into the hands of actual end investors all across Europe?

Fund platforms – enabled and enhanced by the internet and other advances -– provide a route. But now they face the challenge of the second iteration of the EU's Markets in Financial Instruments Directive (MiFID II).

MiFID II, which comes into force on January 3, 2018, puts fund distributors and manufacturers under pressure in myriad ways. Requirements regarding transparency, inducements and product governance all augment the administrative burden on both distributors and manufacturers and increase the need for data-sharing.

"MiFID II will increase the data needs of our distribution partners," says Sascha Lingling, head of business development at UBS Fondcenter, Europe's second-largest business-to-business institutional platform by assets under administration (AUA). "They have to have the right data available or they can't sell products."

MiFID II 'appropriateness tests', in particular, require fund professionals to have an awareness of the ultimate target audience for a product. This was not previously necessary. Managers have to set a 'target market' definition for funds and monitor it on an ongoing basis, and the strategy for distribution of the funds must be compatible with the identified target market.

"You have to have information in place to make an assessment of investors' knowledge and experience," says Ian Mason, legal director at law firm DLA Piper.

Data then has to be passed up and down what can be quite a long intermediation chain. Depending on their nature, fund platforms find themselves either caught by the requirements affecting distributors or sitting in the middle between the distributor and the manufacturer.

"It's a bit of a challenge when funds are traded across platforms and may be used in discretionary products," says Kenn Taylor, head of wealth at Alpha FMC, an asset and wealth management consultancy. "Giving data back to asset managers is quite a challenge. Some platforms have charged for that analysis. There's quite a lot of work to do to make that part of MiFID work in practice."

As distribution patterns in Europe vary considerably by country, so do the dominant platform types, meaning MiFID II will affect different countries in different ways. Statistics from Platforum, which gathers data on platforms, show that business-to-business, or B2B, fund platforms that are used by financial advisers are mainly found in the UK, which accounts for seven out of the top ten adviser-focused platforms, with two German platforms and one from Italy completing the list.

The UK, with its longstanding independent advice model, also has a large number of direct business-to-consumer, or B2C, platforms. However, UK B2C platforms have not succeeded in reaching beyond their borders in the way that mainland European platforms have. Platforum's top ten B2C platform list includes Nordnet, which operates in Finland, Denmark and Norway, as well as its home market of Sweden, and BinckBank, which covers Belgium, France and Italy, as well as its home market of the Netherlands.

PLATFORM CONSOLIDATION

There is broad agreement that the new regulatory burdens introduced by MiFID II will prompt consolidation in both the adviser and direct platform sectors. In the UK, this has already started to happen with Standard Life buying Axa Elevate and Aegon purchasing Cofunds from Legal & General last year. Platforms that don't scale up in size will probably have to scale down their offer.

"Smaller platforms will have to focus what they are doing," says Lingling. That may involve moving away from the open architecture model. Certainly, in the UK – which provides a foretaste of MiFID II, as some similar requirements were implemented there through the Retail Distribution Review (RDR) – a number of independent financial advisers have stopped picking funds themselves.

"They either outsource to discretionary fund managers or use portfolios created by platforms," says Alpha's Taylor. "There are increasing flows to these kinds of solutions."

This doesn't quite fit with the original ethos of fund platforms, which was to offer as wide a selection of fund managers as possible. Furthermore, it may mean some fund managers are squeezed out of platforms.

"Platforms may choose the products they offer more carefully," says Daniela Klasén-Martin, country head at Crestbridge, an administration provider, in Luxembourg. "It could be detrimental to smaller managers. We will see many more product manufacturers selling direct."

In the case of Ucits funds – highly regulated products designed for the mass retail market – you could argue that there is a kind of over-diligence at play in MiFID II.

"Should proportionality apply to Ucits?" asks Marta Oñoro Carrascal, global head of legal at Allfunds Bank, Europe's largest B2B institutional platform by assets. "You cannot treat all financial products the same. Buying a Ucits is not the same as buying a structured product or an equity."

There are also concerns about the universal utility of the inducement provisions in the directive. "It actually takes away the possibility for retail clients to get free advice from banks," says Klasén-Martin.

Managers that run alternative Ucits and non-Ucits face further problems. Selling alternative Ucits to retail clients could become prohibitively complicated under MiFID II. Other kinds of products, such as investment trusts and multi-asset funds, may also be caught by MiFID II's 'complex' designation, which could reduce rather than enhance investor choice. Meanwhile, the focus on charges in the directive could lead to greater use of cheaper passive funds.

"There will be a much greater focus on what you are getting for active management," says Mason. "If there is more focus on charges, it will be harder for platforms to recover costs."

STANDARDISED TERMS

For all these reasons, clear and sensible classifications will be essential to the smooth working of MiFID II. To this end, Allfunds is bringing together fund managers and distributors to try to agree on standardised terms, which – as far as possible – span Europe's borders.

"We started in Spain with share classes," says Oñoro Carrascal. "Working with the Efama [European Fund and Asset Management Association] consultation paper, we try to agree with fund managers something that works for all of them. We are looking for standardised terms that will work in all countries."

Similarly, UBS started discussions about data standardisation and delivery two years ago. Together with Credit Suisse, and Julius Baer, it set up a not-for-profit association named Open Funds (www.openfunds.org), whose goal is to establish a common industry standard for the interchange and dissemination of fund data.

"MiFID II will have a huge impact, but if we do it well, it could be a benefit," says Lingling at UBS Fondcenter.

Standardising where possible is particularly important because there are bound to be country differences in the way MiFID II is implemented that require individual attention.

"There's always a bit of gold plating in Europe," says Klasén-Martin at Crestbridge. "That creates a lot of work."

Overall, data management and automation will be key. Alongside initiatives such as those promoted by Allfunds and UBS Fondcenter, reference data utilities may form part of the solution to the problem of increased and more complex data needs. Peter Moss, CEO of SmartStream Reference Data Utility, a reference data management service, says: "It's forcing people to look at how they manage reference data and how they can get access to additional data to fulfil MiFID II regulatory requirements."

This is all part of a changing market where consolidation of data management and institutional fund platforms sits alongside a distribution offering that is actually splintering. Execution-only sales by individual managers and new online sales platforms, often powered by robo-advisers, are on the increase – though, as Taylor at Alpha FMC notes, "many robo-advisers use tried-and-tested fund platforms to do trading".

In some ways, however, it's a case of plus ça change, plus c'est la même chose. Figures from Platforum show that the banking sector controls more than 80% of retail fund distribution in Austria, Italy, the Netherlands, Spain, Sweden and Switzerland – a figure that is little changed since the Ucits directive was first introduced in 1985.

It would be wrong, though, to deny the progress that has been made. The difference now is that bank distributors can access a huge variety of funds through institutional platforms such as UBS Fondcenter and Allfunds. Both offer more than 50,000 products, including ETFs in the case of UBS Fondcenter. It's then up to distributors to decide which funds best meet their clients' needs and what added-value services they want to offer.