

FUND SELECTION UNITS UPSET THE OLD ORDER AND RESHAPE FUND DISTRIBUTION

INDEFI has been monitoring Fund Selection Units (FSUs) since 2012. Our latest research¹ confirms the key role that these entities play in intermediating third-party assets on behalf of Global Financial Institutions (GFIs) and underlines the changing competitive dynamics in the European distribution market.

FSUS: A WINNING FUND DISTRIBUTION MODEL

FSUs have taken centre stage at most GFIs today in the way the latter interface with third-party managers. They provide a tool for GFIs to “make open architecture pay” in a world where most of them own affiliated asset managers and are looking to better control asset leakages.

FSUs have experienced steady asset growth (as measured in terms of intermediated assets) driven by the consolidation of their role within their group.

INDEFI expects FSUs to keep strengthening their position and expanding their footprint:

- The forthcoming fund distribution regulations in Europe (MiFID II, PRIIPS) have spurred groups to get their act together in terms of fund distribution and strengthened their FSUs as open architecture centralisation, risk and compliance monitoring platforms;
- Margin pressures in the asset management industry will drive distribution groups to make open architecture “pay more” and FSUs are an ideal tool to improve margins in an open distribution system;
- Consolidation in the private banking and asset management sectors will further enhance the intermediation prospects of FSUs.

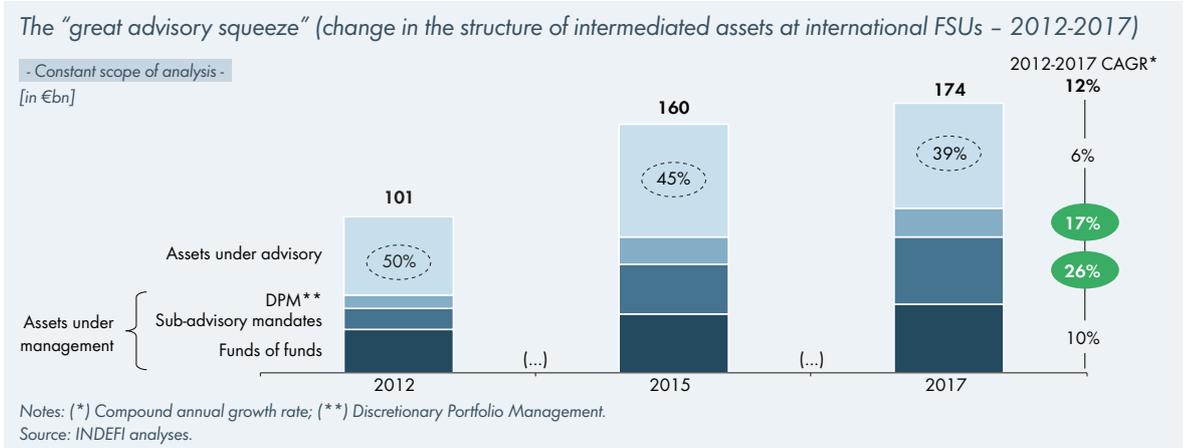
What are FSUs?

FSUs (Fund Selection Units) can be best described as entities affiliated with large financial distribution groups (business units / subsidiaries) which intermediate “open architecture” assets on behalf of group entities and, increasingly, third-party clients as well. Their intermediation role includes:

- Gatekeeping duties (validation of third-party managers and funds, operational due diligences);
- Selection and advisory services (creation and promotion of buy-lists towards clients);
- Asset management services (incl. funds of funds, sub-advisory platforms and discretionary portfolio management).

FOR THIRD-PARTY MANAGERS, FSUS ARE RESHAPING THE DISTRIBUTION OPPORTUNITY SET

FSUs are instrumental in engineering the “great advisory squeeze” in the European fund distribution market. While the latter used to be driven by the advisory business, the past five years have seen a complete change of dynamics with the increase in insourcing by distributors, as highlighted by the relative growth of assets under management (AuM) at FSU level vs. assets under advisory (AuA).



1. INDEFI Market Research, “Fund Selection Units 2017 – Anatomy of a €240bn market opportunity”, September 2017.

Within the AuM space, sub-advisory platforms are the fastest-growing business line. This model offers many benefits to FSUs:

- Enhanced risk management;
- Exclusivity for their affiliated distributors;
- Compliance with regulatory guidelines;
- Rationalisation in relationships with third-party asset managers;
- Optimised pricing terms.

These trends result in the shrinking of “shelf space” for third-party managers. In addition, FSUs are further rationalising GFI’s relationships with third-party managers. Beyond sub-advisory, our research shows that buy-lists have been restructured and reduced in spite of FSUs’ business growth. This is caused by aforementioned benefits spilling over into all aspects of the FSUs intermediation role. At many distributors this will result in privileged partnerships with a selected number of third-party managers. The latter are expected to secure a significant part of available “shelf space” (about two-thirds of selected funds) and, accordingly, capture a majority of the flows.

CONCLUSION

FSUs are at the heart of the wide-scale transformation of the third-party distribution business in Europe, which can be summarised as: from retail advisory to “wholesalisation” to “institutionalisation”.

As a consequence, key success factors (KSFs) for third-party managers in the distribution market are changing. While mostly related to products in the advisory market (performance), KSFs in the ongoing “wholesalisation” process are more and more attached to the manager’s ability to meet distributors’ expectations: pan-European scale, enhanced service model, width of fund range, completeness and competitiveness of asset management capabilities, local marketing and business development resources with head office support.

Furthermore, the growth in tailored outsourcing models will increasingly blur the traditional distribution vs. institutional divide which often hampers managers’ effectiveness in winning business from FSUs. Flexibility becomes of the essence as asset managers obsessively focused on one-size-fits-all UCITS distribution are likely to lose out in the institutionalisation phase of the distribution market. This flexible approach will need to be supported by a strengthened key account strategy (which goes beyond mere coordination as we too often see) and enhanced distribution personnel skills.

ABOUT INDEFI

INDEFI is a strategy advisor for the investment management business in Europe. Our exclusive focus on top line growth in one industry, the use of our own field research and the skill diversity of our consultants form the bedrock of our consulting philosophy. This gives us an unparalleled vantage point from which we aim to serve our clients - asset managers, private equity and infrastructure investors (and their portfolio companies) - with understanding, insight and actionable advice. We provide strategic business growth advice to our clients which can cover markets, products, client groups and a combination thereof.

We would be pleased to work with you on your business strategy in Europe, for specific product categories or international client groups.



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