



“Strategic Issues and Challenges of the CIS Industry Seminar

**Distribution channels  
Alternatives to the Concentration in Banks’  
Branches and Competition**

**Irene Tagliamonte**

**Italian CONSOB – Senior Officer, International Relations**

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# REGULATORY FRAMEWORK

- EU legislation (level 1 and 2)
  - UCITS IV
  - MiFID
- Level 3 (guidelines by CESR/ESMA)
  - Consob chairs the Asset Management SC
- National law (level 1, 2 and 3) transposing the EU legislation

## REGULATORY FRAMEWORK (2)

A number of distribution models are permitted:

- Direct distribution by the product provider
- Indirect distribution (retail banks, private banking, financial independent advisors, funds of funds, etc.)

The same rules apply regardless to the distribution model

# REGULATORY FRAMEWORK (3)

## Promotional activity (selling)

- UCITS IV and ESMA work
- From prospectus to key investor information

## Service to the customer

- Appropriateness (non-advisory)=customer's expertise sufficient to understand risks
- Suitability (advisory)=more in depth knowledge of the customer (awareness, investment experience , financial position, investment objectives)

## ...mutual fund distribution channels in Italy

- ❑ Substantial net outflows recorded by funds in recent years
- ❑ Structural causes include vertical production-distribution integration models (placement by banks; in house model)
- ❑ Captive strategies by banking distribution networks affect *pricing* and product design

## The Italian starting point

- ❑ Traditional bank-centric model: asset managers belonging to the same banking group of distributors - “production” less important than “marketing”
- ❑ Group profits mainly from the distribution channel
- ❑ Asset managers lack sufficient resources to improve their core activity (management) and to set up quality fund processing systems and risk management
- ❑ Competitive pressure by other easy-to-sell substitute products (typically financial-insurance products and bonds issued by banks)

## The Italian starting point (2)

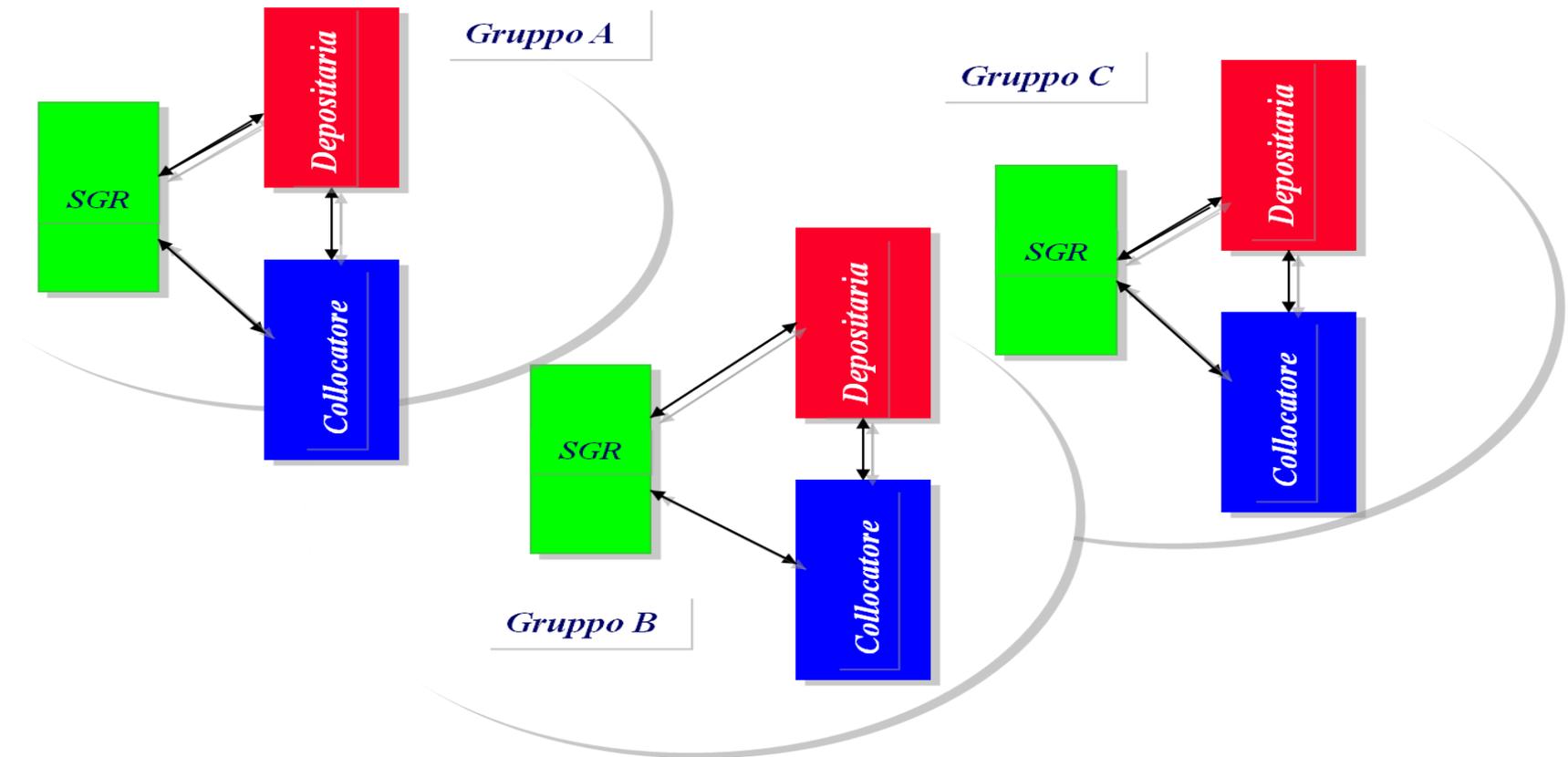
In this context

- ❑ “delocalization” through vehicles in Luxembourg and Ireland used only to get regulatory and fiscal benefits
- ❑ no effective international competitive strategy
- ❑ **limited mergers** between asset managers, when it happened it was due to consolidation between respective banking groups

### ...as a consequence

investors suffer from sub-optimal business and investment decisions in the sector, due to the capture by the banking distribution network

# Vertical integration between investment fund “production” and “distribution” in the Italian banking groups (1)



## Vertical integration between investment fund “production” and “distribution” in the Italian banking groups (2)

The **technical and operational structure** of the Italian CIS distribution model is like a **plurality of “close worlds”** with no connections with outside business



Use of an **integrated platform** and a **single entry-point** at group level to process subscription and redemption requests

## ...advantages of vertical integration

- ✓ Economies of scale and scope: cost reduction at group level
- ✓ Internal efficiency: all participants to the fund processing can dialogue through a group integrated platform

# ...and its disadvantages

- ✓ **Operational barriers:** the group platform obstacles the starting of new business relationships with third parties – multiple systems, procedures and languages leading to fragmentation
- ✓ **Limited competition:** insufficient diversification of fund marketing channels and limited investors choice in selecting intermediaries and services (including problems of portability)
- ✓ **Costs to clients:** almost 80% of charges remunerates distributors



**Limitation to the range of CIS offered to investors**  
**Risks of distorted provision of distribution and advisory services**

## ...the risks for the system

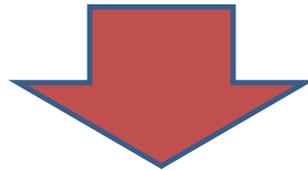
Incentives to misbehaviors by intermediaries



Risk of sub-optimal level of investments in CIS



Risk of reducing trust in the financial system



**Regulatory and supervisory actions**

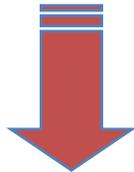
# ...ensure a level playing field

## ❖ Directive 2004/39/EC (MiFID)

- Directive 2006/73/EC
- EU level 3 measures

## ❖ Directive 2003/71/EC (Dir.Prospectus)

- Regulation 809/2004/EC
- EU level 3 measures



Maximum harmonization at EU level to avoing regulatory and product arbitrage



## ... at national level, regulatory initiatives

❑ **Consob Regulation on Intermediaries n. 16190/2007**, implementing MiFID, is intended to ensure a level playing field across distribution models and across financial products

### More in details

❑ Placement rules applicable to financial instruments have been extended to financial insurance products and financial products issued by banks

❑ Consob is competent for the enforcement and supervision in this area

❑ Close look to internal processes and compliance with rules of conduct in the distribution of financial products

## Incentives to alternative operational solutions

*Open architecture*



### Working Group CONSOB – Bank of Italy

Set up in 2008 to analyse operational issues connected with subscription and redemption information flows (so called fund processing)

## The Working Group CONSOB-Bank of Italy

### Support to the setting up of a standardised system infrastructure

- ❖ to interconnect participants' information flows
- ❖ standardise and automate fully and efficiently all the stages of fund processing



**open up the distribution market and  
increase business opportunities for asset  
managers**

# Two step approach

1. Standardisation of languages and procedures to ensure certain and prompt execution of the processes (reduction of fragmentation and operational risks)
2. Creation of an integrated system infrastructure (a single entry point) accompanied by a central depository management of CIS units and dematerialisation (increased reduction of fragmentation and operational risks)

## Advantages from this model

A “*single-entry-point*” benefits:

- ✓ **Asset managers** which may devote more resources to the core business (*product design, portfolio management*), since the fund processing is made through the system infrastructure
- ✓ **Intermediaries** which may exploit a more open system and access a wider range of products to distribute to the public in view to reach a broader spectrum of investors with different level of sophistication
- ✓ **Investors** since they will enjoy the improved quality of products due to competition

## Steps towards the single integrated infrastructure

- **Industry efforts** to standardise languages and procedures for fund processing (top-down approach by reference to the EFAMA uniform standards)

### **INDUSTRY GUIDELINES ISSUED IN OCT. 2010**

- **Implementation** by single intermediaries (by mid 2012)
- **Monitoring** by supervisory authorities in view to fuel the process

# Lessons Learned

- ❑ Internationalization of markets gives asset managers a chance to expand business
- ❑ The development of a competitive scenario and the improvement of quality in product and service provision is essential to add value to investors and protect their interests
- ❑ An essential step towards this direction is to ensure a level playing field across distribution models and financial products
- ❑ Another essential step is to incentivise an integrated system in view to overcome barriers and open up the distribution market
- ❑ System standardisation and single entry point should not be viewed as alternative or conflicting
- ❑ The entire process has to be progressive, be promoted by all the various stakeholders and take account market developments