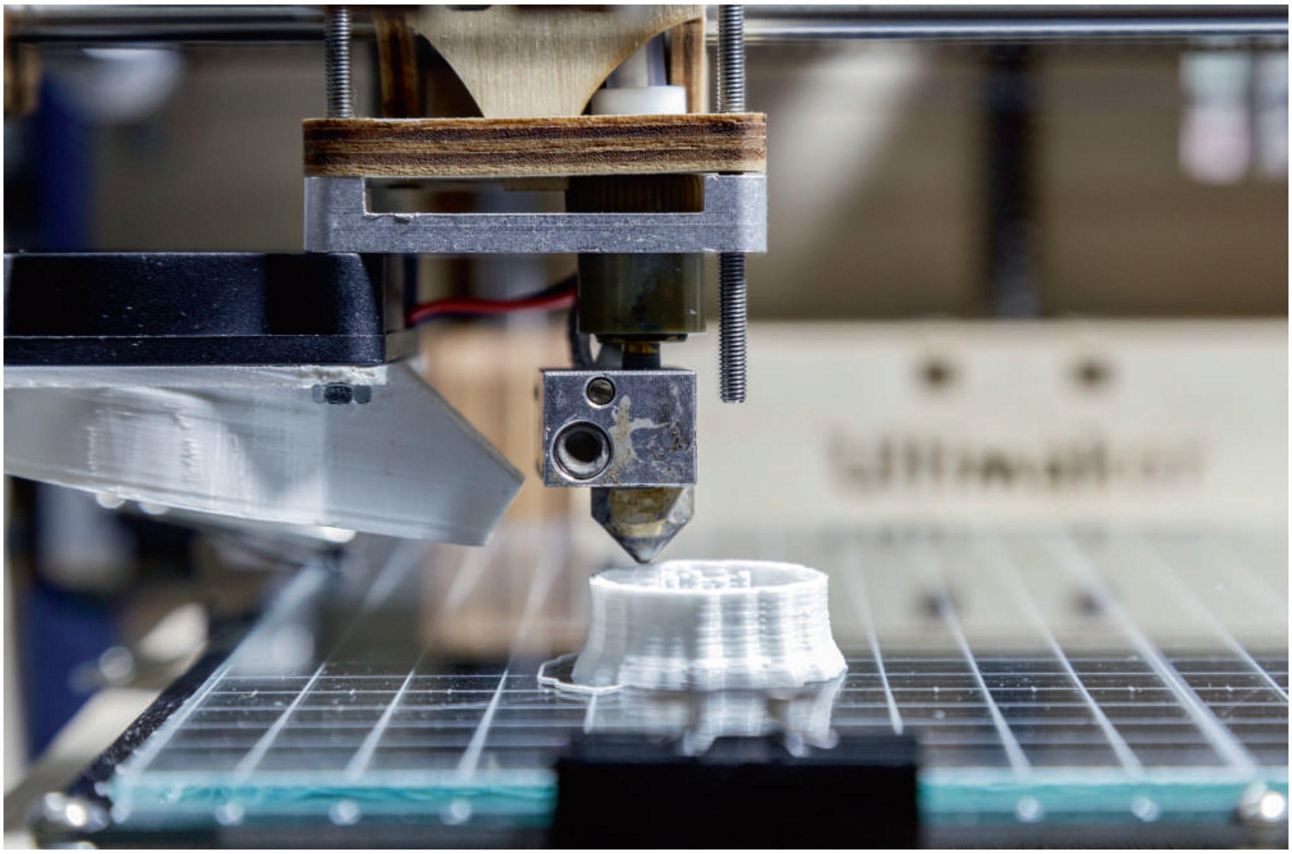

FUND SOLUTIONS: LESSONS FROM 3D PRINTING

Defined contribution pension provision means the number of fund solutions required is set to explode. Kevin Openshaw and Nathan Travell of Milestone Group look at the administration capabilities needed to deliver cost-controlled investment outcomes.

AT THE FUNDS industry's Alfi Autumn Conference in Luxembourg, a firm set up a 3D printer on its exhibition stand. As well as creating replicas of world-famous landmarks, people could have a 3D scan taken of themselves such that they could be 'printed' off-site, and a miniature replica posted on completion. Judging by the list of names signed up for this, there will be a lot of 3D printed, miniature asset managers in Christmas stockings this year.

The conference also included a panel focused on the long-term savings gap across Europe and the continuing trend away from government-backed pensions to workplace and individual savings schemes. The UK is already well on its way via auto-enrolment and the recent liberalisation of the annuities market.

The industry response to this switch of focus to individuals saving through defined contribution schemes has been to develop more fund solutions. These include multi-asset funds, multi-manager funds, blended or fund-of-fund solutions, which along with glide paths and asset allocation structures are designed to take people up to and through retirement. With dedicated wealth managers out of the reach of most, the average person (or the trustee acting on their behalf) will be looking to outsource their asset allocation decisions and manager selections, and simply invest in a solution designed to give them an appropriate outcome.

For the majority, this solution will be the default investment option selected by the pension scheme trustees and their advisers. This solution is typically designed to meet the needs of a large cohort of people, many with different characteristics and personal circumstances.

What is limiting the creation of more granular fund solutions to address more focused segments of pension investors? As with the 3D printer anecdote, why can't we approach a provider for an equivalent '3D scan' of our wealth, circumstances, and retirement needs, and have that same provider create a bespoke solution at an appropriate cost?

This is the area that 'robo-advisors' are starting to enter. But typically even they still only place people into a limited number of solutions. This is because the standout factor limiting fund solutions is that of high administration costs.

WHAT HAS 3D PRINTING GOT TO DO WITH IT?

3D printing has generated a lot of buzz recently. The newfound ability to manufacture highly customised goods without having to design or reconfigure machines promises a significant fall in production costs. The brilliance of 3D printing is that the value of the finished good lies almost exclusively in the design, not the manufacturing process.

There is an analogy here with the funds business. The equivalent of the traditional manufacturing plant would be the 'NAV factory', where administrators 'manufacture' daily net asset values (NAVs) in a fairly standard fashion, at high volume for the associated lower cost. These processes and systems don't tend to cope well with the requirements of highly bespoke fund solutions. These solutions need to operate within complex, multi-tiered fund structures, requiring complex cash allocation and rebalancing processes to operate effectively. And they still need to work at scale due to their building-block nature (the number of potential fund solutions is limitless).

The point is that the 'NAV factory' of old is no longer enough. There is a need for something additional, analogous to the 3D printer – a 'funds solution' factory.

What this means in practice is the ability to manufacture new fund solutions at low marginal cost ('manufacture' meaning the design, creation and ongoing administration of these solutions).

To illustrate this point, consider the following representation of the fund industry. At the 'bottom of the stack' are the fund products, where traditional asset managers work hard to achieve returns. The administration of these portfolios typically follows the traditional manufacturing model: aiming for high volume and low cost, generally via an outsourced third-party administration partner to achieve scale.

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At the core of this stack is the new world of fund solutions. These typically invest in fewer assets than an underlying portfolio, transact less and have simpler corporate actions to process.

However, they also require the capability to manage complex, multi-tiered funds structures, process capital flows and manage sophisticated target allocation models through different rebalancing methodologies, calculate management fees and rebate accruals and ultimately strike their NAVs each day.

These new solutions require a new manufacturing capability – one that is fundamentally flexible in the way 3D printers are – to cost-effectively service higher numbers of them for more and more targeted investor profiles.

AN EXTRA DIMENSION: Why can't we obtain a '3D scan' of our wealth, circumstances and retirement needs?

CREATING THE FUND SOLUTIONS FACTORY

This demand for new and more tailored fund solutions has run ahead of the industry's technological capability. Those administering these new solutions have typically failed to grasp the possibility of adapting to these new demands at a technological level. Many are simply accommodating the new requirements as best they can within the old 'NAV factory' paradigm.

As a result, administration rate cards do not necessarily differentiate between the administration of more traditional fund products and tailored fund solutions, often making it prohibitively expensive to manufacture the ideal number of fund solutions to meet the requirements of different segments of investors. Default funds are perhaps, therefore, not ideal for all – even target-date funds are generally limited in their vintages to five years or more.

For the funds industry to achieve the equivalent breakthrough that 3D printing is bringing to manufacturing, it must embrace recent developments in fund technologies that have the same potential to support mass customisation of solutions.

Embracing the right technology will enable the emergence of the fund solution factory to sit alongside the traditional NAV factory, allowing more tailored fund solutions to be implemented as the marginal administration costs and minimum fund under management required to justify the fund's creation are reduced.

Only then will the funds industry achieve a revolution similar to what we are seeing with 3D printing – highly customised products at affordable cost.