Quoted Funds

The Convergence of Listed and Unlisted Funds

MAINSTREAM

To date, the existing system of listed and unlisted funds creates an unwieldy, inelegant landscape for investors, brokers and fund managers alike. With unjustifiable demands on brokers for building messaging software, an enormous paperwork load and complex product offerings for investors, **the system has failed to keep pace with the rapid digitisation and consolidation of the world today.**

It's for this reason Mainstream has responded to fund manager demand for a single investment vehicle which can be transacted as listed or unlisted. This new solution can result in reduced costs and simplified investment options - whilst ensuring there are no impediments to broker take up. When accompanied with robust digital solutions it can also reduce risk and resource demands.

In this whitepaper, we'll address **the convergence of listed and unlisted funds,** the factors leading to this solution and the benefits to key stakeholders.

Unlisted managed funds vs. active ETFs

Fund managers over the last five years have gone about attracting different kinds of investors by having two separate funds – one listed, and one unlisted.

A key drawback for unlisted funds has been the excess of paperwork required from an investor applying to buy or sell units. Investors have been required to complete 15- to 20-page application forms for each fund they choose to invest in - and most of these are still paper-based in 2020. Furthermore, trading unlisted funds can take weeks, as forms have to be posted and processed.

To address this issue, in 2014, the ASX launched mFund, a settlement service designed to enable investors to trade with fund managers through a broker.

By 2015, active exchange-traded funds (ETFs) were introduced to the Australian market. Active ETFs allow for simpler trading - an investor only needs a broker account and doesn't need to go through Anti-Money Laundering and Know Your Customer (AML/KYC) for each transaction.

However, investors who have a financial adviser typically invest through an IDPS or platform. For these indirect investors, the preference for investing will continue to be through unlisted funds, and as a result many managers end up with identical dual funds – one listed and one unlisted.

mFunds: step one in the evolution

While mFund is a great concept, a key weakness is its inability to achieve uptake with brokers. For global and high-volume brokers, adopting mFund requires the establishment of additional operational infrastructure, costing too much to build a strong business case. Because brokers earn their money by trading stocks in and out, and a managed fund has a five- to seven-year time horizon, they lack the incentive to build these new messaging tools. Without brokers on the messaging system, mFund hasn't gained enough broker penetration to take off.

This leaves fund managers and investors in an awkward position. Managers have to offer two funds with effectively identical strategies and costs, but different mechanisms for trading. Meanwhile, investors are left with confusingly similar listed and unlisted options and overcomplicated trading processes.

The emergence of quoted funds

Driven by client demand to consolidate listed and unlisted funds, Mainstream have developed a means for fund managers to offer one fund that can be accessed by investors through the traditional means of applying and redeeming units in an unlisted managed fund by the funds cut-off. These investors are managed by the registry and transact using a Shareholder Reference Number (SRN.) Alternatively, investors can trade on the exchange through their broker, using their holder identification number (HIN).

"We have to challenge the paradigm a little," says Mainstream's Group CEO Martin Smith, "and think about what our clients are trying to achieve for their investors. Our goal is to simplify investor interaction and transacting. Our competitors are saying their listed system does one thing while their unlisted does another, while their portal shows the collective. What we're arguing is that, instead, we need to be creating a single system that handles listed and unlisted funds together, so the data at source is one repository."

The result of this convergence is of considerable benefit to fund managers, investors, brokers and administrators.

The benefit to fund managers

By adopting a consolidated product, fund managers are able to offer the same benefits of dual funds to investors, without the duplicate cost structures. Rather than having listed and unlisted funds doing the same thing, managers have a single vehicle that can be transacted through either mechanism. As a result, the management company can streamline resource costs.

"We estimate fund managers can save in the vicinity of $150,000 per annum by consolidating dual funds into a single product," says Nick Happell, CEO of Mainstream Fund Services, Asia-Pacific. "At the same time, they're eliminating the confusion of having dual funds and improving their customer experience."

The benefit to investors

With fewer conflicting options, investors have a more simplified view of their investments.

"The main focus of this new style of product is the registry offering," Happell explains. A key feature is ensuring investors can seamlessly move between SRN and HIN and vice versa. When listed and unlisted units in the same fund aren't handled by the same system, this process cannot be automated through the investor's broker. Consequently, the messages are rejected and the investor must process the change manually.

"What we're seeing in the industry is that listed and unlisted registry is most commonly done out of different systems, with different teams operating the services. We have built the listed functionality in our unlisted platform to ensure the investor experience is automated whilst ensuring regulatory requirements and ASX operating rules are adhered to. Our solution also ensures a seamless web experience for the investor, with one web login across both their listed and unlisted investments held with Mainstream."

On top of this, the necessity to complete AML/KYC with each investment decision is removed, enabling easier trading.

The benefit to brokers

For brokers, this product eliminates the need to build a bespoke 14-message system. By making use of existing messaging tools, the demand to introduce low-return infrastructure is removed and thereby so too are the barriers to adoption. Brokers are able to buy unlisted units for a client as simply as if they were buying on the ASX.

The benefit to administrators

"To me, this is long overdue," says Smith. "It's Uber versus taxis. This solution is doing the same thing as the existing structures, but with greater access, more efficiency and robust digital support."

For administrators, doing away with excessive paperwork on the investor's end also means more intelligent, secure digital systems. By reducing paper shuffling and human intervention, the administrator is able to reduce operational costs as well as risk of error.

Moving forward with Mainstream

Mainstream's goal is to remove the barriers impeding investor activity in listed and unlisted funds. Developing a solution that immediately addresses the demands of an increasingly digital and fast-paced consumer base not only empowers investors to trade more easily, but offers managers, brokers and administrators a means to keep pace with our rapidly advancing world.

With Mainstream's solution, the landscape of listed and unlisted investing will start to resemble something that's more 2020, and less 1990.

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