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An ALPS Distributors, Inc. Whitepaper

Practical Guide to Establishing a Mutual Fund Distribution Syndicate

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Summary

This white paper is intended to provide the reader with a broad synopsis of key considerations when attempting to establish a "Mutual Fund Distribution Syndicate" in the "Liquid Alt" market space ("*1940 Act Liquid Alt Mutual Fund Space*"). There are organizations that portray building a cost-effective Mutual Fund Distribution Syndicate as a simple Sunday drive or an all-too easy endeavor. However the information provided herein is intended to provide investment professionals an understanding of certain fundamental issues to consider in order to assist them in making an informed decision before entering Liquid Alt market space and establishing a Mutual Fund Distribution Syndicate.

Organizational Assessment – *Strengths & Weaknesses*

When investigating the addition of the Liquid Alt space to your firm's asset gathering channels, does your firm have clearly defined expectations about what "success" would look like? In order to answer this question, a detailed market analysis is required to establish reasonable expectations of a potential product's ability to gather sufficient assets for the proposed product to be deemed internally as a success.

A firm should conduct a candid self-examination to identify its organizational strengths and weaknesses. The regulatory requirements imposed by the Investment Company Act of 1940 (the "1940 Act") are substantial for registered investment advisers. However, one can take comfort in the fact that there are approximately 20,000 mutual funds offered today with support services and operational muscle readily available. Furthermore, alternative methods of participating in the 1940 Act Market Space are also available such as participating as a sub-adviser. However, such methods have their own respective advantages and challenges.

Starting a mutual fund is a "Process". One that requires an experienced partner to assist you with the many hurdles and challenges that building a 'distribution syndicate" in the 1940 Act Market Space will require. The remainder of this paper will focus on key considerations and steps of the "Process" that firms should endeavor to answer when entering the Liquid Alt market space.

Planning – *Selecting the Correct Product Structure*

Certain key elements of your start-up fund that should to be resolved prior to the selection of any service providers and/or the final decision to move forward are provided below. If these key elements are not resolved at the outset, the cost curve to address any short comings or unresolved matters dramatically rises:

Investment Considerations	➢ Can the strategy be implemented given the regulatory restrictions around short selling, investment restrictions and daily liquidity?
Target Market	➢ Is your firm's marketing collateral permissible and is the national distribution plan able to grow and maintain assets?
Product Structure	➢ Does your firm's share class selection address the needs of your target market?
Operational Considerations	➢ Does your firm have the financial resources to support distribution related costs (i.e. minimum fees; finder's fees and advance commission payouts)
Regulatory Considerations	➢ Does your firm understand the limitations associated with the use of Rule 12b-1 and non-12b-1 monies for payment of fees?

Preparation – *Selecting Distribution Platforms*

Almost any national distribution plan will involve executing an agreement with one or all of the major mutual fund distribution platforms and/or financial intermediaries ("Financial Intermediaries") that currently dominate access to retail and institutional investors. These Financial Intermediaries have grown so powerful over recent years that they now have their own unique entry requirements into the 1940 Act Market Space they service. These barriers generally come in two forms:

- the imposition of a "set-up" cost associated with operationally establishing new start-up mutual funds; and
- the requirement of pre-existing demand for a new product from an investment professional who is utilizing that specific Financial Intermediary's services.

These requirements burden start-up mutual fund products with the classic dilemma: "*which comes first, the chicken or the egg?* In other words, how can start-up firms gather sufficient assets prior to gaining access to the handful of Financial Intermediaries that currently control vast majority of the 1940 Act Market Space?

The table below provides a sample of Financial Intermediaries start-up fees and eligibility thresholds.

Types of Intermediary	Set-up Costs	General Eligibility Requirements
Supermarkets	Initial Setup Fee: $10,000.00 Per Fund Setup Fee: $1,000.00 Monthly Minimum: $2,000.00 Basis Points: 40 bps (10 bps Class I)	Must have insider demand. Due diligence cannot begin until prospectus is effective with the SEC. Minimum of 9 to 12 weeks to setup post effective date of the prospectus
Wirehouses	Initial Setup Fee: $25,000.00 Per Fund Setup Fee: $2,500.00 Positon Charges: $16 per positon Annual Minimums: up to $250k per year	Must have insider demand, six months of performance history and $25 million in AUM before due diligence will begin.
Clearing Firms	Initial Setup Fee: $5,000.00 Per Fund Setup Fee: $1,500.00 Amend Agreement Fee: $2,500.00 Monthly Minimum: $100.00	Dependent on Introducing Broker-Dealer demand post launch.

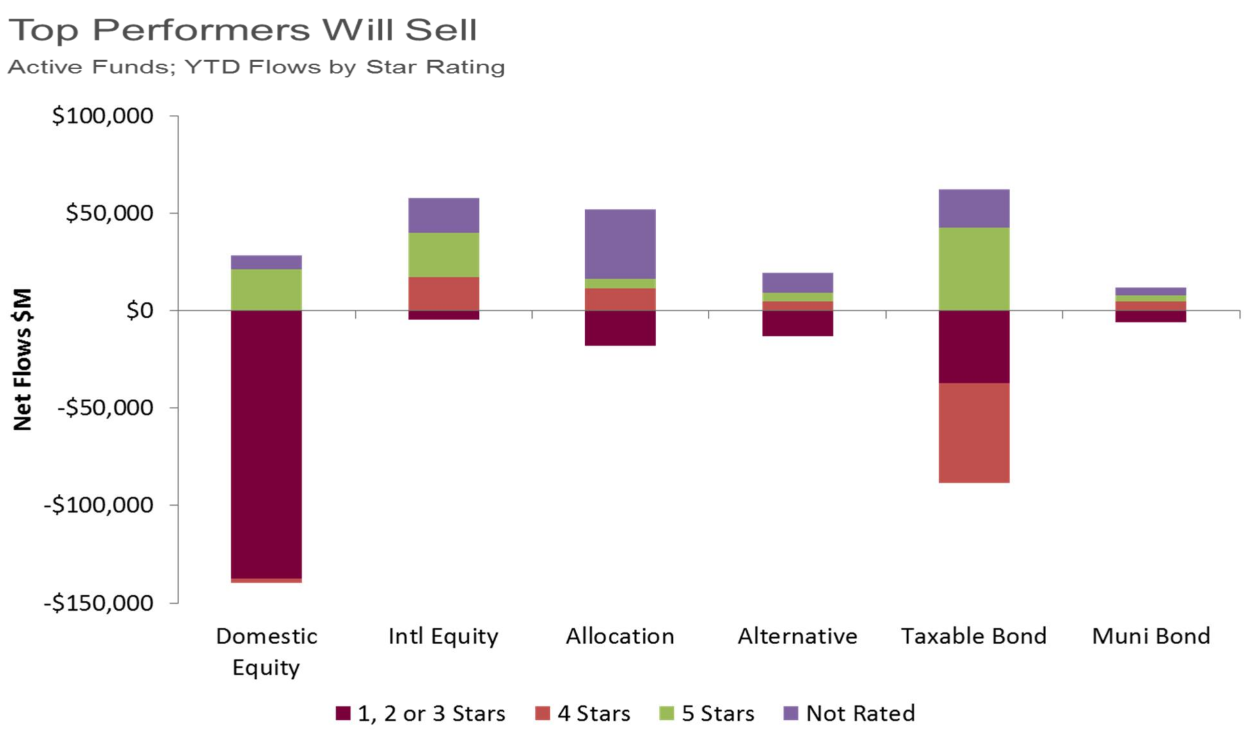
Conviction and Confidence – *The Measure of Organizational Commitment*

One of the common denominators that ALPS has seen culturally across those firms with which we have partnered with to successfully navigate these challenges, is a strong conviction and persuasive narrative regarding the value of their strategy. These characteristics can be successfully communicated and marketed through a wide variety of methods of messaging and branding. For example, some firms may leverage the reputation of a particular portfolio manager, while other firms focus on a unique investment process, where another will focus on branding itself as a boutique or specialty firm. Financial Advisors in the 1940 Act Market Space may be more likely to take a risk on a start-up fund which offers a compelling reason rather than selecting a passive investment strategy that meets an equivalent need.

In closing, conviction and confidence need to be authentic, demonstrable, and deliberate. Support from Financial Advisors will be critical for your product to negotiate each Financial Intermediary's eligibility requirements. One of ALPS' clients which has successfully established a cost-effective 1940 Act Market Space Distribution Syndicate stated in hindsight: ***"There were no short cuts".***

Performance – *Best Performers Will Sell*

Now the good news - for firms that make the organizational commitment and diligently work to resolve the "which comes first" dilemma, significant positive cash flows can be achieved. The chart below demonstrates that start-up mutual funds (*the "Not Rated" category*) for 2015 had positive cash flows in all six broad investment categories.



Sources: FUSE, Morningstar

An intriguing piece of information demonstrated in this chart is what ALPS refers to as the *"Inflection Point"*. As the reader may already know, Morningstar does not offer a "Star Rating" until a mutual fund has established a three-year track record.

The chart suggests that a mediocre rating has more negative impact on a fund's ability to gather assets than no rating. Therefore, those funds that can place themselves in the top tier of their peer group can, with reasonable confidence, expect to experience a net positive cash flow as Financial Advisors will generally see this as validation of the "conviction and confidence" messaging established at the mutual fund's inception.

Partnership – *It Really is a Marathon*

Your firm's flexibility will be challenged both organizationally and financially by the 1940 Act's demanding learning curve. This is the reason why the selection of your service providers is such a crucial part of the process. The best of breed in this industry are the service providers that:

- are flexible and adaptable to your organization's specific needs
- compliment your organization's strengths
- provide ongoing assistance as your organization builds out its internal expertise
- can accommodate scale as your organization grows; and
- culturally define their success by their clients' success.

In closing, ALPS would like to offer five questions that every firm should consider when deciding to move into the Liquid Alt space:

- What are the hurdles that could hinder our distribution strategy and how will your service provider be able to address these?
- Has my firm correctly aligned its product's fee structure with our firm's target market(s)?
- What are the financial and non-financial eligibility requirements that must be met before our product can gain access to our target market(s)?
- What are the economic costs to on-board our product to key mutual fund distribution platforms?

- How do we define the break-even point at which a key platform becomes profitable?

This white paper is provided for informational purposes only, in order to equip those firms considering moving into the 1940 Act Market Space to make well-informed decisions. Hopefully after reading this paper, you will agree that building a successful distribution syndicate is anything but a Sunday drive, and we hope it better prepares you for the journey ahead.

If your investment firm wishes explore any of these topics in greater detail or discuss opportunities, please contact James Curry at james.curry@alpsinc.com or 720-623-2577.

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