GLOBAL CUSTODIAN

IN BRIEFS/PEOPLE

REDOUBTABLE THOMAS

THE MAN WITH THE CRYSTAL BALL

LONDON—Simon Thomas of Davis International Banking Consultants (DIBC) is a modest man. He would never tell you that he numbers among his clients two of the City's leading custodian banks, State Street and the Royal Bank of Scotland. Any discussion of his career is peppered with verbs like "support" and "help" rather than "manage" or "direct," and he refers to himself as "the third executive director at DIBC." Such reticence is unusual in a man who was once an investment banker. He is similarly self-effacing about a book he co-authored earlier this year with Michael Beacham, an information technology specialist at the Los Angeles office of Thomas' erstwhile employers, KPMG Management Consultants.

DIBC's Thomas: sorting the sheep from the goats

After training as an accountant with Coopers & Lybrand, Thomas joined the internal systems department at SG Warburg in 1983. Over the next two years, he helped to manage technological change and improve operational efficiency in the merchant bank's asset management, banking, and Eurobond departments, thereby acquiring his first real taste of the business of securities administration. Plunged into Warburg's new strategic business and financial planning unit in 1985, he was closely involved in the merger of Warburg with broker Rowe & Pitman, market-maker Ackroyd & Smithers, and former gilts broker Mullens & Co during the prelude to Big Bang in October 1986. In January 1987 he joined the financial sector group at KPMG, part of a team of 25 wrestling with a £7.6-billion settlement backlog that afflicted virtually every bank, investment institution, and securities house in the City of London. As if that were not enough, KPMG clients also called on the firm to unravel unsettled securities trades in Milan and Madrid. He considers the experience valuable. "It was how we got our hands dirty in the area of custody," he says.

KPMG was already working with many firms—London clearers, merchant banks, asset managers, and European universal banks—on their settlement problems. They were understandably anxious about the erosion of their client base by well-organized and technologically proficient American global custodians. As banks were casting around for management tools, systems advice, and new business strategies, it was Thomas who began to offer them answers. He became one of the most familiar figures on the burgeoning custody conference circuit, and he now boasts a client list that comprises small asset management firms as well as giant custodian banks.

DIBC, created in 1980 by Steven Davis—an alumnus of Harvard Business School, JP Morgan, and Bankers Trust Company, and the author of the acclaimed *Excellence in Banking*—is Thomas' new home. "The move to DIBC was made after much soul searching. The justification is the unique primary research capability the firm has developed, and its equally unique strategic planning capability. In my view, the future of management consultancy to the custody industry is largely strategic in nature, which fits exactly with the DIBC culture and objectives," says Thomas.

In his book, Thomas describes the custody industry as "one with declining margins, substantial fixed costs, increasing competition, and a rapidly changing environment." Few custodians would dispute that view, but few are in as good a position as he to tell which will survive and which will fail. He is not drawn easily into sweeping predictions, but a picture of the ideal custodian of the 1990s gradually emerges in the course of conversation. Unusually, he singles out the London merchant banks for the quality of their reporting, suggesting that only the top half-dozen custodians can match them in that area. There is

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the more obvious matter of the quality of the management in an industry that is still very young—"The professional managers in this business stand out because there are so few of them," he says—but it is something consultants can affect only tangentially. Systems, strategies, and structures are his main themes. "Five years out, many of the inefficiencies from which custodians make money today are going to be smoothed away," says Thomas. "Some custodians are going to have great difficulty making money when rolling settlement and DVP on T + 3 and below are finally achieved. Those custodians which want to continue in the business must devise a client service which goes far beyond the basic service they have traditionally provided."

It is this that convinces him the most successful custodians will be those which offer an integrated service, such as Treasury services as well as custody. This will necessitate integrated banking and securities systems to ensure that declining income from basic settlement and safekeeping services is offset by improved cash management, reporting, and stock lending services. "The amount of cash earned per billion of assets under custody varies enormously, from losses to very significant profits," explains Thomas. "Much of the difference is down to the way a business is structured." Theoretically, clients that previously dealt with a variety of institutions will gravitate toward a single, integrated provider that offers a better service at the same net cost.

Thomas discerns two major threats to the continued growth of the custody business. One is the increased danger of disintermediation. In approaching this sensitive subject, he distinguishes between emerging markets (where the quality of the people on the ground is crucial, and industry specialists can emerge) and sophisticated markets (in which success hinges largely on the quality of the technological platform and the efficiency of the delivery systems). In many of the main financial centers, institutional investors are already linked directly with central securities depositories. Industry cooperatives like SWIFT, and commercial communications firms like GE Information Systems and Reuters, are now building networks that threaten the proprietary communications systems run by the banks. This may pitch some banks into regional alliances, sharing technological overheads and common communications networks. A more insidious threat is insensitive regulation. The attraction of custody to many banks lies in its promise of handsome fees in exchange for a minimal capital commitment. Thomas fears that too many weak and poorly capitalized banks are muscling into the market, and that any bank failure which jeopardizes client funds will have the custody industry crawling with the national and supra-national regulators. He is unconvinced by the standard custodial riposte that client funds are carefully segregated, arguing that it is difficult to achieve this with cash or derivative instruments. "We are aware of a number of institutions that do not properly segregate or shield custodial assets," he says. He fears the imposition of stiff capital requirements on custodians would shrink cross-border investment drastically, and perhaps halt it altogether in the developing world: "The regulators are beginning to take a more active interest in cross-border investment. They are likely to want capital to be put up against this business, where there are inherent risks which are not yet fully analyzed or understood. That capital requirement could be substantial, and before any regulatory group comes stamping into this embryonic market custodians must start thinking about how they are going to provide it and what they should do to prevent such a crisis occurring. We need a self-regulatory approach."

Even these worries cannot cloud an obvious sense of enjoyment and enthusiasm. Thomas thinks global custody is the most exciting aspect of the international banking scene today. He just wishes he had not written a book about it. "Balancing time spent on client work and maintaining domestic harmony while at the same time writing a book was a humbling experience. I would not recommend it to anyone," he says.

–Dominic Hobson

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