

The global challenge

Simon Murray - 14 Sep 1998

The custody industry is entering a new phase requiring different skills

The global custody revolution in the UK is entering a new phase. Until now, insurance companies and pension funds have tended to concentrate on basic custody requirements in their evaluation of independent global custodians.

But an increasing number of funds are now considering using their global custodian's investment accounting services as well. This requires a different set of core service requirements, and different custodian skills. Unfortunately, not all funds going down this route have been satisfied with the results. What lessons can be learnt from their experiences? What are the pros and cons of using a global custodian's investment accounting services?



Investment accounting data is used by insurance companies and pension funds for a variety of purposes, including internal reporting, external audits, compliance, performance measurement and risk monitoring. An investment accounting service should provide funds with timely, accurate and complete data on their investments. The service should produce consolidated transaction and holdings statements and asset valuations across all investment managers and asset classes. Crucially, the core data should match the positions held by the underlying investment managers and custodians.

In terms of how these services are currently handled, the market breaks down into three broad segments. The first and largest segment includes the traditional, integrated arrangements where custodians are appointed directly by a fund's external investment managers. Insurance companies and pension funds in this segment normally carry out master record keeping and investment accounting in-house or through an external bureau.

The second segment includes funds that have appointed an independent global custodian, but which have decided to retain separate investment accounting functions. There can be various reasons for this decision. The funds may, for example, have in-house investment managers, or they may be satisfied with the level of service and reporting received from existing suppliers.

The third segment, which is growing in size, includes the funds which do use their global custodian's master record keeping and investment accounting services. Global custodians already keep

a set of records across all investment managers and communicate daily with the managers. They have access to the necessary cash and securities data, including external price feeds for valuation purposes. The major global custodians have developed flexible and user- friendly on-line reporting systems, which make some of the bureau systems look distinctly dated. Global custodians may also offer sophisticated 'added value' investment monitoring and performance measurement services.

Can global custodians deliver the required results? In reality, global custodians will always make mistakes. They work with many different internal and external parties, and very few people or systems are perfect. However, mistakes in the investment accounting area are particularly serious and costly, because the data is used for accounting, monitoring and audit purposes.

The sad fact is that some funds have not been able to rely on their global custodian's accounting data. For example, the positions and valuations data may not always be reconciled, within acceptable time limits and tolerances, with investment managers. Some custodians are not even that good at reconciling different sources of data held within their own offices or with other custodians. They may fail to maintain totally consistent and transparent pricing sources and methodologies. They may not account for the full range of book costs and prices on their system. They may not maintain sufficiently detailed historical data for certain types of fund investigations. Even if their front-end reporting systems look marvellous (and this is not always the case), it is what goes on behind the scenes that really matters.

The silver lining for insurance companies and pension funds is that the leading global custodians are well aware of these issues. They have invested considerable time, money and management resources to improve the quality of their services, to the point where funds can reasonably expect that the investment accounting data they receive will be timely, accurate and complete.

Experience shows how important it is to find a custodian with first-class investment accounting capabilities. But how does this square with a custodian's credentials as a global custodian? For instance, is the quality of investment accounting services more important than, say, asset safety? Some of the more advanced global custodians have relatively small European operations and small balance sheets. How important is size relative to the quality of added-value services? These are difficult trade-offs, but ones which funds are increasingly being forced to make.

Simon Murray is a director of Thomas Murray, an independent

*firm of management consultants specialising in the global
custody industry*