

# Consultants thrive despite consolidation in custody

Juliette Pearce - 27 Sep 1999

## Consultants are struggling to find global custodians to take on mandates of less than \$1bn

The limited choice of custody providers - with just 11 houses attempting to offer global services - should mean that custody consultants face a tougher task peddling their wares to institutional clients.

And given that very few of those global custodians are prepared to take on funds of less than \$1bn (€961m) let alone \$500m, medium-sized UK pension funds in particular are left with little choice of where to go for global custody services.

But all consultants, both specialist and traditional actuarial and investment consultancies, have reported increases in business over the last two years.

In 1996, when the first pension funds - [Wellcome Trust](#) and [Courtaulds](#) - stepped out ahead of their peers to consolidate custody reporting and fee structures under a single global custodian, it was in the wake of specialist investment management structures and the dawning of onerous regulatory pressure. The same year, [Baring Asset Management](#) and [Prudential](#) started the trend of investment management outsourcing custody.

Then there were dozens of custody providers, and Wellcome and Courtaulds called in specialist consultants Chatham Partners, then known as [Kohlberg Associates](#), based in the US, while [Baring](#) and Pru sought advice from UK-based custody specialist [Thomas Murray](#).

A host of custody providers were serving the marketplace, including [Lloyds Securities Services](#), Nat-West, [Barclays](#), [Morgan Stanley](#), [JP Morgan](#), [Midland Securities Services](#) and [Royal Bank of Scotland](#), as well as a vast number of large US houses.

But with Lloyds closing its business this year, there now remains just one UK-owned custodian - HSBC's [Global Investor Services](#). [RBS Trust Bank](#) is soon to be swallowed by [Bank of New York](#), making it the largest provider in the world with around \$6 trillion of assets under custody.



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Curt Kohlberg,  
Chatham  
Partners

Whether medium-sized pension funds and smaller fund managers will go for global custody remains to be seen, and whether institutions need to pay out for costly consultancy fees is another matter.

But as [Curt Kohlberg](#), of specialist custody consultants Chatham Partners, says: 'Even though there are only seven or eight firms left in the business there are substantial differences between them and the capabilities of these firms change quite rapidly. For that reason, in addition to helping clients save money both in terms of negotiating the contract and identifying inefficiencies in their back office, we feel we add a considerable and valuable view.'

And as [Jeremy Hester](#), vice-president of corporate and institutional services at [Northern Trust](#), adds: 'With outsourcing by fund managers, consultants can add objectivity. There can be vested interests within different departments of an insurance company or fund manager which is looking to outsource and a consultant's independent recommendations can help ease the process.'

Only Bank of New York, [Chase](#), [State Street](#), [Deutsche Bank](#) - which now has the [Bankers Trust](#) business - Northern Trust, [Citibank](#), [HSBC](#) and [ABN Amro/Mellon Bank](#) plus the likes of [Royal Trust](#), [Paribas](#) and [Brown Brothers Harriman](#) are trying to join the global club. Yet in the UK alone there are now more consultants than there are global custodians.

Thomas Murray and Chatham Partners are the two main specialist custody consultants operating in the UK, advising both pension funds and investment firms. They also do strategy work for the custodians themselves as well as analysing local markets and central and international securities depositories.

Other specialists offer a variety of services, but do not have such a wide remit.

These include Bank Relationship Consultancy, which occasionally appears in strategic and custody reviews by banks under its more general role, [R&M Consultants](#). Lee Schwartz Associates is largely a surveyor of the industry, while [Capital Markets Company](#) provides strategic consultancy, operations and technology support to wholesale banks and central depositories globally. The likes of [Global Securities Consulting Services](#) and the Bank Relationship Consultancy also appear in fund management and bank reviews.

More recently the UK and European market has seen the entry of actuarial and investment consultancies, which solely serve institutional pension funds and, usually, just their own investment clients.

Towers Perrin was the first actuarial consultancy to carve out a specialist global custody advisory unit ahead of its peers. Having carried out much work in Australia and Hong Kong, Towers was well positioned to cope with the move towards global custodians by UK and US clients.

Other leading investment consultants have really only developed custody expertise in the past 18 to 24 months.

Bacon & Woodrow has three key people handling custody, but this is not their full-time job. Given that B&W's clients are more small and medium-sized funds, the firm still does see the need to have a team dedicated to custody.

But as John Santer, senior investment consultant at B&W, adds: 'We are increasingly getting requests for custody arrangements and even when pension funds are not appointing a global custodian, trustees still seek advice on being a signatory on a fund management contract.'

There are so many aspects to custody that consultants can help clients, not least with fees. Custodians don't have a fixed fee scale, they build in a basic fee and transaction fees. Because these largely depend on transaction volumes, fees can get very murky - there is scope for custodians to juggle the two elements.'

Other leading investment consultants, Watson Wyatt and William M Mercer - which both have custody databases - plus Frank Russell do have individuals specialising solely in custody.

Watson, for example, has four specialists working within the UK investment team, two in the US, one in Singapore, one in Australia and two in Hong Kong. The firm mostly advises its own clients, although custody review work for non-clients has been carried out on request, while Mercer's team, headed by Martin Buck, has been actively touting for stand-alone business, say custodians.

Brian Hill, head of custody consulting at Watsons, says: 'The number of candidates may be reducing, but custody remains highly technical and there is a lot of processing capacity that raises a lot of questions over whether the custodian can do the job properly. Large companies with corporate treasurers could do the research themselves but it would take them considerable time and effort to build up sufficient expertise.'

Although actuarial firms have a ready-made custody consulting client base, they are still seen as having a long way to go in terms of depth of research and negotiating clout.

Despite concentrating more on capital markets, CSDs and

wholesale providers, Thomas Murray - with its highly structured and transparent methodologies that remove subjectivity from analysis - has been handling more pension fund reviews in the past 18 months than ever before.

One leading pension fund says: 'Investment and actuarial consultants are in some cases stretched enough doing fund manager research, so it is questionable how up to date their research on custody is. Custody is still viewed by many of them as an optional extra. Their fire power is not great, which is why we went to someone that only does custody.'

Meanwhile others question whether specialists, who are also working for the custodians, can be seen as truly impartial on mandate reviews.

Chatham Partners, which since 1994 has carried out 48 custody review projects for institutional clients worldwide with about £250bn of assets, has advised seven of the largest custodian banks.

But Kohlberg says there is no conflict of interest.

'We have always fully disclosed all of our relationships before we take on a new pension scheme client and we have to treat all custodian banks the same. We can't play any favours or we would be out of business in a second and we are very careful about that.'

He also believes clients view the firm's connections with banks as an advantage: 'Because of the deal flow we provide from the UK, US and Switzerland, we have a good amount of leverage to get the right deal for a client and provide after-care support to get any problems sorted out quickly.'

He adds: 'Basically we are very boring people - probably the most boring people you will ever meet - but we do know this business extremely well. This is all we do and we have been doing this for a very long time. We very much understand what is going on behind the scenes at these banks.'

Of course, not all institutions will pay consultants' high fees, but custodians estimate that 95% of their business comes through consultants in the UK.

Some prefer just to buy a consultant's questionnaire and carry out the review themselves. Others opt to do the whole move to a global custodian internally - as Tate & Lyle did two years ago.

Hester of Northern Trust adds: 'Pension funds who have never had a global custodian before often have a relatively low knowledge level of what a custodian can actually do. There

needs to be education and the trustees need to have all the information on the options available to ensure they choose the right provider.'