
Custodians on rating matters

By Dickon Reid
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Global custodians are one of the few financial sectors without ratings but if RCP or a partnership between Thomas Murray and Standard & Poor's have their way, this gap will be filled in a year's time. Thomas Murray and Standard & Poor's have announced joint plans to launch a set of ratings aimed at assessing the operational efficiency of global custodians. Global custody lacks transparency, says Roger Fishwick, director of Thomas Murray, and clients are increasingly concerned about risk management and they want to know what custodians offer, and how efficiently. Many of the smaller funds cannot afford structured searches for global custodians and the ratings should act as an alternative benchmark. "They should reduce the need for research by consultants," he says. According to Fishwick the lack of transparency helps shelter inefficient custodians so the ratings will allow well-run, efficient custodians to stand out.

Thomas Murray and S&P have contacted half the global custodians and issued an initial questionnaire similar to a request for proposals. One aspect of the ratings are custodians' credentials – an essential component that will cover the size of the group and the diversity and variety of the client base. S&P will also scrutinise the financial strength of custodians and their willingness to indemnify.

Service Quality Evaluations (SQEs) will evaluate the quality and breadth of custodians' services including investment accounting and reporting; trusteeship; index and management and performance measurement, among others. The ratings exclude value-added services but SQEs for these are available on request and at a price. After Thomas Murray and S&P produce a rating, they will present it to the relevant custodian to decide whether the rating is apt. After consultation, it will either be issued publicly, available privately or – if the two parties fail to agree – shelved.

Thomas Murray and S&P will also launch Domestic Custody Ratings (DCRs) aimed at banks offering local custody services. "This should help the analysis of banks by global custodians in their periodic review of agent bank arrangements," says Fishwick. The DCRs are based on the same ideas and aimed at the 200 or so eligible agent banks. Fishwick admits the ratings are in their infancy and the first is unlikely to be out before 2001.

RCP & Partners says it intends to provide a similar rating but its approach is different. RCP has asked Robert Kay, managing director of Global Securities Consulting Services, to head a working party, due to meet this summer, to decide the structure and methodology of a potential rating and a valid means of comparing institutions. Kay says the structure of the rating will follow that used by RCP in assessing asset managers. Since a lot of customers demand a service for many years, they need reassurance a custodian can deliver consistently.

Ratings will concentrate on issues like management controls, technology, resource commitment, consistency in delivery, understanding of fiduciary responsibility and compliance procedures opposed to day-to-day performance. Kay's working group, comprising seven large custodian banks, will produce what he calls shadow ratings of one of the group members and then discuss it to test its methodology and validity. This should be completed by the first quarter of next year.

Even if the methodology is a success, it doesn't necessarily guarantee the rating will launch. "We are being cautious about it both in terms of whether it can work and, if it works, whether there's any demand for it," he says. "Only when we have satisfied ourselves that the measuring criteria make sense and deliver a result that is fair and reasonable, would we consider launching a service"

Kay says there have been mixed reactions to the ratings: "While there are some people who think this is the right way to go, there are a number of people who believe there is no value to this process." Some institutions see it as a logical progression and something clients will inevitably consider a factor in choosing their custodian. Others have said the ratings are unnecessary. "There's a number of custodian institutions I have spoken to that have basically said 'why would we bother with that sort of thing, everybody knows who we are already?'," says Kay.

A hint that pension funds, particularly those in the US, would use the ratings and refuse to employ a custodian below a specific level, would give the ratings a lift. Infact there had been no such endorsement to date. Whatever happens, RCP, unlike Thomas Murray, will not provide the service for sub-custodians as it is convinced people using sub-custodians already know enough about them.