

Resource sharing provides benefits

Richard Greensted - 7 Aug 2000

■ Banks are bowing to the inevitable and pooling services to cut the cost of delivery and sales

■ Everywhere you look, groups of banks are setting up electronic exchanges. As more and more financial products become commodities, banks are bowing to the inevitable and are pooling resources to cut the cost of delivery and, more crucially, the cost of sales. Having a highly paid team of FX or bond sales people isn't particularly smart if a business to business (B2B) exchange can do the job more effectively and at a fraction of the price.

At the end of last month, five European banks announced plans to expand their investment banking alliance, which used to be known as Inter-Alpha, with the launch of an electronic exchange pooling their capital markets, products and services. Banco Santander Central Hispano, Commerzbank, The Royal Bank of Scotland, Sanpaolo IMI and Société Générale, which are all linked by cross-equity holdings, have developed an e-marketplace to offer a range of treasury and capital markets services. These include foreign exchange, derivatives, fixed income and money market products. The service will enable clients to view the products and prices from each of the five banks and conduct transactions in a single market place.

Can this concept of resource sharing be extended to custody? Generally speaking, custodians cannot bear to countenance the prospect of co-operation, even when it makes solid commercial sense to do so, but there have been isolated incidences of logical thinking. In 1996 there was a well-intentioned but ill-fated plan to create a central custody processing platform for Europe, cooked up by Midland, Deutsche Bank, Paribas, ABN Amro and Credit Suisse.

More recently, the big Americans came together under the aegis of the Association of Global Custodians to lobby successfully to get changes to the SEC's poorly drafted rule 17f-7. It is the issue of 17f-7 that suggests that global custodians need to start re-evaluating some of their core beliefs.



Thomas Murray, headed by Derek Duggan, launched a depository risk assessment service with Standard & Poor's

17f-7 puts an onus on custodians to assess the risks of using a central securities depository (CSD) and to advise their clients of that assessment and their continuing analysis. Many of the top global custodians offer their services in 90 or more markets, so the regulatory burden is not a light one, even though they all do this to a greater or lesser extent already.

One enterprising consultant, Thomas Murray, headed by Derek Duggan, decided to try and capitalise on this by launching a depository risk assessment service in collaboration with Standard & Poor's, but few custodians have expressed much enthusiasm for the concept because they believe that they have to conduct the analysis in-house and do not want to pay for it twice. Similarly, whenever the thorny issue of network management is raised, global custodians become defensive, claiming that their network is a significant and unique selling point.

This is plainly hogwash. Network managers love to claim that they have a tough job and that they can make all the difference between a good and a bad service, but the reality is in sharp contrast. In many markets, there is simply no choice of agent, which significantly reduces the scope for service differentiation: in other markets there may be a choice, but it is between uniformly poor suppliers (the UK being a prime example). Then there are markets where one supplier stands head and shoulders above all others (BNP Paribas, for instance, in many European countries), making the choice so straightforward that even a network manager can handle it.

What does make the difference is the operational relationship between a global custodian and its agents, and that, of course, is largely based on the service level agreement. Getting that agreement right, and making sure that both sides stick to it, will ultimately deliver a better service for clients. But there is little value to be added through the sub-custodian search and evaluation process, so why don't the custodians form an alliance specifically for this purpose? If they lobbied the regulators as effectively as they did to get 17f-7 amended, they might well discover that the concept of a central utility for agent bank, market and depository evaluation is given a sympathetic hearing. In fact, that utility already exists, if not yet in the right shape. ISSA, the International Securities Services Association, is famous for its market reports and has the gravitas and reputation to take on the role.

Will it happen? It seems unlikely. Despite the repeated claims of the custodians that they want to move up the value chain, they are unwilling, just yet, to give up the nuts and bolts of the business, clutching desperately to core processing like a comfort blanket. Agent bank selection makes them feel secure, even though it is a huge duplication of time, effort and money. Until custodians begin to confront simple issues like this, the higher ground they seek will continue to be beyond them.

Richard Greensted is a consultant to the custody industry and editor of www.scrip-issue.com

