

# Selecting a Global Custodian: Present and Future

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During the 1990's the process of selecting or re-selecting custodians to support large institutions has become considerably more professional in the UK, although it still remains something of a 'Cinderella' industry compared with the selection of fund managers by institutions. The structured approach now being applied to the selection of custodians, outlined below, has become the norm, and has generally replaced the old approaches of either leave it to your fund managers, or talk to one or two custodians you know.

However, the custody world continues to evolve and, within this, Thomas Murray is looking to internet technology to support the selection process, and is working with Standard and Poor's to formally rate the service capabilities of custodians to enhance the transparency and comparability of their offerings by institutions.

The reasons for the improvements in the selection process in the 1990's are:

Administrative complexity arising out of growth in size of assets, new instruments and changing asset allocation

The growing size and international spread of institutional investment has made the task of those responsible for the security and administration of financial assets immensely more complicated, and at the same time, considerably more important.

Multi-national groups and the increasing trend towards specialist managers and multi-manager funds have increasing internal and commercial pressures to standardise accounting, reporting, and performance measurement data across group entities.

Increased concerns about asset safety and risk amongst institutional investors

Banking/securities house crises and emerging market problems have highlighted the need to understand the custody risks - i.e., the risks of holding cash and securities in foreign markets.

Consolidation of the global custody industry, due to increased investment requirements to meet ever-tightening service standards at a time when fees have been falling, leaving players requiring increasing economies of scale to remain profitable.

Impact of Central Securities Depositories ('CSDs') and shortening settlement cycles on the domestic sub-custody infrastructure,

Source: Thomas Murray

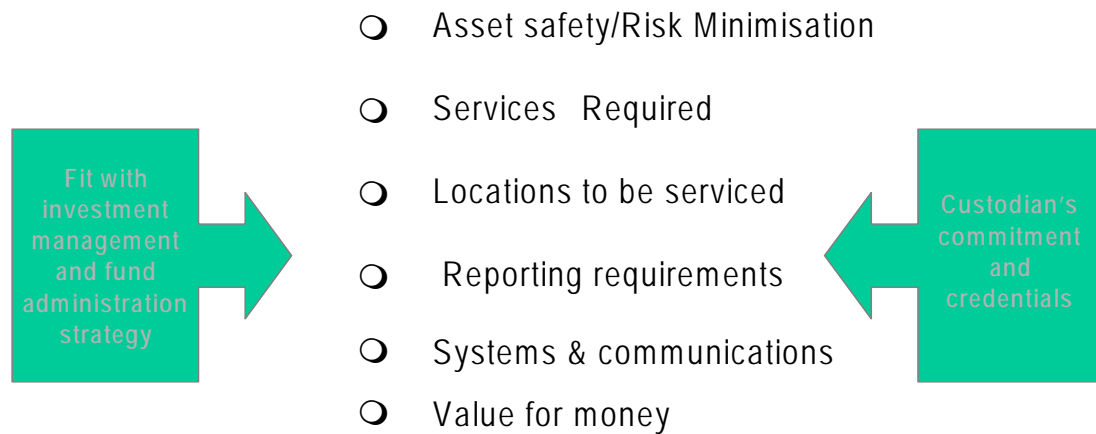
## The formal selection (or reselection) process

The main stages are:

- Determine the clients requirements
- Draw up a long list of potential providers
- Design/Tailor the RFP (Request for Proposal)
- Send out to long list and obtain the custodians responses
- Analyse responses and agree shortlist
- Due diligence and appointment

Looking at these in turn:

## Determining the clients requirements



Source: Thomas Murray

These requirements can be determined at a high level initially and used to draw up a long list of potential providers, then can be refined and changed in priority as the selection process proceeds. Typically, for example, value for money is not important as an initial qualifier, but it comes more to the fore in the final stages of the process. It is invaluable to have some key qualifier, for putting custodians onto the long list, agreed within the Institution, so that the process can be seen to be fair at the outset, and those left off the list understand why. Typically, Thomas Murray looks for up to 10 custodians on the long list, to get a good, competitive offering for the client.

### **Design/tailor the RFP**

Institutions who decide to do the process themselves are faced with the somewhat daunting task of devising an RFP from scratch at this stage. This is an area where experienced consultants in the securities industry, such as Thomas Murray, can add real value. Through a highly structured and well thought out RFP, which looks at all the relevant factors and asks structured questions, a client's needs can be reflected in the analysis and comparison of the responses from the custodians. The structured questions are typically closed questions wherever possible, designed to elicit just the information that is required.

Once the questions are agreed, the RFP can be sent out to the long list of custodians. To facilitate the analysis, this is best done in electronic format.

### **Analysing responses and agreeing the short list**

Preparing a comparative analysis of RFP responses can be an extremely complicated and time-consuming exercise, even when the majority of questions are closed. An RFP covering the full range of basic, added value and related services may have as many as 400 or more detailed questions. Custodians' responses can run into several volumes, especially if the custodian includes examples of their reports and differing service level commitments for all the markets in their network. Again, consultants experienced in the industry can be of considerable assistance here, analysing, scoring, comparing and critiquing the offerings of the various group included on the long list.

Institutions should consider dividing the RFP analysis stage into two parts, starting with a first cut analysis of key criteria questions, before progressing on to a full-scale analysis of the RFP responses. The key criteria questions are identified from the requirements drawn up at the outset, and should be identified as such in the RFP document when it is sent out.

## Short-listing candidates



Source: Thomas Murray

Proceeding in this way enables an early view to be taken of the most likely candidates for the short list, while not ignoring the complete RFP response. Out of this process, a ranking of two or three leading candidates will emerge which are best able to meet the key requirements.

### The crucial final steps: due diligence, and appointing the right custodian

The final choice of preferred custodian will be based on the detailed assessment and review of the full RFP responses, followed by due diligence meetings and discussions to clarify specific issues or uncertainties, and the final contractual and fee negotiations. The clarifications of the responses will indicate which custodians are best placed to meet all of the service requirements, while a supporting fee analysis will help to determine value for money and support the negotiation process. Normally, these discussions give rise naturally to a preferred provider, who provides the best balance of meeting the service requirements and value for money criteria. It is helpful at this stage to also take up relevant third party references on the short listed providers.

### So, how will this change in the 21'st Century?

The demands of institutions for more transparency in the market for global custody services will give rise to ratings products for custodians, such as those now offered by Thomas Murray and Standard and Poor's. These ratings will, once they are widely available, make the process of selecting a custodian much simpler for institutional investors.

We will see much more outsourcing of added-value services such as investment accounting and reporting to custodians, as their capabilities become more tailored to the UK market, and the UK institutions realise the benefits of outsourcing, where their requirements are relatively standard. We may also see the reverse trend in some developed markets, with institutions seeking to go direct to their domestic Central Securities Depository, rather than accessing the CSD indirectly through their custodian.

There will be a trend for global custodians to outsource the selection and management of their sub-custodial network management functions, as this becomes increasingly commoditised, rather than a source of competitive advantage.

The impact of internet technology will be felt as consultants, such as Thomas Murray, and other participants in the securities markets seek to improve and streamline all of the processes involved in the selection of custodians. The requirement for the garnering and analysis of large amounts of data inherent in the selection process makes this a natural area for the application of internet technologies, as we have already seen with fund manager selection.