

Custody outsourcing grows

Richard Greensted - 17 May 1999

Far fewer UK fund managers are running their own custody operations

Who remembers the Forum for Independent Custodianship (FIC)?

Formed in 1992 in the aftermath of the Maxwell affair, FIC was specifically established to lobby Professor Roy Goode's Pension Law Review Committee, arguing strongly in favour of the principle of pension funds appointing custodians separately from fund managers.

Its five founding members - Arthur Andersen, Boston Safe, ESN Pension Management, GM Investment Trustees and Royal Bank of Scotland - disliked the traditional model of pension fund custody, where trustees simply delegated responsibility to the fund managers and left them to sort out the details. They wanted the law to mandate a separate contractual agreement between the custodian and the trustees, independent of any other relationship.

FIC, which attracted much criticism from other custodians and fund managers at the time, failed in this objective. It also failed to persuade the Goode Committee that all pension schemes should be required to place their assets under the control of a custodian. FIC probably under-estimated the power of the fund management lobby, through its trade association Ifma, and overestimated the amount of interest that the committee members had in custody.

But FIC's work was not in vain. Although the group eventually withered away as the individuals who ran it moved on, its legacy remains. At the beginning of the decade, there were numerous fund managers running their own custody operations in the UK; today, there are less than half a dozen of any significance. Firms like Gartmore, Prudential and Barings have all appointed preferred external custodians to whom they will direct their business unless the client insists otherwise. And Mercury, for so long the champion of in-house custody through Warburg, currently uses RBS Trust Bank and will shortly be a client of the Bank of New York after its acquisition of Trust Bank is finalised.

A few managers have resisted the trend, with Phillips & Drew and Schroders two of the biggest. There has been much speculation about P&D's continued commitment to running an asset administration operation, and some believe that a consultant's Request for Proposal (RFP) issued to custodians last year was for their business.

Schroders, however, has been through a very public evaluation of external custodians. Rather reluctantly, Schroders decided to review its internal custody arrangements to see if external providers could deliver a better range of services and, critically, improve risk protection for clients. Using [Thomas Murray](#) as a consultant to develop the RFP, Schroders established a project team under John Lambert. The precise details of his departure remain something of a mystery, but Lambert did not survive the process. By the time Schroders had narrowed down the contenders to just two - [Chase](#) and [State Street](#) - Lambert had retired to his estate in Suffolk.

But neither Chase nor State Street ended up with the mandate. Schroders backed away from the deal at the last minute. One member of the evaluation team suggested that the firm was worried about Y2K issues and had decided to keep the problems in-house, but that is unlikely to have been the real reason. According to those in the know, Schroders had asked for unreasonable indemnities, especially in respect of the sub-custodian network, and neither Chase nor State Street would agree to its demands.

Schroders retreated and the review was quietly shelved. Just a few days ago it announced that it had appointed Bank of New York as custodian for its US assets, thus signalling its intention to continue running its own custody network.

But Schroders is part of a dying breed. Research by investment consultant [William M Mercer](#) shows an increasing trend towards pension funds appointing a third-party custodian rather than using an associate of the plan's fund manager. In its 1999 European Pension Fund Managers Guide, [Mercer](#) says these changes are being driven by the desire for greater transparency and to separate custody from investment management. Mercer also says this trend is putting pressure on managers' fees.

Was FIC ahead of its time? In many ways it was, but there was one trend it failed to predict. At the beginning of the decade it was worried about fund managers building large custody businesses. At the end of the decade, the new concern is about custodians - such as [Deutsche/BT](#), State Street, [Mellon](#), [Northern Trust](#) and [Citibank](#) - building large fund management businesses.

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