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The last twenty years have seen an overhaul of the global custody industry. According to Joanne Parker, director at custody consultancy and information services group Thomas Murray in London, even the terminology has evolved since the mid 1980s and the range of services provided by a custodian nowadays can be better grasped using the word investor services rather than the old-fashioned global custody.

In fact Ms Parker believes one of the new frontiers of custody services is represented by the outsourcing of non-core back office functions,

She adds that a wide range of factors have contributed to an increasing demand for securities services stemming from the growing sophistication of investors' asset allocations. Examples of these trends have been the rise in cross-border assets, in the proportion of securities held in equities and in the number of specialist mandates. Peter Jacaruso, head of European custody services at Deutsche Global Securities Services argues that one of the main reason behind the company's strength in Europe has been its ability to understand the growth potential of capturing cross-border assets.

The rapid growth in cross-border investment has highlighted the challenges and issues faced by institutional funds or their agents who are responsible for the safety and administration of invested assets around the world. These include; administrative complexity arising out of growth in assets, new instruments and changing asset allocation; need for common reporting and performance standards; concerns about asset safety and risk; and industry consolidation and the impact of Central Securities Depositories ('CSDs') and changing market infrastructures. These challenges have lead to the need for innovative and tailored solutions provided by custodians. A plain vanilla platform offering basic services such as safekeeping, income collection and corporate actions has gradually become no longer sufficient.

A more complex and integrated world meant that custodians have had to either establish global networks or to develop sophisticated due diligence processes enabling them to minimise risk in their relationship with sub-custodians. They have also become focused on a specific client segment enabling to build up customised services based on strategic partnerships between buyers and suppliers. Citibank aims at attracting a small number of large clients according to Francis Jackson, global head of investor service group. On the other end of the spectrum, the Dutch custodian KAS Bank has just entered the UK market targeting small institutional accounts.



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And of course not everybody has been able to survive in this increasingly competitive environment. In five years high profile institutions of the calibre of Barclays, Morgan Stanley and Lloyds Bank have all pulled out of the market. And, according to Ms Parker, this is a risk that should be carefully considered when it comes to drafting a contract with their custodian. She outlines: "Transfer, re-registration and legal cost mean a significant bill if the custodian pulls out of the market. Best practice is now where groups offer to establish exit indemnities implying a cash penalty or a reduction in fees on exit."

Meanwhile competitive pressure was stepped up by a trend towards a decrease in custody fees fuelled by, among others, automation, economies of scale and lower market costs. Custodians have had to invest massively in technology or acquire their competitors to avoid being driven out of business. Andrew Tucker, partner at Brown Brothers Harriman, a custodian which specialises in servicing collective investment vehicles, prefers the former to the latter: "It is difficult and expensive to inherit multiple platforms arising from the integration of several businesses, we prefer to invest 15-18% of our revenues in technology."

But Thomas Murray believes the downward trend in custody fees may be about to end. Reduced competition, provision of unbundled added value services and the new capital requirements recommended by the Bank for International Settlements (BIS) will all contribute to this trend according to Ms Parker. In fact within the new international regulatory framework worked out by the Basel Committee on Banking Supervision custodians will be required to set aside capital against operational risks which may strengthen the international financial system but it is likely to make custody services more expensive.

But paying too close attention to fees explicitly charged by a global custodian could potentially end up being very misleading from a client's perspective

At the end of the day higher fees may be justified if the custodians spare its clients other less evident costs. There are several examples of implicit or potential costs to be considered when drafting a contract with a custodian. Termination clauses and the length of the period for which fees are fixed are straightforward examples. However there are many more subtle issues only an experienced practitioner may be able to pick up. Is the custodian taking responsibility for cash held by sub-custodians? Are there liens over client's assets? Is the custodian responsible for passing instructions as received when it comes to executing corporate actions or is he assuming responsibility for all publicly available information? Ultimately value for money should consider the quality of service and representations, as well as fees.