

ACCESS ALL AREAS

The *Funds Europe* custody survey finds a greater presence of custodial banks in Europe and emerging markets, and highlights the challenges surrounding the implementation of new regulation, writes *Fiona Rintoul*

A GLANCE AT the European office network table for Europe's custodian banks offers a fairly shrewd picture of which markets have historically been most important to custody providers. Virtually every bank is present in Germany, Italy, the Netherlands and the UK.

What is perhaps more surprising is the number of banks that now have a presence in Poland. This reflects both the increasing importance of the Central and Eastern European markets, which are cited by many respondents to the *Funds Europe* European Custody Survey 2007 as a key growth area, and a renewed focus on cost considerations. For many groups, setting up in a market such as Poland offers an opportunity to access well qualified back office staff at a lower cost than in the traditional Western European centres.

Cost is becoming a key consideration for custodian banks, with greater transparency putting pressure on fees. A common solution is to cut core custody fees then attempt to garner additional revenue from value added services, though not everyone favours this option.

"We are not advocates of the subsidy approach," says Jeff Holland, partner at Brown Brothers Harriman Investor Services. "We are more transparent about how we price the business. The more open you are, the more successful you are."

Whatever approach custodian banks take to fees, there can be little doubt that the services they are being asked to provide by clients are becoming more complex.

Market expansion

The expansion of third-party distribution means coverage of more markets is required, reflected in an expanding presence on the ground by many banks, with European offices being opened in markets as diverse as Denmark and Bulgaria. A typical sub-custody network now includes banks in markets such as the Ukraine and Serbia. There is also expansion outside Europe to consider – China and India are cited as key markets – and sectoral developments, such as increased use of fund platforms.

At the same time, the products that clients run are becoming more diverse and more sophisticated. Many respondents report increased demand for custody support for hedge funds and fund of hedge funds, real estate funds, and pooling solutions.

Many of these developments are driven or supported by regulation. Uciits III has been key to expansion of derivatives use, for example, and supporting derivatives and the related convergence of long-only and alternative strategies are cited as key challenges for the future by many respondents.

There is some frustration surrounding some of the new regulation, particularly Mifid. "The most significant challenge currently facing Europe's fund managers is the issue of changing market regulations and inconsistencies across markets," says one custodian bank CEO. "This process, which is wholly inefficient for the funds, fund sponsors, and investors, has slowed the growth of funds, discouraged the introduction of new products,

'THE TRANSPARENCY UNDER MIFID WILL LEAD TO BETTER PRICING DISCLOSURE'

and deterred companies from entering new markets."

European regulation moves at a majestic pace and there is no quick fix for these kind of problems. It falls to custodian banks both to institute new products to deal with the new paradigm and to keep abreast of developments through dialogue.

Investment in infrastructure

"With regard to regulation, in order to help their funds' clients, securities services providers need to deliver highly specialised tools, such as sophisticated compliance systems, and at the same time engage in on-going discussions with regulators," says Francis Jackson, senior vice president of JPMorgan Worldwide Securities Services.

This means greater investment in infrastructure, particularly IT infrastructure, and handling this in an environment of declining fees is cited as a key challenge by many survey respondents. A way of remaining competitive is to standardise as many core services as possible, while developing in key

new or expanding areas, such as performance attribution, customised securities lending and OTC derivatives pricing.

Development in new areas is often made more complex by a lack of standardisation. This is particularly the case in the funds of hedge funds and derivatives space. Nonetheless, several respondents report that they are introducing automation of the fund of hedge fund transactional process and reporting cycle.

Benefits of regulatory change

In the alternative investment space generally, the biggest challenge, according to one respondent, is that the custodian must rely upon the investment manager to value the alternative investment securities accurately and in a timely fashion. Another challenge is obtaining historical information for new clients.

Custodian banks work in a market that is becoming increasingly complex and demanding and there is some sense of fatigue with the constant round of regulatory change, in particular. At the same time, regulation and increased transparency ultimately may bring benefits for custodians.

"The transparency under Mifid will lead to better pricing disclosure," says BBH's Holland. "I would expect people to pay more for derivatives than for equities because they are more expensive to service. Mifid will allow asset managers to understand more about what they are paying for. But it will also help custodians as it will show how much we are paying to support derivatives." **fe**

CUSTODY SURVEY 2007

The matrices below summarise information on local offices in Europe and services offered by the custody companies that participated in the *Funds Europe Custody Survey 2007*

CUSTODIAN BANKS IN EUROPE – SERVICES OFFERED IN EUROPE

Custodian bank	Securities lending	Equity finance	Cash management	Collateral management	Prime brokerage	Tax reclamation	Commission recapture
BNY Mellon	Yes		Yes	Yes	Yes	Yes	Yes
Brown Brothers Harriman	Yes		Yes			Yes	Yes
CACEIS	Yes	Yes	Yes	Yes		Yes	Yes
Citi	Yes	Yes	Yes	Yes	Yes	Yes	
HSBC SS	Yes	Yes	Yes	Yes		Yes	
JPMorgan WSS	Yes		Yes	Yes	Yes	Yes	Yes
KAS Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Northern Trust	Yes		Yes	Yes		Yes	Yes
SGSS	Yes		Yes	Yes	Yes	Yes	Yes
State Street	Yes	Yes	Yes	Yes		Yes	Yes

CUSTODIAN BANKS IN EUROPE – EUROPEAN OFFICE NETWORK

Custodian bank	Austria	Belgium	Bulgaria	Denmark	Finland	France	Germany	Greece	Guernsey
BNY Mellon		Yes				Yes	Yes		
Brown Brothers Harriman									
CACEIS		Yes				Yes	Yes		
Citi	Yes	Yes				Yes	Yes	Yes	
HSBC SS						Yes	Yes	Yes	Yes
JPMorgan WSS						Yes	Yes		
KAS Bank							Yes		
Northern Trust									Yes
SGSS						Yes	Yes	Yes	
State Street	Yes	Yes				Yes	Yes		

OTHER SERVICES AND GEOGRAPHIES:

Brown Bros Harriman CACEIS	Infomedary® data infrastructure solutions. Trustee services, regulatory reporting, tax reporting, tax reclaim, fund structuring, fund accounting, automated pooling, financial reporting, fund unit pricing, daily, intra-daily and real-time valuations, hedge fund and FOHF valuations, multiple share class, multiple pricing, shareholder record keeping, shareholder reporting, company secretary service, virtual pooling, cloning, dealing room functions, funds dealing.
Citi HSBC SS	Also present in Cyprus, Czech Republic, Hungary, Romania, Slovak Republic. Alternative Fund Administration, broker custody *, outsourcing, derivatives and futures clearing *, treasury management (including outsourcing), equity and bond execution *, liquidity funds *, transaction cost measurement (* = service offered in conjunction with HSBC's Corporate, Investment Banking and Markets or HSBC Investments divisions). Foreign exchange
JPMorgan WSS KAS Bank	Enterprise risk management for pension funds; cash flow mapping; compliance monitoring; performance measurement; universes; attribution and risk analysis; external and regulatory reporting; currency overlay; duration overlay; asset rebalancing; investment pooling; defined contribution schemes; order execution.
Northern Trust	Foreign exchange, corporate actions, income, risk and performance services, on-line reporting and accounting, market information, unitisation services, regulatory reporting, multinational services, trade execution analysis, derivatives clearing, reporting and processing, investment manager outsourcing and pooling solutions.
SGSS	Complex OTC products pricing and middle-office, risk attribution, pan-European paying and representative agency.

Performance attribution	Proxy voting	Compliance monitoring	Fund admin services	Transfer agency	Distribution support	Transition management
Yes	Yes	Yes	Yes	Yes	Yes	Yes
Yes	Yes	Yes	Yes	Yes	Yes	Yes
Yes	Yes	Yes	Yes	Yes	Yes	Yes
Yes	Yes	Yes	Yes	Yes		Yes
Yes	Yes	Yes	Yes	Yes	Yes	Yes
Yes	Yes	Yes	Yes	Yes		Yes
Yes	Yes	Yes	Yes	Yes		Yes
Yes	Yes	Yes	Yes	Yes		Yes
Yes	Yes	Yes	Yes	Yes	Yes	Yes
Yes	Yes	Yes	Yes	Yes	Yes	Yes

Ireland	Italy	Jersey	Luxembourg	Netherlands	Poland	Portugal	Spain	Sweden	Switzerland	UK
Yes	Yes		Yes	Yes			Yes			Yes
Yes			Yes						Yes	Yes
Yes			Yes	Yes					Yes	
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Yes	Yes		Yes						Yes	Yes
Yes	Yes		Yes	Yes			Yes		Yes	Yes
				Yes						Yes
Yes		Yes	Yes	Yes						Yes
Yes	Yes		Yes		Yes		Yes		Yes	Yes
Yes	Yes		Yes	Yes					Yes	Yes

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Country of origin: United States

Length of time in Europe: 38 years

European subcustody network:

Bank Austria Creditanstalt AG (Austria)
ING Bank Belgium SA/NV (Belgium)
ING Bank NV (Bulgaria)
Zagrebacka Banka dd (Croatia)
HVB Bank Czech Republic as (Czech Republic)
Nordea Bank (Denmark)
AS Hansabank (Estonia)
Euroclear Bank
Nordea Bank Finland plc (Finland)
BNP Paribas Securities Services SA (France)
Deutsche Bank AG (Germany)
Citibank International (Greece)
Citibank Zrt (Hungary)
Landsbanki Islands hf (Iceland)
BNP Paribas Securities Services SA (Italy)
HSBC Bank Kazakhstan JSC (Kazakhstan)
Hansabank A/S (Latvia)
SEB Vilnius Bankas AB (Lithuania)
ING Bank Belgium SA (Luxembourg)
HSBC Bank Malta (Malta)
Fortis Bank NV (Nederland)
Nordea Bank Norge ASA (Norway)
Bank BPH SA (Poland)
Banco Santander de Negocios (Portugal)
ING Bank NV (Romania)
ING Bank (Eurasia) ZAO (Russian Federation)
HVB Bank Serbia and Montenegro (Serbia and Montenegro)
ING Bank NV Bratislava Branch (Slovakia)
Bank Austria Creditanstalt Ljubljana (Slovenia)
BNP Paribas Securities Services SA (Spain)
Skandinaviska Enskilda Banken AB (Publ) (Sweden)
UBS AG (Switzerland)
ING Bank Ukraine (Ukraine)

Business split:

51% is funds custody, measured by revenue

Fund assets under custody in Europe:

2007: €291,427m

31.12.2006: €291,427m

31.12.2005: €296,200m

31.12.2004: prior data not available

31.12.2003: prior data not available

31.12.2002: prior data not available

Third-party fund custody by asset class:

Bond: 14.2%

Equity: 27%

Balanced: Not disclosed

Money market: Not disclosed

Property: Not disclosed

Hedge funds: Not disclosed

Short Duration: 11%

Other: 47.9% (real estate & farm, global custody assets, mortgages, notes, contracts, sundry assets & liabilities)

Products and services that have seen the greatest increase in demand over the past twelve months:

Fund administration in Europe – traditional and alternative

Fund of hedge funds

Property funds

Management company services

Pooling solutions

Investment management outsourcing

Full hedge fund back office outsourcing

Securities lending

Transition management

Daily attribution and performance

Increased convergence of long and alternative investments

Independent OTC derivative valuations

OTC collateral management

Value at Risk reporting for alternative assets

Products and services to be developed over the next twelve months:

Continual investment in derivative capability that can service the three core businesses: fund administration, investment operations, outsourcing and global custody
Reporting and performance reporting of derivatives

The provision of outsourced daily performance reporting for investment managers

Automation of the fund of hedge fund transactional process and reporting cycle

Deployment of a data warehouse for investment manager outsourcing clients

Development and broadening of country-specific customised securities lending programmes

Automation of mutual fund share dealing

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Senior executives: Bruno Prigent, Etienne Deniau, Sebastian Danloy, Serge Jacqueline, Gert Rautenberg

Country of origin: France

Length of time in Europe: 142 years

European subcustody network:

Most of its European network of subcustody network is managed internally

Business split:

Not disclosed

Fund assets under custody in Europe:

2007: €2,448,000m

31.12.2006: €2,262,000m

31.12.2005: €1,418,800

31.12.2004: €1,114,839m

31.12.2003: €1,023,015m

31.12.2002: €863,523m

Products and services that have seen the greatest increase in demand over the past twelve months:

Pan-European paying and representative agency

Products and services to be developed over the next twelve months:

OTC derivatives pricing and middle-office

Global transfer agency

Class actions

Issues and challenges that have been met in the past twelve months:

Roll-out of pan-European global custody platform

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Country of origin: United States

Length of time in Europe: 25 years

European subcustody network:

Not disclosed

Business split: 85% is funds custody

Fund assets under custody in Europe:

2007: not disclosed

31.12.2006: €1,379,000m

31.12.2005: €1,221,000m

31.12.2004: €1,038,000m

31.12.2003: not disclosed

31.12.2002: not disclosed

Challenges over the next twelve months:

Financial services companies around the world are faced with rising regulatory scrutiny and the related cost of compliance. Companies have to re-evaluate their business processes, policies and conduct.