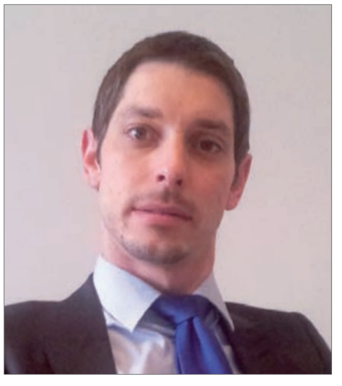
CREDIT SUISSE

The future of custody

Jean-Daniel Zandona, sales director at ***Credit Suisse Fund Services****, reflects on the challenges and opportunities custodians face in the current technological and regulatory environment*

Looking back at the early days of my career, I recall landing in the custody business in the middle of a global economic crisis, wondering, frankly, what I was doing there, but I felt happy indeed to have a job. I found the custody industry to be rather complex but I liked the fact the asset managers were always ahead of the custodian banks in terms of innovation, which forced the custodian banks to constantly develop and update their processes. The industry was mature, even 'commoditised', with large volumes, low margins, the safekeeping of liquid assets was even being provided free of charge in exchange for decent volumes of cash, foreign exchange or lending activities, at a time when 'best execution' was a vague concept and the Markets in Financial Instruments Directive (Mifid) had not even been formulated. In any event, the custodian was rarely the one with the deep pockets if something went wrong.


Jean-Daniel Zandona

Years later, several factors have destroyed this old way of conducting the custody business. Firstly, the assets held in custody worldwide have grown steadily, with the top 50 global custodians now holding approximately $130 trillion in safekeeping. In this business, size matters. Smaller or niche players in specific markets or asset classes have either been acquired or have disappeared entirely, reducing the number of custodians in the market. This trend towards concentration has been reinforced by a second factor: the recent 'regulatory avalanche' everybody is talking about. Not only has this made the day – or the year? – for many lawyers and consultants, but it has also significantly increased the blind for custodians to remain at the table. Without sufficient size or a strategic commitment to the custody business, no financial institution is willing to pay to see the 'flop'. This has resulted in recent transactions in which custody businesses such as Nordea, ING and Commerzbank have changed hands.

Investments to upgrade and maintain increasingly complex IT architectures, adapting the business model to cope with more internationalised businesses and more cross-border cash/asset flows, and training staff in more complex assets and more stringent regulation are all factors that are dramatically changing the landscape for custodians.

Taking the Alternative Investment Fund Managers Directive (AIFMD) as just one very topical example, the 'reverse burden of proof', among many other factors that are increasing liabilities for custodians, is in some ways transforming banking into insurance. Coupled with decreasing revenues from cash, foreign exchange and lending activities – strongly correlated to markets – this 'scissor effect' makes me wonder why I am still here.

Fortunately, the situation is not as desperate as it may seem. The winners of tomorrow have already adapted to this new environment and anticipated new growth drivers to create new products and services, addressing the changing demands that are arising from the factors affecting the custody business. Once considered a necessary evil, custodians need to realise they can create tangible value up the value chain. More than just back-office safekeeping and settlement services, clients are now looking for integrated solutions. In this respect, new regulations such as AIFMD and Ucits present an outstanding opportunity. A sizeable number of alternative asset managers do not plan to become the official alternative investment fund (AIF) manager for their AIFs themselves, but will instead focus on sourcing and executing deals. Offering fully fledged AIFMs or even AIF platforms for rent is clearly one of these new growth clusters for custodians. Sitting on the core data, some custodians have already begun to implement new risk management solutions on a stand-alone basis, or to use their in-house AIFMs to deliver the risk function under AIFMD or Ucits. These new value-added services not only generate superior revenues, but they also reduce the profit and loss exposure to stock markets and volatility.

In the future, beyond this vertical integration of new value-added products and services, custodians will finally be more and more horizontally integrated within their respective banking groups. More connectivity and internal co-operation will be key to fostering cross-selling and maximising the wallet share of multi-business clients, and building bridges among private banking, investment banking and investor services.

Jean-Daniel Zandona is sales director for Credit Suisse Fund Services, in charge of sales and structuring. He promotes and advises on structuring and asset servicing solutions for fund managers, together with white-label platforms and Ucits/AIFMD-compliant management company services. Before joining Credit Suisse, Jean-Daniel held various senior positions in several locations for a top-10 global custodian in the field of product development and sales, having begun his career with a big-four consultant. He is an active member of several industry bodies, a board member for regulated and unregulated investment vehicles and a regular lecturer and speaker at funds-related conferences.