



## Mind your backs

*As the trend for fund managers to outsource middle and back offices to global custodians picks up speed, regional and domestic custody providers could lose out*

Regional custodians are currently in a precarious position. They must carefully consider the best use of funds to gain the most value for their customers and themselves.

Regional custodians might be leading US domestic players or leading specialists in one European region. They want to minimise costs, while providing excellent customer service to ensure they retain and attract new customers. However, there is a storm on the horizon.

The storm is the pent-up demand from the buy side to outsource back or middle office processing to focus on core competencies and reduce costs. The global custodians are the most likely candidates to offer outsourced services. The concern for regional custodians is that their custody services will go with the outsourced back/middle office to the global custodians.

Many regional custodians have undergone mergers or acquisitions in recent years. The resultant custody, stock lending and accounting infrastructure is un-integrated and inconsistent, so economies of scale and cost saving across combined businesses have not been realised. The "customers" do not have consistent mechanisms for delivering and receiving transactions, and typically don't have a single view of consolidated reporting and statements.

The regional custodians generalise customers into two groups. The first main group are the owners and buy side firms that are local or domestic to that region, which not only undertake local trades and other transactions, but also global transactions. The regional custodians must send and receive all their transactions via Swift, file or even fax, but then use the global custodians to process only relevant global transactions, typically via Swift.

Clearly this adds to already complex internal post-merger architecture. In order to get the required cost savings, all transactions delivered via Swift and custom files should be automatically routed not only to the various inhouse custody and accounting systems, but also to the global custodians, without the need for manual investigation and intervention. One regional custodian we work with calls this automated routing of trades and other transactions "global turnaround".

It receives trades via Swift and ISITC files, as well as re-keying faxes, and routes the global trades to various global custodians via Swift. The opposite is true of statement and FX information.

Equally important is the need for a single consolidated data warehouse to aggregate statement and reporting data so the customer doesn't notice the numerous underlying systems processing the various transactions. This data comes from not only the various internal systems, but also the global custodians that have undertaken the processing of the global transactions. This must include taking account of the various tax implications and other regulatory issues around the world. In this way, the end customer gets a consolidated picture of its holdings and transactions, thereby avoiding the "why don't we go direct to the global custodian?" argument. To preserve these types of customers, this consolidated view of information is essential.

The second main group of customers is effectively where the roles are reversed. The global custodians send the local or domestic trades and transactions to the local or domestic custodian for processing, since they do not have the network or infrastructure to undertake the settlement and other processing. The global custodian will expect very high levels of service, particularly in the processing and reporting of the transactions. Automated routing and processing must be as slick as possible. Management of transactions must be undertaken on a truly exception basis.

To protect their businesses, regional custodians must address two fundamental requirements: automated transaction routing from multiple sources and consolidated reporting across their customer base. In so doing, they will retain customers in their newly merged environment with an apparently consolidated customer view of information, without the expense of moving all accounts to a single accounting platform.

In the future, they may consider offering back/middle office outsourcing services, such as trade matching, aggregated reconciliation and trade dated portfolio accounting, in a highly flexible and customer driven manner. But they need to do this before the global custodians gobble up that market and the regional custody with it.

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