Awaiting Clarity

Leading figures in the world of custody and investors' services discuss how they are helping clients cope with new regulations and take advantage of the opportunities this presents.

Joseph D. Giarraputo, publisher, *Global Finance*: We are at a uniquely unpredictable time. In recent years, many changes have occurred that impact custody and investor services. Many more changes are on the horizon. What is likely to have the biggest impact on the industry globally?

Robert Dame, senior vice president of client operations, global services, State Street: There is considerable change under way in the United States and certainly in Europe, and really globally. But new regulations are not in final form, so although you can begin to prepare, you can't fully get ready because you don't know what all the rules will be. I believe that these changes will be a challenge, but there is some opportunity out there as well.

Kerry White, managing director, global product management at BNY Mellon Asset Servicing: I would agree that there is an unprecedented amount of regulatory change out there globally. There are a number of areas that will be impacting asset servicing, and when you take a look at various new regulations across the globe, there are a number that seemingly have the same objective but are not always in concert. So it's very difficult to resolve until the regulators actually paint a clear picture.

Paul d'Ouville, senior vice president, global head of product management, Northern Trust: The totality of change within compressed timelines is really what is causing some stress in the markets. And it is impacting clients. It is affecting the institutions that serve those clients by causing uncertainty. People are not making decisions because they are not sure how some of those rules will be written. Working with the regulators and educating clients are ways we can add value and help our clients to navigate these turbulent times.

ROBERT DAME
Senior vice president, State Street

Robert Dame is a senior vice president in State Street's global services business. He is responsible for a client operations service group, including several strategic relationships. He also manages the division conversion group. He has experience in operations, product development and technology implementation. Dame worked in State Street's Australian and Asia/Pacific operations from 1997-2000. He was managing director of State Street Australia and chief operating officer of global investment services Asia/Pacific in 1999 and 2000. He joined State Street Mutual Fund Services in 1980. Dame earned a B.S. in business administration from Boston University, and an MBA from Boston College.

JDG: What specific regulations are affecting the asset servicing business?

KW: In the US, there are a few that come out of the Department of Labor that are not 100% clear. For example, the DoL proposed a new definition of the term "fiduciary" that—as it was originally worded—would sweep up virtually everybody in the industry into the category of fiduciary.

That certainly got an awful lot of feedback to the DoL, not only from client sponsors, custodians and asset managers but also from the legislators themselves. And then there are some fee disclosure requirements, also from the DoL, the scope of which will require many service providers to invest in systems enhancements in order to satisfy these requirements.

> **"One really interesting space is the emergence of developing countries creating opportunities for investment and institutional investors beginning to grow there"**
> ***—Robert Dame, State Street***

RD: There are reporting implications, for example there will be a requirement to report information to the financial stability oversight council relating to systemic risk. There will also need to be living wills in place. Basel III certainly will have a big impact. Client's business models may need to change a bit, and we're going to need to be able to respond to that. There is a big effort working with our clients on how they will comply with these changes. We spend a lot of effort making sure that we are prepared and that we remain ahead of clients to anticipate their needs.

PD: The regulators are doing what they think is in the best interest of the industry to protect participants and reduce or mitigate systemic risk across certain industries. But at what cost to the ultimate beneficiaries? And what are the unintended consequences of some of these particular regulations, for example, on retirement security or the cost of an efficient retirement program? The last thing we need in this economic climate is to add cost to retirement programs.

KERRY WHITE
Managing director, global product management, BNY Mellon

Kerry White, managing director of global product management in the asset servicing division of BNY Mellon, is responsible for strategic and business development for the corporate, government and not-for-profit lines of business.
White joined Mellon Financial Corporation in 1995 and has served in various capacities with expertise in relationship management, strategic planning, proprietary financial modeling, corporate investment and pension & investment reporting.
During her tenure at BNY Mellon, White served as head of multinational business and product development for ABN AMRO Mellon in Amsterdam for several years, focusing on strategic and business development.
White held a number of roles managing client service and operations at an institutional fixed income asset management boutique, Merganser Capital Management, and she began her career in 1986 at State Street Corporation.

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JDG: What is new on the tax front?

KW: Our clients tend to be very global in their investing patterns, so that means that they are beholden to a number of different taxing entities around the world. That is a big part of our support role. There are a number of new or changing requirements in a variety of jurisdictions that clients are struggling with. For example, some pension funds who we would typically tax exempt are now being subjected to capital gains taxes. This situation creates a new level of support that clients require in managing such tasks as filing applications to invest in certain jurisdictions, locating a reputable tax agent and so on. It's a very important part of managing our clients' investment requirements. And then on top of that, we have all the new global tax compliance requirements that clients are dealing with and we are analyzing as well.

RD:There are many countries right now that are looking at new tax revenue streams and it is ever changing and complex. All of the organizations here have the expertise in place to help clients manage that. There is the Foreign Account Tax Compliance Act, which requires reporting on offshore accounts.

PD: Governments are trying to identify and close loopholes or potential loopholes and gather tax revenue from that. With all the potential compliance change you're going to see a massive amount of investment in technology to be able to track and meet these tax rules. Also, given the increased focus on taxes, there is a resultant increase in interest from asset managers and investors to ensure that they are getting the greatest tax efficiency from their investments.

JDG: Let's move on to risk management.

PD: All the investors that lived through the financial crisis have sharpened their focus on risk management. And while risk management is defined in many different ways, there is a heavy focus on transparency: understanding your investments and what level and type of risk you want.

The complexity of accomplishing transparency can be daunting from an institutional investor's perspective, which is where custodians and information aggregators can help investors understand on a real-time or near-real-time basis what they're exposed to, and help them quantify those risks.

KW: Our clients and the asset managers who service them have a much lower tolerance for any sort of risky behavior anywhere through the value chain than before the crisis.

For asset servicers who deal with data all the time, this really plays into our strong suit in terms of helping our clients understand their exposures and ensuring that they have appropriate policies and procedures in place to manage them.

Particularly around data aggregation, often our clients are looking for us to be a central point in liaising with all of the third parties from which data comes.

RD: There is a regulatory expectation that management practices will improve around risk management: valuations, stress testing, liquidity and so on.

PD: The key issue here is the data. You have to have good data to make a decision, as it represents what you really own and the value of it.

There is no sense in using poor data to hedge because you'll miss-hedge and create additional risk. As a custodian and asset servicer, you are the gatherer or the source of the bulk of the information; you normalize the information with your business rules and accounting rules.

So normalization, aggregation and standardization around that data are critical.

PAUL D'OUVILLE
Senior vice president, Northern Trust

Paul d'Ouville is a senior vice president at Northern Trust-Chicago. D'Ouville leads the product management and development activities for Northern Trust's corporate and institutional business. The broad range of products and capabilities support Northern Trusts' strategic goals globally.

He leverages his experience in operations, technology, risk management and client service to ensure Northern Trusts clients optimally benefit from the solutions his team brings to market.

Prior to taking this leadership role, d'Ouville headed the investment risk and analytical services division.

Many initiatives Paul has participated in have brought new capabilities to clients or optimized the organizational efficiency of Northern Trust.

He earned a B.S. in Business Administration from Butler University in Indiana and a M.S. degree from DePaul University in Chicago, and is a CFA and a member of both the Investment Analysts Society of Chicago and the Global Association of Risk Professionals.

JDG: How has securities lending changed as a result of the crisis?

PD: The securities lending industry has contracted from 2008 to now. Demand has decreased, as hedge funds have delevered. But this trend has stabilized over the last year. Securities lending is still viable and provides support to an efficient market and price discovery. Recently, clients have been trying to ensure that they are fully versed about securities lending and looking at it again in different ways. It goes back to risk management, operational due diligence and transparency.

RD: I agree. The supply continues to be there, but certainly the demand is down. Spreads are different than in the past, and that is a big driver right now. One thing to watch is that there is a lot going on in the securities lending industry in Europe, and there may be some wide-reaching implications from that on the industry as a whole.

KW: One area that has helped us as an entity to be able to bring back some clients to securities lending is to be very focused on transparency into the program itself and into the collateral reinvestment pools in particular. We are keeping a close eye on the regulatory discussion around concentration requirements and ceilings to different counterparties, which could have a significant impact on part of our business.

JDG: What are we seeing develop in the world of outsourcing?

KW: Outsourcing is always an interesting topic, and as a product it seems to be in vogue and out of vogue every five or six years. With all the new regulations on the horizon, many fund managers are once again interested in it and how we can manage those requirements for them—either through outsourcing or co-sourcing arrangements, or what have you.

This is important particularly in Europe, with new legislation such as that around financial company passports, and so on. These are creating opportunities for fund managers, and they want to be able to grow their footprint as quickly and efficiently as possible.

So sometimes we see those types of entities look toward institutions like ourselves to help them facilitate that objective. Our job is to provide that and make it scalable to meet their needs as their footprint grows.

PD: I have had countless discussions with COOs around their desire to launch funds or trade in new asset types faster, trade in new jurisdictions or utilize derivatives to enhance investment strategy; and the next question is invariably what will the cost be to develop the necessary infrastructure, hire teams of people, and so on. Given the speed and the complexity of the industry these days, it may cost them more in lost opportunity costs than the actual build-out.

They are looking at outsourcing solutions as a way to accelerate their business growth to globalize investment processes. Over the long term it is a cost-efficiency or value play because they will get an institutional and scalable platform that we continue to reinvest in because we are supporting multiple entities.

JDG: The potential of you as a provider is greater and is a strategic decision rather than just a cost play?

PD: Discussions now center on core businesses as an asset manager and doing what they do best. To build a whole new infrastructure for the back office takes a lot of time, effort, energy and financial capital to get there.

This was highlighted with the crisis, as asset values fell so rapidly. There is a fixed cost that's embedded in all that technology and operation, and it can be challenging to manage a viable revenue stream with that level of fixed-cost base.

And then we see portfolio managers and traders that are leaving investment banks and starting their own asset management firms, or hedge funds. These are smart people with great ideas and they are looking for infrastructure and a platform to enable them to execute their business plan. This where the specialist model and focusing on what you are good at clearly works best.

RD: Outsourcing is a continuing trend as the products and investment strategies that are being introduced continue to become more sophisticated. Providers collectively have brought a lot of innovative products and services to the market that are supporting these new strategies. Customers are looking for things like collateral management and risk and performance analytics.

JDG: What are the key issues, particularly in the current environment, around investment in technology?

KW: We continue to invest heavily in technology—it is one of our top investment categories every single year. And no discussion of it would be complete without looking at technology infrastructure. Going back to risk management, clearly institutions such as ourselves could be targets for various different technology-related threats, such as cyberfraud, identity theft and so on. So we have to be very diligent about not only our front-end, client-facing technology but also the infrastructure that backs it up. We are in the midst of a multiyear, top-to-bottom systems and technology transformation program for both front-end and back-end systems. Following regulations is clearly eating up a lot of our capital, but we see this transfromation as critical to allow us to redeploy more of our capital budget toward innovation.

We are investing in things like our private cloud [cloud computing environment] for application development and testing. This is

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—Paul d'Ouville, Northern Trust

important to us because we can do this without disrupting our business, and it is important from a risk management perspective.
RD: Our clients are looking at how information is delivered to them, and we spend a lot of time and energy around information delivery platforms—how we get the information and data out to customers. It is also important to manage the divide between resources going to infrastructure and those going to innovation.
KW: One of the things we are always focused on is the client-facing delivery mechanism. For example, this summer we released our first iPad app for Workbench, and launched our knowledge network—a site for investment managers and clients to come together and engage each other in discussion.
PD: As we all know, this industry is about people, process and technology. Investment in technology is a critical aspect of being successful in the asset servicing industry but just as critical are the people that transform technology into solutions for our clients. We continue to invest in information solutions to help our clients make informed decisions. Much of our data is delivered to our clients through our Northern Trust Passport portal. The value we are adding is transforming data into information that our clients can use to make decisions faster.

JOSEPH D. GIARRAPUTO
Publisher, Global Finance

JDG: How do you manage human capital in what is essentially a tight-knit industry globally?
PD: A critical aspect of success is our people and their intellectual capital. We spend a lot of time hiring the right people and investing in them. Ensuring we hire the right people with the right skills to help our clients be successful is critical. People ultimately want to feel valued and respected at the firm where they work.
RD: Our clients connect with their client service team. They are talking to them every day, answering questions and developing solutions. There is a strong connection there.

JDG: A lot of what we discussed today ties into the changing capital model for the custodian business. Can you explain how that is changing, and the impact?
KW: Part of it simply has to do with the pace of change in the business. Clearly if we are in a business where settlement cycles are shorter, it's important to be able to adapt and modify your business quickly.
PD: The core evolution of the business is really moving from custody, depositaries and transactions to information management. It is much more about how we handle the information that our clients trust us with and being able to deliver answers that help with decision-making.
RD: I think that custodian banks and trust banks served the markets very well during the financial crisis. So certainly the function and purpose and responsibilities are very important to the market. But business models continue to evolve, and I would be surprised if the market did not look different in five years.

JDG: Where are you seeing growth, and how is that changing?
RD: We continue to see good growth in Europe, and as customers go into Europe, they quickly follow on with Asia Pacific, and so those regions are an important part of our growth strategy.
PD: One really interesting space is the emergence of developing countries creating opportunities for investment and institutional investors beginning to grow there.
Substantial wealth has been created in the Asia-Pacific region through sovereign wealth funds. These investors are now seeking to expand their investment portfolios and leverage the infrastructure that global custodians have built up—and also leverage those relationships to ensure they understand how various markets work operationally across the globe. ■