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Investor Services Journal

OTC Derivatives - Future Present

Profile - William J Brodsky of WFE

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THE CUSTODY AND ASSET SERVICING INDUSTRY MAGAZINE

New African Custody

cutting edge systems, technology without the legacy lag

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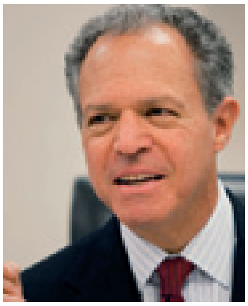

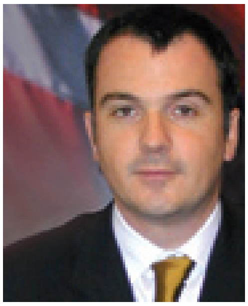

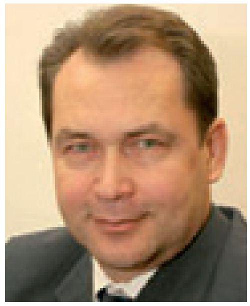

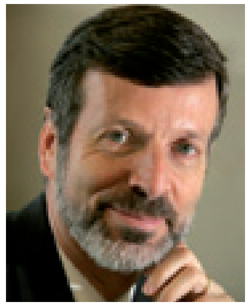

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Editor-in-Chief's letter

Globalisation of the markets is most certainly not a new theme. Indeed, I moved to the UK in 1987 just as the first tidal wave of cross-border investment was cresting and placing new demands on investors, global custodians and local agents. I heard the sound of the crashing wave in October 1987 after a scant few months helping build a new global custody product. I remember visiting clients and prospects whose idea of "real time positions" was having a manual ledger.

Just over twenty years on from what had at the time been the worst crash since 1929 - we are once again emerging from... the worst crash since 1929.

Hopefully many lessons have been learned, but one of the most interesting results is the recognition of just how interconnected the world is and how the pace of change accelerates.

Governments and central banks came to the rescue and in the end, just did what needed to be done to keep the world's banks and markets afloat. Whereas previous regulatory guidelines focused on capital, it was really liquidity that mattered during this crisis and inevitably all eyes have now switched to this central topic. At the heart of market liquidity is the world of repo. There are many changes afoot across the globe and the article from the chairman of the European Repo Council sets out some of the prescient moves of the repo industry ahead of the crisis and lays out a number of the challenges that lay ahead. Investors are well advised to watch the action in the repo markets as we move into an environment where central banks need to remove the excess liquidity they have been pumping into the markets over the recent, painful past.

If there is a silver lining that has come out of all this turmoil, it is the recognition of the interconnectedness of the markets and the need for a consistent and where possible, harmonised framework of regulations for investors across the globe. There has been an unprecedented degree of cooperation, discussion and consultation amongst regulators, the public and trade associations including the acknowledgement of the links between cash and derivatives markets. This reality was embodied when William Brodsky became the first leader of a derivatives exchange to become chairman of the World Federation of Exchanges.

Today when new markets emerge, they do so with high standards and sometimes even higher expectations. We look at several African countries and see depositories, dematerialisation and significant investment in infrastructure across an area that is often neglected. Not without issues perhaps, but more developed than many would give it credit for. As investors return to the hunt for much needed performance, it seems certain that they will turn to African investments to help meet those goals. It seems they can do so with confidence in the infrastructure in many of the markets.

A more integrated, sophisticated, interdependent world, partly by choice, partly by necessity. And of course, "real time". Just check my ledger.

Latest mandates

Month	Winner	Client	Location	Assignment	Mandate size
February	BNY Mellon	La Caxia		Custody	USD 1 billion
February	State Street	Wellington West	Canada	Custody	
February	RBC Dexia	Pantera IGS Fund	Luxembourg	Custody	
February	BNY Mellon	Goudse Insurance	London	Core custody	

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Custody

Carlsberg AS has announced the appointment of BNY Mellon as depository for its sponsored American depositary receipt (ADR) program. Carlsberg is one of the world's largest brewery groups with a comprehensive brand portfolio that includes four out of the 10 largest European beer brands. Carlsberg is a constituent stock of MSCI Pan-Euro, FTSE Euro First, and Dow Jones Nordic 30. Five Carlsberg ADRs represent one Carlsberg ordinary share.

SIX SIS, the international custodian, has announced plans to move into the Brazilian market from March 2010. Offering its settlement and custody services, from this date clients will be able to settle and hold Brazilian securities in the Brazilian market via SIX SIS' local custodian Citibank in Sao Paulo. This is in addition to SIX SIS's presence in 55 markets worldwide.

Standard Chartered has launched custody and clearing services for clients investing in Bahrain and Oman, bringing the number of Middle Eastern markets where the firm provides securities services to five. Giles Elliott, global product head of securities services, cited "ongoing demand for regional and international investment services" in the Middle East as the reason for the firm's decision to expand.

Société Générale Securities Services (SGSS) has extended its relationship with European insurance giant the Generali Group, winning a mandate to provide custody to its subsidiary Generali Belgium. SGSS already provides custody and depositary services to a number of Generali Group businesses in France.

HSBC Securities Services (HSS) has picked up two mandates, signing a deal to continue as global custodian for West Yorkshire Pension Fund in the UK and becoming administrator and transfer agent for US asset manager Castle Creek Arbitrage. The West Yorkshire deal will involve HSS looking after around GBP2.35 billion of assets under management and the renewal will come into effect from the start of April.

Citigroup has been signed by

Bank of Ireland Securities Services to provide sub-custody services in 13 markets across Eastern Europe and Latin America. The deal will see Bank of Ireland gain access to Citi's proprietary network, which has 57 markets across the world. Of these markets, 31 are in the Europe, Middle East and Africa region. Bank of Ireland Securities Services currently has more than USD170 billion in assets under custody and administration.

The National Depository for Securities (KDPW), Poland, has announced the creation of an operational link which will allow Bulgarian companies to be listed on the Warsaw Stock Exchange (WSE). In addition, UniCredit BulBank, the Bulgarian custodian bank, has signed an agreement with the KDPW to provide the clearing and settlement of transactions of Bulgarian stocks listed on the WSE. This aligns closely with the KDPW's initiatives to establish new international operational links and to improve the profitability of existing links.

RBC Dexia Investor Services has picked up a mandate to provide custody, fund administration and transfer agency services to Luxembourg-based Pantera Investment Grade Strategies Fund (Pantera IGS Fund).

The fund is an open-ended specialised investment fund, participating in purchases of bank medium term note and bond issuances.

BNY Mellon has been chosen by UK soft drink firm Britvic to act as depository bank for its American depository receipt (ADR) programme. "Establishment of the ADR program and quoting on the otcQX International market will facilitate ownership for a broader range of investors who will be able to benefit from any of our future successes in the US," said John Gibney, group finance director of Britvic. "We look forward to building our relationship with BNY Mellon over the coming years and are confident that their expertise and capabilities will help drive our strategy forward."

Britvic sells more than 1.7 billion litres of soft drinks annually and owns a number of well-known brands, including Robinsons, Tango and Fruit Shoot.

MICEX Settlement House (MICEX SH) has begun operating as The National Depository Center (NDC) regional representative in Nizhny Novgorod.

NDC's participants are now to be served in MICEX SH's Nizhny Novgorod branch, situated at A 46 Ulyanova str. 603155 Nizhny Novgorod.

Of the movement, Eddie Astanin, the director general of NDC said:"The transfer of NDC representative's functions to MICEX SH's branch in Nizhny Novgorod represents a step towards formation of a settlement depository on basis of NDC and MICEX SH approved by MICEX Group's shareholders. For NDC this is a core project for 2010. We believe that results of the project's implementation will be in line with the shareholders' expectations and that regional market participants will now get additional opportunities for securities trading and settlements."

Previously the functions of the regional representative of NDC in Nizhny Novgorod were implemented by Regional Exchange Center. The terms of depository services offered to NDC participants remain unchanged.

Fund administration

Sanjiv Sawhney has rejoined Citi after being appointed global head of fund services for the bank's securities and fund services division. In his new role, Sawhney will take charge of the firm's hedge fund, private equity and mutual fund administration operations. He was formally in charge of J.P. Morgan's European fund services operations and was also managing director of J.P. Morgan Bank Luxembourg.

Transparency will play a key role as international competition in the fund market grows over the coming year, according to a new survey from RBC Dexia Investor Services. Along with demand for third-party funds and improved performance, transparency will be one of the main focus points for investors, rather than domiciliation. More than four out of five respondents, made up of fund promoters, distributors and

other industry players, said that they expected third-party funds to increase in popularity over the next 12 months. UCITS evolution and open architecture were other factors that were expected to see an increased focus.

J.P. Morgan has expanded its reach in the Middle East, opening a new office in Abu Dhabi in an event attended by some of the biggest names in finance in the region, including the Central Bank of UAE chairman, Khalil Mohammed Sharif Foulathi. The bank has had a presence in the region for more than half a century, when The Chase Manhattan Bank – which merged with J.P. Morgan in 2000 - opened an office in Beirut, Lebanon.

RBC Dexia Investor Services has been chosen to provide custody, fund administration, shareholder services and performance analytics for Selector Management Fund's Luxembourg-based funds. The mandate win is the latest in a long line for RBC Dexia, and the second within a week based in Luxembourg. Last week, RBC Global Asset Management selected RBC Dexia to service its Luxembourg-based UCITS/ SICAV funds.

People moves

LCH.Clearnet Group Limited has announced the appointment of a new non-executive chairman, Jacques Aigrain. Mr Aigrain replaces Chris Tupker, who has been chairman since July 2006 and who announced his intention to step down in September 2009.


Chris Tupker

Mr Aigrain was previously CEO of Swiss Re in New York, which he joined in 2001 as Head of Financial Services. Prior to thishe spent 19 years with JP Morgan Chase, working in a number of senior roles in its New York, London and Paris offices.

Timothy E Hartch and Seán Páircéir have been appointed partners at Brown Brothers


Tim Hartch

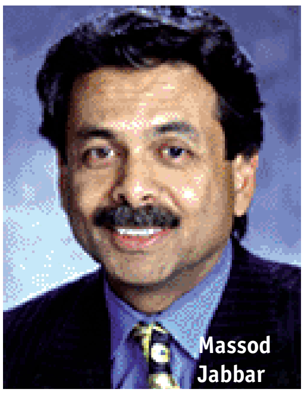
Harriman, the bank has announced. Hartch has been with the firm since 1996, beginning in the corporate finance department before become co-head of equity investment management in 2005. He was also involved in the implementation of BBH's large cap investing strategy BBH Core Select. Páircéir joined BBH in 2000 as managing director, resident in Ireland, and has spent


Seán Páircéir

his whole 20-year career in the global investment funds sphere. He is currently managing director of the firm's Dublin office.

Chi-X Europe COO Hirander Misra has stood down from his role and left the trading platform in order to "pursue other interests". Misra joined Chi-X at its inception and helped bring the platform to its current position as a challenger to the major European platforms, such as Deutsche Boerse and London Stock Exchange.

Sun Microsystems veteran Masood Jabbar has become the fifth independent director appointed to the board of


Massod Jabbar

Calypso Technology, a provider of trading, risk and processing platforms. Jabbar spent 16 years at Sun Microsystems, reaching the level of executive vice president of global sales operations before leaving the firm in 2002.

CACEIS has confirmed that Michel Bois, the managing director of the firm at its inception in 2005, has left the company. A CACEIS spokesperson said that the firm would not be releasing any more information about the departure for the time being.

Regulation

A provision of the Alternative Investment Fund Managers (AIFM) directive is "protectionist", according to the Alternative Investment Management Association (AIMA).

The directive has already received large amounts of criticism from the hedge fund industry, and the AIFM is unhappy with a change in its most recent form – a compromise text by Spain, the current presidency of the European Council.

The European Central Bank (ECB) has made a new appointment as it seeks to deal with system risk in the financial sector, with Mauro Grande taking up the role of director general of the Directorate General Financial Stability. The move is part of a wider restructuring at the ECB, which saw the Directorate Financial Stability and Supervision become the

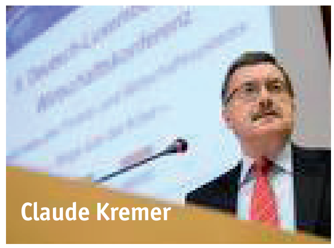

Hector Sants

Directorate General Financial Stability. The reorganisation is aimed at dealing with the increased responsibilities the ECB now holds in monitoring, identifying and assessing system risks both in the euro area and the wider EU.

Hector Sants, CEO of UK regulator the Financial Services Authority (FSA), is to leave his post in the summer after three years in charge of the organisation, and some experts have predicted that his replacement will take a tougher line with the markets.

Sants, who oversaw the FSA during the financial turmoil of the past two years, had revealed his intention to serve for three years when he was initially appointed by the board.

The UCITS brand has undergone so much change since its initial introduction that it is barely recognisable to industry practitioners, the FTfm reports. Claude Kremer, the president of the Luxembourg fund association


Claude Kremer

Alfi, said at a press breakfast in London that the idea of a separate category of simplified UCITS was under discussion at a high level within the industry.

Settlement

EuroCCP and Turquoise have launched their services in the Hungarian and Czech markets, with EuroCCP becoming the first pan-European CCP to provide clearing services in the 25 components of the Hungarian BUX index and the Czech PX index. The new clearing offering will be available to any trading venue linked to EuroCCP which trades in the BUX and PX securities.

Pritchard Stockbrokers has joined the settlement system provided via EMXCo's automated link with Euroclear UK and Ireland. Pritchard is the latest firm to join the service, which launched in November 2009 with a number of firms already signed up to use the offering. The launch came at the same time as cross-border transaction network Calastone announced its own plans for an alternative.

EuroCCP is to launch clearing services for European-listed Exchange-Traded Currencies (Currency ETCs). Turquoise will be the first multilateral trading facility (MTF) to offer trading in Currency ETCs cleared through EuroCCP. Euro CCP will clear 18 Currency ETCs, securities traded on exchange that track the performance of underlying currency indices, that provide long or short passive exposure to the currencies of G-10 countries versus the US dollar.

Technology

GlobeOp Financial Services has announced that it has paired with Linedata Services to offer an ASP-delivered, front-office order management system fully integrated with GlobeOp's middle- and back-office services. This new partnership will mean a reduction in time to market for start-up long/short equity managers and commodity trading advisers. It also intends to enable new and existing hedge funds to reduce overall technology investment.

KBL European Private Bankers, a Luxembourg-based pan-European fund promoter, has opted to join Calastone's cross-border transaction network. KBL focuses on natural resources, emerging markets and other alternative investments, and through its UK affiliate Brown Shipley offers a sterling bond fund.

The InfoHedge Hosted Platform, an advanced IT solution belonging to InfoHedge Technologies, is now fully compliant with the new Massachusetts Data Privacy Law. InfoHedge Technologies is a technology provider to the alternative investment industry, and has built the platform so that any personal data used, for example, social security numbers, driver's license numbers and financial information, is protected by the Massachusetts guidelines for data security. This privacy law is also known as MA 201 CMR 17.

Financial institutions and regulators must work together to develop reference data standards, according to attendees at the 3rd Annual Reference Data Management for the Banking Industry conference. Participants from a number of different institutions, including the European Central Bank, Committee of European Securities Regulators and regulatory think-tank JWG, warned that a "tsunami" of regulatory requirements will soon hit the banking industry, but many are not ready to deal with the new rules.

Bravura Solutions has signed an agreement with Calastone which will see the firm's clients receive direct connectivity to Calastone's live messaging service and transaction network. Bravura's Tony Klim, CEO for EMEA at the wealth management solution provider, cited the Calastone network's straight-through-processing (STP) capabilities as the reason behind his firm's decision to partner with Calastone.

Prime Brokerage

Hedge fund managers are Increasing the number of prime brokers they use in an effort to reduce counterparty risk, a new Omgeo-commissioned survey has found.

The report, carried out by Greenwich Associates, found that 60% of managers worldwide have diversified their prime brokerage list, with the managers have taken steps to improve transparency, with one third of respondents saying they now seek more independent accounting and valuations.

Interactive Brokers, the global broker dealer and proprietary trading business, has announced earnings 87.8% down on the same quarter last year. These results, plus poor fourth quarter earnings of 6 cents per share, are reportedly due to competitive pressure on spreads and constrained liquidity in the market as a whole.

Securities Lending

The US Securities and Exchange Commission has voted to introduce restrictions on short selling. This in a bid to relieve fears that the practice was responsible for some of the major banking collapses seen during the financial crisis. A majority vote among the SEC's five commissioners saw a restriction put in place on stocks which fall by 10%. When this threshold is met, only short sells at prices above the market's best bid will be allowed.

The Hong Kong Stock Exchange has added Wumart Stores stock to its list of securities eligible for short selling, potentially opening up borrower interest in the Chinese retail giant's shares. Wumart is a non-state-owned enterprise with most of its premises operating in Beijing, Tianjin, Hebei and the north-west of China. Short selling of Wumart stock will be permitted from March 2010, adding to the 512 listed securities which are eligible for short selling on the Hong Kong Stock Exchange.

The announcement comes in a time of increased interest in China for the securities lending industry, with the country's government and regulators recently making moves to allowing securities lending within the Chinese markets.

Knight Clearing Services has chosen to use SunGard's Loanet securities finance solution to run its front-office, settlement, clearing, accounting and regulatory operations in its new securities lending business. Loanet Smart Loan will allow Knight to control stock position and manage locates, with a view to introducing large levels of automation into the business.

Brown Brothers Harriman (BBH) has upped its presence in Asia following the appointment of Robert Lees and Richard Meek respectively as head of securities lending trading and head of securities lending relationship management for the Asia Pacific region.

Both men will move to BBH's Hong Kong office, with Lees reporting to Jeff O'Neill, global head of securities lending trading, and Meek to Elizabeth Seidel, global head of securities lending relationship management, business development strategy and marketing.

Chris Donovan, global head of BBH securities lending commented: "We are delighted to have Rob and Richard leading our trading, relationship management and business development efforts in Asia. BBH is committed to enhancing the service we provide to our clients across the globe and these appointments are an important part of our strategic growth plans for the region."

Go to ISJ.tv daily for up to date daily news on the investor services industry.

Leading edge

William J. Brodsky, Chairman and CEO of the CBOE & Chairman of the World Federation of Exchanges, talks to Kimberley Ferguson about what 2010 holds for him.

"My objective is to continue to reaffirm that exchange operations were not connected to the causes of the current financial difficulties"

William J. Brodsky is Chairman and CEO of the Chicago Board Options Exchange (CBOE), and in October 2008, became the first leader of a derivatives exchange to be named Chairman of the World Federation of Exchanges (WFE).

As Chairman and CEO of CBOE since 1997, Brodsky successfully managed a period of exponential growth and product innovation at the exchange, a particular highlight being the transformation of the CBOE's traditional "open-outcry market model" into a world class hybrid trading system.

In addition, Brodsky serves as the industry's leading advocate in shaping market policy and regulation, and is currently guiding the CBOE through demutualization from a membership organisation to a for-profit stock corporation. He has also recently encouraged the Chicago Mercantile Exchange (CME) and energy and soft commodity market operator Intercontinental Exchange (ICE) to become members of the WFE.

Speaking to ISJ, Mr Brodsky outlines the WFE's goals for 2010: "The major initiative for WFE in the aftermath of this financial crisis is to establish better coordination among the world's markets and regulators, so that evolving regulations are more uniform and consistently applied throughout the global marketplace. Specifically, the WFE has targeted reform in the regulation of OTC derivatives markets, and an examination of the structure of fixed income markets as immediate priorities".

And how does Mr Brodsky expect to tackle these challenges? "My objective is to continue to reaffirm that exchange operations were not connected to the

"The major initiative for WFE in the aftermath of this financial crisis is to establish better coordination among the world's markets and regulators"

causes of the current financial difficulties, and that the liquidity provided by daily trading has made a genuine contribution to the world economy.

"WFE aims to help minimize regulatory arbitrage by creating an environment where there is regulatory coordination. The WFE Exchange leaders expect to continue to be part of the solution to the capital markets problem as there are still a number of issues, including unregulated markets and their fragmentation of price discovery that need to be addressed.

"None of us can easily envision the architecture of the world's financial system even a year or two forward, or to what extent the existing exchange client base may be modified," Mr Brodsky said.

"We will continue to actively work with policymakers, particularly those in the U.S. Treasury and the European Commission, to make them aware of the threats facing regulated exchanges".

Brodsky's career history is equally impressive and diverse. He has previously served as Vice Chairman of the WFE from 2007 to 2008.
The election as Chairman in 2008 marked the culmination of four decades of leadership roles in the U.S options, futures and securities markets, and reportedly reflected the WFE's increased focus on asset classes beyond equities.

Before the CBOE, Brodsky served for 15 years at Chicago Mercantile Exchange (CME) where he joined in 1982 as Executive Vice President and Chief Operating Officer. In 1985, he was promoted to President and Chief Executive Office, where he oversaw the launch of the CME Globex trading system and played a pivotal role in the development and globalization of stock index futures.

Brodsky's early career began as an attorney in the securities industry with the firm of Model, Roland and Company in 1968. He went on to join the American Stock Exchange (AMEX) in 1974 where held various roles, including the Head of Options trading in 1976 and Executive Vice President for Operations between 1979 and 1982. He also served for 7 years as the AMEX representative on the board of The Options Clearing Corporation.

In 1994, the AMEX honoured Brodsky for his role in the development of its options programmes.

Brodsky is a current member of the Federal Reserve Bank of New York City and the Economic Club of Chicago. He serves on the Kellogg School of Management Advisory Council, as a trustee of Syracuse University and is a member of the Board of Directors of Northwestern Memorial Hospital, chairing its investment committee. He has been a director of Integrys Energy Group, Inc, and also a former chairman of the International Options Markets Association (IOMA).

Brodsky holds an A.B degree and a J.D degree from Syracuse University and is a member of the Bar in Illinois and New York.

WORLD FEDERATION OF EXCHANGES

The World Federation of Exchanges is a trade association of 52 publicly regulated stock, futures and options exchanges.
The market operators are responsible for the functioning of key components in the financial world. WFE exchanges are home to about 45,800 listed companies

WFE STATSTOP

- **The total market capitalization listed companies was approximately USD 46.5 trillion, a surge of 43% as compared to 2008.**
- **Approximately USD 80.5 trillion in equities were traded on WFE stock exchanges, down from USD 113 trillion recorded in 2008, and a dropped for the first time in seven years.**
- **More than 11 billion future and option contracts were transparently traded on-exchange, with proper post trade risk management and guarantees.**

(all findings are at the end of 2009).

Into Africa

African custody is changing. Quality in technology, regulation and services is spreading across the continent reports Craig McGlashan.

Most people involved with the African custody market would agree that South Africa is in pole position, when it comes to both technical and regulatory infrastructure. But a number of other markets have grown strongly over recent years, and it is not inconceivable that some of these could eventually move past South Africa in terms of their ability to provide custody for investors.

Khalid Mukhtar, director of Sectech, a custodial software solutions provider with a number of African clients, believes that African custodians' back offices are far more advanced than some may think.

"In our experience, hardware has never been an issue, except for delays due to customs clearance. The only issue, and this is a problem across the continent, is telecoms - although this has changed tremendously in the last few years. 10 years ago internet connections were rare - but you go now and every organisation is connected. In terms of hardware specifically, I don't think that's an issue."

South Africa's position as a developed market may well have aided this situation, Mukhtar explains: "Any hardware that comes into South Africa gets passed around the other countries as all the banking hardware distributors are usually based in South Africa and all of Africa benefits from it."

Indeed, the fact that many African banks have the latest technology and are not running legacy systems may give them some advantages over their peers in more developed markets, Mukhtar adds.

To many, the most obvious candidate as a rival to South Africa's crown would be Nigeria. With a population of nearly 155 million it dwarfs the next largest country (Ethiopia, with 85 million) and has huge oil reserves. This has of course led to perhaps as many problems as it has provided wealth to the general population.

Corruption has been at the source of many of these problems, and the Central Bank of Nigeria has recently pledged to address this issue. Indeed, in February, a Fitch Ratings report said that corporate governance and accounting disclosure within the banking sector had begun to improve as a result of the Central Bank's initiatives, although more improvement could be possible.

Bruce Lawrence, from HBL Consultancy Services, works heavily in the Nigerian market. He says that Nigeria "still has a long way to go in terms of transparency". He adds: "You have everything there, the structure; but the securities law still needs to be tightened up. It gives you the fundamentals, but if you go through the old version you'll have a clause which has nothing against it - it's still waiting to be drafted or pulled together.

"For example when I was working there in 2007 and 2008, there was no regulation for custodians and it's only in the last 18 months that you've had to register with the Securities and Exchange Commission (SEC) and get their approval. So we've had custodians in the marketplace for some time, without any real rules or legislation to follow."

That is not to say that the Nigerian custodian market has not been changed by new legislation over the past few years, however. Changes to capital rules in 2005 meant that a number of banks merged, while the Pension Reform Act in 2004 - which required all Nigerians to contribute toward their state pension - meant that a new branch of custodians emerged. These pension custodians - all local - are separate from general custodians, and instead of being regulated by the SEC they are governed by the National Pension Commission (NPC).

Indeed, two Nigerian banks - First Bank and UBA - operate in both the general and pension custody spheres, but the different branches must be completely separate legal entities, with different offices and separate mainframes.

According to Lawrence, this model has proved a success in terms of regulation. "They've really tried hard to make it work well," he says. "I would say the NPC is more advanced than the SEC, but then it has a smaller market to play with – they only have five custodians and 32 pension fund administrators. They also don't have the legacy of old documentation."

While Nigeria may not be fully developed in terms of regulation, custodians in the country have access to advanced technology. "They have an infrastructure and it works; there's a central securities depository called CSCS, it's electronic, and that process works."

However, he adds: "It's not a totally dematerialised market – if you want your physical share certificates it's going to take you a bit of time. That's one of the problems we have in the market – if you want to hold your share certificate you do suffer the incompetence of the registrars."

Segun Sanni, head of custody at Stanbic IBTC bank - the Nigerian branch of the pan-African bank Stanbic - also believes that the Nigerian market has come on in leaps and bounds over the past few years, despite suffering during the credit crunch.

" We've had tremendous growth in terms of knowledge of what custody represents, of what it does and of what it can do," he says. "We've had growth in terms of asset values, and so one can say that in the last five years there has been tremendous growth in the Nigerian custody market."

This growth may well continue. Custody is still a relatively new concept in Nigeria, and many local investors choose not to use it - but the growing number of international players in the country may well be leading to a change in attitudes, although not in every industry.

"I think from the discussions we've been having that the SEC is favourably disposed to compelling mutual fund managers to use the services of custodians, just like pension fund managers have been compelled to," Sanni says.

"But to compel stock brokers to relinquish the custody of clients' assets and limit their responsibility - that has been met with fierce resistance from stock brokers and I cannot say how that will pan out."

However, Nigeria still has its problems. Corruption is still rife, and while banking infrastructure may be up to international standards, general infrastructure is not. Regulators - based in the capital, Abuja - are an hour's flight away from Lagos, the financial centre, which can also mean they are behind the game.

No one doubts Nigeria's potential - and it is quickly gathering the infrastructure and expertise to match - but how can it move ahead? Three things need to be done, according to Toyin Sanni, head of custody at UBA.

"We need to fix our electoral process; we very urgently need to have electoral reforms, with credible and tenable electrical processes. We need to have our power infrastructure challenges fixed - we need a government that will address our power problems. We also require corruption to be dealt with definitively," she explains.

"I think that if those three issues are fixed Nigeria will be very much on the way to greatness."

However, Nigeria is not the only market in Africa that is advanced in terms of custody.

Ramy Bourgi, head of emerging markets development for Société Générale Securities Services, believes that Egypt and Morocco also have a claim to be leaders on the continent - particularly when compared to Nigeria's regulatory record.

"The regulatory factor is the most important and customers, when they go into a market, would look at the risk/return and the risk today is not just market risk," he says. "It's market, insolvency, compliance, regulatory, repatriation, operational - there are a lot of risks. And I think this is why Egypt, Morocco and South Africa have been ahead of the game."

He adds: "The second factor is population. The economies matter. The Egyptian stock exchange now is at a EUR106 billion - and it was not unscathed by the financial crisis. We really are finding that clients want competition in those markets. They have grown to the size that it's very open to competition - now Egypt and Morocco are featuring more and more in people's investments and I think people are looking for competition - which will always give you a better service and a better value for the client."

However, Chris Wooldridge, head of securities services at Barclays Emerging Markets, cites some markets as being the most exciting in Africa. Barclays offers custody services in 16 African countries via a combination of proprietary subsidiaries and agent banks, and believes that people should be looking at Kenya and Mauritius.

"Kenya is a very well established market that's been running well for decades," he says. "They have a history of prudence in developing their market, so it's well regulated, it's got good infrastructure, and changes are well planned and developed. Kenya was one of the early adopters of a central depository system; they were one of the early adopters of automated trading, so certainly in Kenya I see great potential.

"They are in the process of finishing off the last segment of immobilisation - namely corporate bonds. They are still physical but they have planned this year to immobilise those. But all other securities are automated."

Wooldridge describes Kenya as a "bright star" on the continent in terms of being a well-run market. "Efficiency is excellent, dividend payment is very good - so they don't have any of the problems investors associate with frontier markets."

Wooldridge also points to other markets that Barclays has a presence in, a total of 10 across Africa. He believes that Mauritius, one of the smallest countries in Africa in terms of population, is also one of the most advanced in terms of custody and financial services. This is partly as a result of the fact that Mauritius has one of the most stable economic and political histories among the African nations, according to Wooldridge.

Jennifer Ah Leung-Bundhun, custody business unit manager at the Mauritius Commercial Bank, agrees that "the political stability and economic prosperity of Mauritius cannot be disputed".

She adds: "The financial services sector is a contributor to that economic prosperity thanks to its regulators, modern infrastructure and know-how. I can hardly see any other African countries with such a track record." Its position as a 'key interface' between Asia and Southern and Eastern Africa - shown in its membership of a number of regional organisations - is also a benefit, she believes.

Leung-Bundhun also sees "great potential" in the Mauritian market. "Making custodians compulsory for investors appointing an investment manager, for example, government giving tax incentives to use collective investment schemes as an alternate means to traditional saving," she says. "I also believe that Mauritius is well positioned to ease investment into the region for reasons already stated above. This would, however, require that the other members have adequate regulations, if not common ones, for investments."


Khalid Muktar
Sectech

Mauritius may have one of the most stable economic and political histories among the African nations, but one country which does not is Zimbabwe. However, it may be surprising to those living in the West that the recent turmoil in the country has not meant its financial institutions are in ruins.

"African custodians' back offices are far more advanced than some may think"

Sectech's Mukhtar explains: "We always forget about Zimbabwe. In terms of the market infrastructure, in terms of the attractiveness of the market, it has done well. Of course, because of the situation there, we don't really hear anything positive.

"What is interesting to note is that the stock market is still ok - it hasn't been affected as much as we think it might have been."

However, despite the power-sharing agreement now in place in the country, there are still problems - in February, president Robert Mugabe defended new regulations which would see large corporations, including banks, be required to sell 51% of shares to locals.

Many of the countries in Africa could stake a claim to being the "next South Africa", each for various reasons. Some have got things right that others have not, while others simply have too much potential to stay quiet for long. While people will have their opinions, it is probably impossible to say which of these markets will develop fastest and furthest. What is certain, however, is that the African market as a whole is far more advanced than many may think.

"We have clients in 10 countries in Africa," says Mukhtar. "All of us travel to all these countries regularly and have never faced any problems. The reality in Africa is much better than the perception. Unfortunately, it is the perception that we need to change and that might take a while."

Africa certainly has its problems, but perhaps sometimes the Western media focuses too much on the negative and not on the positive - such as the rapidly developing and maturing investment market in the continent, and the custodial services to back it up.

CEE Hear

Estonia, Latvia, Lithuania, Ukraine and Russia provide strong opportunities for custodians operating in Central and Eastern Europe, writes Ulf Noren of SEB.

SEB is a major European provider for sub-custody services with a very strong presence in the seven Nordic/Baltic markets (Denmark, Finland, Norway, Sweden, Estonia, Latvia and Lithuania). In addition SEB has a growing sub-custody presence in Ukraine and Germany and has also established a sub-custody operation in Russia as late as 2008. Thereby, SEB's sub-custody markets are made up by 5 traditional Western European ones and 5 normally defined as CEE markets. In the below, we will have a closer look at the 5 Eastern Europe markets and how they fit into the offering.

SEB firmly believe that the future of being a European provider is tightly knit to the providers tactical and strategically positioning when it comes to a number of fundamental choices of which regional reach is one. We are now in the early maturity phase of regional thinking where most clients of significance have made a choice to regionalise all or parts of certain European clusters (like the Nordics, the Euronext markets, CEE etc) and are looking for the next step. A natural next step is to increase the geographical scope to look for an EU-provider, a EUR-Custodian, an all-of-the-continent Custodian and similar constructions. Most clients finds no complete answer to this strive but the positioning, fuelled by certain European regulatory and macro development happenings, will drive Custodians in the direction of either providing more markets than what the client buys today or slowly deteriorate. Strengthening and cementing the position in the five current Eastern European markets plays a very important role in SEB's tactical positioning plans.

Europe is in the beginning of a dramatic re-shape of the trade and post trade landscape. There are a multitude of drivers for this shift but a lot is tied to three mainstream features:

- The increasing competition on trading
- Increased operational & cost efficiency gains and risk mitigation
- Political efforts to harmonise Europe

Starting with the Baltic Markets, all of the above will have an impact. More immediately so than it will have in Russia and Ukraine. For these two markets, it of course makes sense to assimilate to Europe but it would be a naïve hope to believe that to be an imminent development. Both will continue to develop and we see a fantastic upside in both markets if managed carefully with a focus on service wassimilation and risk mitigation to the highest possible extent.

From a trading perspective, all Baltic Markets belongs to Nasdaq-OMX and thereby having the same trading technology set-up as the three Nordic NOMX-markets. That also goes for readiness to meet competition in the shape of MTF's and other forms of trading mechanisms. Our forecast is furthermore that Estonia will be joining the Eurozone in 2011 (acceptance early summer) while we believe Latvia and Lithuania to do so in 2014. This, and put in the context of Target 2 Securities development, will place SEB in a very good position to be unique as the one and only sub-custody bank with an on the ground service in the seven Nordic/Baltic T2S markets.

The financial crisis hit Europe hard and the CEE markets the hardest. The worst now seems to be over in the Baltic's and all three economies are supported by an incipient recovery in global demand. The development of the markets will be very much dependent on the politician's stamina to show ability to balance the positive signs with the continued need for pay cuts and tax hikes, leading to unpopularity, risk of lower consumer confidence and internal tensions. Naturally, for this to be a successful turnaround, the peg to the EUR must hold (and we believe it will) and the international bail out packages for Latvia can't be discontinued.

SEB will certainly remain in Eastern Europe and see the markets as necessary compliments to our regional portfolio of countries served, more so in the future than today.

Ulf Noren
SEB

Secure Structures

The National Depository Center is at the centre of the depositary and settlement infrastructure in Russia. Director general Eddie Astanin reviews progress.

The integration process and unification of depository and settlement infrastructure are topical issues practically for all developed and developing financial markets. The National Depository Center (Closed Joint Stock Company) (NDC) is an active participant in such processes in Russia.

Among our priority tasks we see provision of settlements on securities and monetary assets on Delivery Versus Payment (DVP) term held in various currencies, bringing of national standards of exchange of information related to securities in conformity with international norms, implementation and expansion of Electronic Data Interchange (EDI) on Straight Through Processing (STP) base.Being involved in solving of the problems mentioned above NDC actively cooperates with international community: international and national numbering depositories, their associations and the Association of National Numbering Agencies (ANNA).

In its role as Russia's national numbering agency, NDC assigns international ISIN and CFI codes to Russian financial instruments, places information of the assigned codes into international database and updates information of Russian ISIN and CFI codes in international database. For 2009 NDC assigned international ISIN and CFI codes to 727 Russian securities; ISIN codes were withdrawn from 261 Russian securities. In autumn 2009 NDC began assigning ISIN codes to additional share issues of Russian joint stock companies after getting of an appropriate approval by ANNA's Board of Directors and ANNA Service Bureau Advisory Board.

On 13 October, 2009 we launched a new version of www.isin.ru web site, an official source of information on international ISIN codes assigned to Russian financial instruments. In 2008 the web site has been authorized by Russia's Federal Financial Markets Service (FFMS) as a source of information on foreign financial instruments complying with FFMS's qualification requirements.

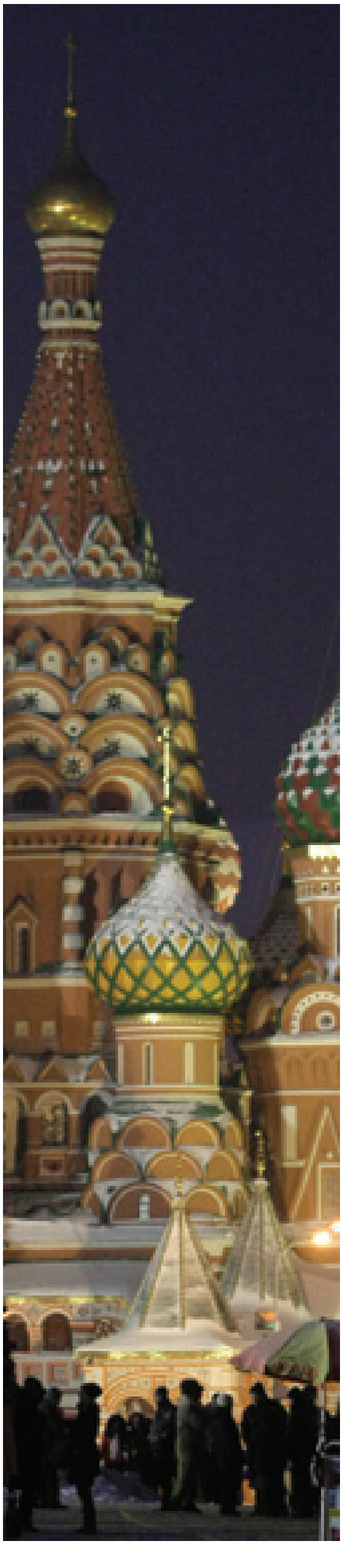
Development of a new version of the web site has been undertaken to improve Russia's stock market participants' awareness of NDC's activities as Russia's national numbering agency and a substitute numbering agency for the CIS in ANNA. The new version of the site provides expanded search capabilities for information regarding assigned ISIN codes.

With regard to interaction with national depositories we follow a principle of opening of nominee accounts with Russian depositories by foreign central depositories, at first instance by the depositories-members of the Association of Eurasian Central Securities Depositories (AECSD) (http://www.aecsd.com/en/). Now foreign depositories are only allowed to open Omnibus accounts with Russian depositories according to Russian legislation.

Speaking on development of NDC's settlement services we would like to mention implementation of a technology of settlements on OTC cross border transactions with Eurobonds included in the Bank of Russia's Lombard List and with depository receipts on Delivery Versus Payment term (DVP-1 model according to the Bank for International Settlements, Basel) through Euroclear Bank S.A./N.V., an international central depository. NDC clients were also suggested to use a service providing settlements on the Bank of Russia's REPO transactions on the OTC market (DVP-3 model according to the Bank for International Settlements, Basel).

Having accounts opened with ICSD Euroclear Bank S.A./N.V. and Clearstream Banking S.A., NDC began providing services associated with the corporate actions of the issuers of foreign financial instruments. These actions included voting of Eurobonds owners in the course of regular/extraordinary meetings on decisions (with or without compensation paid), certification of Eurobonds owners, voluntary early redemption and buy back of Eurobonds (with or without compensation paid), exchange/conversion of Eurobonds and participation in Dutch auction. Thus NDC's clients can use services associated with the corporate actions, and these services are generally accepted in developed markets.

Settlement services have been developed and implemented by NDC jointly with MICEX Settlement House, a MICEX Group's company with banking license. It is worth pointing out that in 2009 MICEX Group's shareholders decided to integrate the Group's depository and settlement businesses represented by NDC and MICEX Settlement House correspondingly and to form a united company which would be acting as a settlement depository with a status of credit organization. According to our plans, a synergy due to the integration will give the new company's customers additional opportunities related to settlements on transactions. It will also allow the new company to decrease its costs. This is a key NDC's project for 2010.



Analyse This: Technology

Netik

Colin Close, President

Déjà Vu …All Over Again! A Perspective on the Securities Industry in 2010

Like the echo of the Big Bang in a radio telescope, the 'noise' of the financial crisis of 2008 and 2009 reverberates daily in the press – for anybody that spots the evidence and the linkage. Within the few days this week that it has taken me to gather my thoughts for this article, I can recall several major stories that emanate directly from that troubled time. Stories like the Madoff Operations Director who has finally been implicated in that massive investment fraud; like the hedge fund manager who was caught manipulating the valuations of his trading positions; and if these two serve to awkwardly remind us of some of the excesses and bad behavior from that time, then a third story serves to remind us of what some of the consequences have been on the securities industry – the potential for multiple layers of 'regulation'. In one of the first international initiatives to get specific, the organization empowered by the G20 to advise national regulators, The International Organization of Securities Commissions (IOSCO), has just announced its 'template' for eradicating hedge fund secrecy. With this template, national supervisors will collect 11 types of data from hedge funds from September 2010 so as to "provide a consistent set of data to monitor systemic risk and prevent gaps in regulator reporting".

With this last step, we begin to see the governmental and other 'standards police' reaction to the crisis getting very tangible. To this, we can add the inevitable arrival of other such initiatives that vary only in degrees of severity and impact – but for the investment industry as a whole, all adding to the burden and complexity of disclosure, transparency and reporting. For example, two global proposals that similarly seek to normalize the information relayed to investors to facilitate the comparison of data across service providers are GIPS (Global Investment Performance Standards, to be adopted this year) and IFRS (International Financial Reporting Standards, to take effect in 2014).

It seems to me that it is important that we don't assume that many of the characteristically complex investment practices that underpinned the era of the financial crisis are not resurgent. They are. For example, securitization, which is one of the investment practices most closely associated with the crisis era, is surprisingly not dead! CDOs and CLOs have quietly returned in evolved, lower leveraged form. Also, hedge funds - which continue to bear the brunt of distrust because of Madoff, Stanford and Galleon - are back delivering high returns that are having almost pheromonic attraction to institutional money.

> "We begin to see the governmental and other 'standards police' reaction to the crisis getting very tangible"

The added twist this time around, significantly compounding operational complexity, is both the emergence of new hedge fund products, such as multi-strategy funds and hedge fund-like mutual funds, and the burden of operating model changes and transparent reporting that is required to attract institutional money.

In conclusion, then, the investment industry is bouncing back. Along with demonstrable alpha generation comes the observation that 'it was ever thus…' or 'déjà vu' all over again. Some investment practices that were associated with the financial crisis are alive and well. Yet, there is a 'crunch' for firms to manage; increasing complexity in the middle and back office at a time when regulators and money-owners are demanding better risk management, better controls, transparency and disclosure. All compounded by stressed margins leaving little funding for operational initiatives.

For buy-side firms to satisfy these demands in 2010 and beyond, they must invest in an integrated middle office data management and outsourcing solution and use this platform to enhance reporting, improve risk/exposure management and build a global infrastructure. By this they will achieve the best practice that is expected of them. Their ability to attract and retain assets will increasingly depend on them demonstrating success in such initiatives.

DST Global Solutions

Geoff Harries, Head of Asset Servicing

With the Investment Management community recovering from the pressures of declining fees and squeeze on operational budgets, 2009 could be defined as The Age of Enlightenment. Operational improvement projects were scrutinized and analysed to ensure close alignment to business strategy and re-evaluated against 6 to 12 month return on investment metrics. As a consequence of the unwinding of operational projects that have not delivered the anticipated results, 2010 will be The Age of Realism where pragmatic solutions come to the fore with more realistic goals of visibility and control replacing some of the large business process re-transformation projects of the noughties that failed to deliver.

A backlog of operational improvement projects are being evaluated against more stringent and new criteria where project risk, as well as ever decreasing payback periods, are essential for the project to get approval. So what operational challenges fit the new criteria? Or are we talking about a different approach to some of the key operational projects that have been on the agenda in different formats? Everything so far points to the latter; if not about changing the operational agenda it's about resetting objectives scope and approach to achieve a realistic goal.

Many existing projects will still progress but the driving goal of process automation and cost efficiencies may not be enough to keep them in the Top 5 without being tied to the clear and present dangers of specific operational risk and creating improved visibility and control over the existing operation.

ISJ speaks to key providers about issues facing technology users this year

Derivatives: Visibility and Control - refocusing on near term objectives
As the derivatives market infrastructure landscape matures, and models for CCP and associated margining obligations become clearer, so buy-side participants will be able to make informed decisions about the associated costs of exchange traded versus over-the-counter derivatives and the operational jigsaw of systems they need to put together to meet investment control requirements.

Assumptions that crossover vendors are able to make the transition to successfully support the buy-side have had limited success. With traditional buy-side firms' capabilities for portfolio management based on a cash securities heritage, there still exists a requirement to be able to capture OTC contracts in the middle office in a consistent and audited process, to minimise operational risk and provide counterparty exposure metrics.

> "2010 will be The Age of Realism where pragmatic solutions come to the fore with more realistic goals of visibility and control"

While the industry has focused on market infrastructure connectivity, one of the most basic areas of control and visibility has been overlooked, that of OTC trade capture to enable a visible, audited and consistent repository of OTC contracts. Whichever way the market goes, one thing is for sure, the ability for the middle office to keep accurate records of contracts and manage post trade activity is essential and a pre-requisite to broader OTC project initiation. In addition, the ability to quickly establish counterparty exposure has risen in priority, and the ability to not only track but also establish operational procedures in place to prevent further exposure are key to the design of solutions to meet today's requirements.

The OTC Lifecycle can only begin after successful and controlled trade capture and the creation of the validated contract repository which gives the capability to manage the post trade contract maintenance activities, a logical place to start the journey of OTC derivatives control and visibility improvements.

Eagle Investment Systems

John Lehner
Chief Executive Officer and President

The lingering impact of the economic crisis and the political and regulatory magnifying glass over the financial industry has amplified the challenges facing investment managers over the past year. These factors have caused organisations to reinforce and accelerate their data and risk management strategies, while simultaneously managing expenses closely in the quest to return to previous profitability levels.

The model for solving these ongoing requirements has changed as investment managers are facing smaller technology budgets, leaner operations staff, shorter timelines for deliverables, and unclear end state reporting and information requirements. Financial pressures, industry maturity, and shifting business priorities have created opportunities for financial technology vendors and service partners that are able to invest in new technology and service models to address these changing industry demands. Organisations are confronting the reality of not being able to afford and rely predominantly on in-house development and technology supplemented with external packages and technology components to solve these issues.

In order to maintain the traditional in-house technology development model, organisations face fixed and higher expenses and the expectation of technology reinvestment to try and stay current. The absence of flexible hybrid technology/service solutions that allow investment managers to retain the necessary flexibility around propriety data requirements and preferences, combined with legacy outsourcing models primarily focused on back office accounting [making them unsuitable for the front and middle office data requirements], has complicated the matter. This has forced asset management firms to outsource, without having the confidence of being in a better financial and operational position upon doing so. Eagle Investment Systems has kept pace with the changes taking place in the industry in preparation for the day when organisations would rely on service models to manage technology and applications. The trend towards hosting for Eagle started long before the global slowdown with a significant increase in acceptance of and demand for these services 2-3 years ago.

Eagle and its parent, BNY Mellon shared the vision that outsourcing, hosted services or a hybrid approach of service and technology, would become popular cost-effective alternatives for organisations to operate their back offices. Service providers offer investment managers a tangible ROI with a team of resources to help manage the system and enable reallocation of resources to their core business issues. The collective efforts of Eagle and BNY Mellon, combined with the maturity of the market, brought tremendous interest in these services in 2009 with approximately half of Eagle's new deals being hosted via its ASP. All signs point to this trend continuing over the next year and beyond.

> "there is tremendous focus on working with a vendor that has sustainability"

Today more than ever, there is tremendous focus on working with a vendor that has sustainability in this current landscape of companies closing shop, merging or being acquired. Organisations want proven examples of lower total cost of ownership, proven return on investment, and scalability. Technology purchases are viewed as investments in the business, and right now the whole industry is very risk averse. Investment managers also want a commitment from vendors for additional future development, as the industry continues to rollout new investment types and strategies.

Looking ahead, investment managers must be able to do more with less, whether it is people or systems addressing their needs. Value for the spend has never been more important. Organisations are working with vendors offering scalable, open technology that can add value beyond the requirements that exists today. Vendors are being asked to stretch their solutions to gain access to new reports and granular detail, and they want data at their fingertips to address new instruments and new regulations and to provide a competitive edge.

Though there are signs pointing to the end of the recession, most organisations will still follow a pragmatic approach to selecting new systems and services as they watch expenses.

Godfried De Vidts
Chairman of the International Capital Market Association's, European Repo Council considers the market.

Developments in the European repo markets

Without doubt the secured financing or repo market in Europe has had a remarkable run over the past 15 years. Repo was adopted in Europe in the mid 1990s by national central banks, based on principles used in the USA. The creation of the Euro currency provided added impetus to the development of what became by June 2007 a mature EUR 6. 7 trillion market (source: ICMA- ERC Repo Survey June 2007), providing liquidity to many financial institutions. The industry has worked hard to develop this market – the creation of the Global Master Repurchase Agreement (GMRA) in 1995 (revised in 2000) and the provision of 68 supporting legal opinions, which are updated annually, provide a robust, legally certain, cross-border framework that is used globally. And indeed the industry continues to work on the development of the market, with a number of projects already in the pipeline to improve the efficiency of its infrastructure. This article highlights some of these, in the areas of clearing, collateral management, new forms of eligible collateral and a revision of the GMRA.

At the same time, regulatory proposals are currently being debated which should be given very careful thought prior to implementation to reduce the risk of damaging the repo market - which is one of the largest and most active sectors in today's money markets and, as evidenced in the recent market turmoil, plays a critical role in liquidity provision for the financial system. The impetus to regulate the OTC markets in Europe is gaining momentum, and will impact the repo markets. Additionally, the forthcoming MiFID review will cover not only equities, but also the fixed income and derivatives markets; and it is highly likely that these markets will be required to be more transparent, particularly in relation to post trade transparency. We also expect a European directive on clearing. In order to ensure the repo market remains robust and well functioning, while still being open to innovation, the repo community must be ready to interact with regulators and the central banks.

Global standards – clearing

The repo community can point to a number of successful industry initiatives. In 2009 the G20, supported by EU Member States, advocated maximum use of central clearing. However, the repo market had established the use of Central Counterparty (CCP) Clearing in Europe in 1999 when LCH Ltd, supported by market practitioners in the Repo market, created Repoclear. This was followed by Clearnet (later merged into LCH Clearnet group), Eurex Clearing and CC&G. However two euro-zone countries still lack a CCP, despite calls from market practitioners, and national barriers to connecting directly to local central securities depositories (CSDs) prevent direct connectivity.

Another successful industry driven solution has been the constant improvements in the "bridge", the interconnectivity between the two international CSDs (ICSDs) achieved with the co-operation of both Euroclear Brussels and Clearstream Luxembourg. The ERC has requested similar interoperability for the triparty product to support central clearing of baskets (in one form or the other) in order to free-up liquidity.

From a regulatory perspective, some 10 years ago the Giovannini working group concluded that there was a need to create an adequate cross-border clearing and settlement framework in Europe - but this would not be possible unless a number of barriers were removed. In the last 10 years significant work has been carried out by industry to dismantle many of the barriers, yet some still remain as national protectionism prevents the creation of a seamless clearing and settlement framework.

Collateral management

A project closely watched by the ERC is the new single platform for the management of Eurosystem collateral, known as CCBM2 (Collateral Central Bank Management). Market participants sincerely hope CCBM2 will create a borderless way of bringing collateral to the Eurosystem, independent of national requirements - they would have the option of choosing one national central bank for all collateral flows towards the Eurosystem, which would create a cost-effective way of dealing with the complexity of the enlarged currency zone. However, there is a need to widen this discussion on a global scale. Often market participants have collateral in one currency zone, while lacking cash in another. As the credit crisis has shown, flexibility to move collateral around is crucial. CLS bank has largely solved the time-zone issues for foreign exchange transactions. Discussions between policy makers and market participants should lead to, at the very minimum, a global solution that can be quickly used in case of stress in markets in delivery versus payment. Ultimately that framework could be the basis for a global collateral framework underpinning the bilateral secured markets.

New forms of eligible collateral

As witnessed in the crisis, central banks clearly understood their role as lenders of last resort. The Eurosystem had, prior to the events of summer 2007, a wide range of eligible collateral at its disposal. This gave market participants the option of using less liquid assets as collateral in Eurosystem operations, thereby keeping highly liquid assets (especially euro area central government bonds) for use in repo market transactions. So, when help was needed during the crisis, adequate flows of liquidity against collateral were available. Other central banks followed suit. The wisdom of central banks in previewing and back-testing these facilities proved to be the right investment and market participants applaud these measures.

A new initiative is underway to extend the range of collateral available, with the creation of a facility allowing banks to submit unsecured loans to the corporate sector as collateral to the Eurosystem. The use of these credit claims has risen, although the debate about their appropriateness remains. The European Commission, in the revision of the Financial Collateral Arrangements Directive (FCD), has provided the legal framework. The board of the International Capital Market Association has decided to back this initiative with funding to create the legal framework for the secondary market in credit claims. The Loan Market Association is involved in the project; and the ICSDs have been asked by the ERC to create a common unique data base, which can work largely similar to the corporate bond market facilities created by them. Discussions with ANNA (the Association of National Numbering Agencies) re a unique identification number are progressing and SWIFT has agreed to create a unique messaging system.

GMRA Documentation

The 2009 European Commission consultation on the safety and resilience of the OTC derivatives market highlighted the need for standardisation in order for markets to be manageable. In this context the creation of the GMRA provided a solid legal framework for the development of secured markets. The GMRA has been tested in a number of financial crises - the dot-com bubble, LTCM, the Russian and emerging market crises, and the recent credit crisis. Each time it has provided the necessary legal protection in the event of counterparty default.

Complacency at this point would however be wrong. Under the guidance of the ERC the GMRA is currently being revised to provide an updated version - taking into account the lessons from the crisis in the area of legal protection to produce a legal document that is fit for the coming decade. The GMRA has bridged the lack of a single European capital market by providing a robust cross-border agreement used globally.

Regulatory proposals

The current regulatory review of the financial system should avoid inadvertently endangering what has been achieved so far. When the Basel Committee decided to upgrade the Basel 1 framework into Basel 2, adequate provisions were embedded to support migration from unsecured to secured lending practises. This was implemented in Europe and was in place as of the beginning of 2007. Its beneficial effects have been somewhat hidden because of other events; notably the use of a wide range of collateral without adequate daily pricing. The financial markets have lived through a period of excesses that need to be corrected, however, it would be unfortunate if these events brought into question market participants' ability to organise an adequate framework for well functioning repo markets. Best practice in this market has already been put in place to a large extent, with haircuts being used in various forms and eligibility sheets for collateral, as well as credit lines for counterparties which have to be validated by each bank's risk committees. Banks are risk takers and the intense competition between banks provides a solid base for "cheap" credit to the real economy. Providing a regulatory framework with fixed haircuts (even by each underlying collateral type) may prove to be counterproductive to competition and have unintended consequences for the flows of liquidity between wholesale market participants. Repo markets are not only used for central bank operations; rather the bulk of transactions are actually between wholesale market participants and are witness to a free flow of liquidity from institutions long of cash towards those in need of short term funding.

The Basel Committee has also looked at liquidity. Without a doubt more work has to be done in this area. ERC members have often discussed the appropriateness of the collateral to be used in the light of adequate liquidity of the underlying. Liquidity can be impacted by many influences and it is often the repo trader who has the clearest picture of a bond's liquidity. The Basel Committee has suggested the use of liquidity buffers. Liquidity buffers that can only be created with the use of the best liquid collateral make sense in principle, however, here also one has to be careful of unintended consequences.

The call by the G20 for increased use of central clearing for many products' such as IRS and CDS, will require initial margins, variation margins and default fund contributions. These can be serviced either in cash, or in the form of adequate collateral. Bilateral clearing will also get increased attention and the enhanced use of current bilateral collateralisation will create a need for additional collateral. Cash is king, but due to the evolving Basel framework it will become even more expensive. The use of government bonds will be part of the framework to fulfil calls for risk mitigation techniques, but there are real doubts this will be adequate to fulfil all needs, even with the current high issuance levels. Non-government bonds that are part of central bank eligible programs provide a good alternative and as such equivalent provisions should also be included in the Basel liquidity buffer regime. Market participants will respond to the various consultations by the various policy makers. In this respect I am hopeful that an adequate compromise regarding the many issues on the table can be found. This will provide an adequate response to the G20, to have a more robust framework in place that should be the base of a sound financial system fit to respond to its responsibilities.

World Cup Custody?

Kimberley Ferguson on South African custody

It has been a year since the regulation surrounding South African institutional investors - including long-term insurers, pension funds and collective investment scheme management companies - was relaxed to allow more investment overseas.

The limits currently stand at an overall 20% of total assets for long term insurers, pension funds and fund managers, and 30% of total assets in the case of collective investments scheme management companies and investment managers registered as institutional investors.

Institutional investors are, on application, allowed to invest an additional 5% of their total retail assets by acquiring foreign currency denominated portfolio assets in Africa through foreign currency transfers from South Africa, or by acquiring inward listed securities.

So, what impact have these changes had on the role of the custodian in South Africa? "To be quite frank with you, it hasn't changed a lot," said Adam Bateman, director of business development for investor services at the Standard Bank of South Africa. "If you go back to the late 1990s, there was a lot of anticipation around exchange control relaxing and the opportunities this would create in the form of global custody. As a result, you saw most of the banks seeking partnerships with global custodians to service these segregated portfolios. We were one of the first, partnering with the Bank of New York Mellon.

"So whilst it's true that the rules were relaxed last year, it is certainly not to the extent everyone was hoping for in the late 1990s. When this occurred, we saw a bit of an increase in the mandates that we already had, but nothing too dramatic. The assets have gone up a bit, but we haven't seen a huge take up in additional segregated mandates," Mr Bateman explained.

Like Mr Bateman, Michael Wright, a senior manager at NedBank Investor Services, South Africa also mentioned the anticipation in the late 1990s. "During this time, many South African custodians believed that exchange control might actually be abolished," he said. "In regards to the recent rule relaxation, Nedbank has not seen a major change in their role as custodian. This could be because many of these investments are not direct asset investments, but more through vehicles such as fund of funds or mutual fund investments. Also, the small portion of overall allowance has not made a major impact on the asset servicing requirements in South Africa."

A recent change which is presenting a challenge in the sphere of custody in South Africa is a shift in the retirement fund space. This means that most of the offshore flow is going into pooled products. "You now only have a handful of some of the larger funds which have segregated international funds which require global custody," Mr Bateman explained.

In order to keep on top of challenges such as this one, Nedbank underwent an evaluation of the risks and rewards of the products they offered to their different client and market segments.

"We completed our risk evaluation, participated in industry initiatives to ensure that issues are raised and addressed, and had various client interactions to understand the 'new' client needs. We made sure we were able to inform clients of new regulation and to share new information. The next phase of this process is to complete an impact analysis of the proposed move from a T+5 to a T+3 cycle in preparation of the launch of a major market improvement in March 2012. We are poised for and fully committed to providing our clients with elegant solutions to meet their future needs," Mr Wright said.

This detailed analysis enabled Nedbank in 2000, when the South African market adopted a full electronic settlement for the equity market, to focus on master custody for the retirement industry specifically. "This is reflected in our client segment market share: 13% international clients and 87% domestic clients, which is made up of corporate clients, investment managers, broker dealers, assurance, unit trusts and retirement funds ," Mr Wright said.

Other changes being presented to South African custodians today come in the form of institutional investor demands.

Andre Jansen van Vuuren, the chief executive officer of custody services for FNB Corporate Banking in South Africa said: "With the economic crisis, institutional investors are all looking at their costs and putting pressure on custodians to reduce their fees. This has put the custodians' profit margin level under pressure in South Africa. They also put bigger demands on the completeness and timeliness of information, as well as pressurising us to lobby for a reduction in the fees charged by the Central Securities Depository.

"We also find them looking for more, value added things like cash predictions, to enable them to do better cash management, market information and regular news flashes on updates in the market," Mr Jansen van Vuuren said.

For Standard Bank, approximately a third of their clients are international, with two thirds being local. "The international clients have been quite a sophisticated bunch for quite a while - the global custodians, the investment banks that we support as their South African custodian. We have had a very clean and automated interface with all these clients for quite some time now," Mr Bateman explained. However, the local clients are now beginning to follow suit.

"They are following trends set by their international counterparts years ago, and are now increasingly looking for more timely information. The international guys have been in that position for quite a while now, whereas local clients are only now becoming fully SWIFT compliant and demanding information on a daily, and sometimes intraday basis," Mr Bateman said.

"Regulatory changes have provided us with opportunities in South Africa," explained John Legrand, managing director of EMEA and APAC at Eagle Investment Systems, a subsidiary of BNY Mellon.

"In 2005, the International Accounting Standards Board (IASB) mandated that all listed companies use IFRS (International Financial Reporting Standards) for their consolidated statements in the EU and EEA. Because many South African firms do business in Europe, many have also chosen to implement IFRS.

The introduction of withholding tax, meant to come into effect in 2011 means that the custodian will become responsible for withholding tax on dividends that are paid. As part of that service, the custodian will then have to take a decision on whether or not to develop a 'reclaim service' as an additional product that would support clients who are looking, and who are eligible, to get a portion of that dividend back. "This is something we intend on doing here at Standard Bank," Mr Bateman said. "All of the South African custodians will be required to perform this role of withholding income tax and sending the tax on to the receiver here in South Africa."

The second is a development in the local unit trust space. "The regulations in the collective investment space are being redrafted, and this will impact the trustee and custodian," said Mr Bateman. "We have been playing an active role in that discussion with the various industry stakeholders, our clients, and of course the regulator.

"Most of the focus and debate relates to language in the proposed regulations that relate to the use of OTC derivatives and the new rules that will govern portfolio managers of collective investment schemes, which will need to be monitored by the trustee/custodian of schemes."

In the South African custody market, Mr Jansen van Vuuren believes that Standard Bank is dominant. "I would say that FNB is second, followed by Absa and Nedbank, though who is bigger out of those two, I'm not sure".

And what does it take to dominate? "Service, service and again, service," said Mr Jansen van Vuuren.

Untouched by the economic crisis, South Africa's custodian industry is worth about ZAR 6.5 trillion (USD 871, 479, 880, 958; GBP 576, 843, 480, 392), also have here that amount in EUR and USD. Although in a state of flux at present, it appears to be learning from Europe and America's mistakes, and coming out on top.

Counter Top

Anthony Harrington explores the perceptions and realities of OTC derivatives for custodians and their clients

Derivatives have not enjoyed a particularly good press, following their role in precipitating the financial meltdown and the subsequent global recession. However, the consensus view across the investment industry is that derivatives are far too important and useful an asset class to be knocked back by a welter of bad headlines. What has happened, post the crash, however, is massive pressure for derivatives to be monitored much more closely than they were. This in turn has generated a huge demand for the processing and valuation of derivatives as an outsourced service. The major custodians all have offerings in this space.

Steve Ingle, Global Product Manager for Derivatives at Bank of New York Mellon Asset Servicing, points out that there are a number of different models out there used by custodians, depending on the individual custodian's strengths. "We have a capital markets front office desk and our outsourcing offering on derivatives reflects this," he says.

There is a large and growing body of suppliers specialising in the valuation of specific kinds of derivatives, and those custodians without strong internal expertise will act as an aggregator for their clients for a range of valuation suppliers. However, there are also OTC derivatives, particularly for the larger houses, that really do need the custodian to have the capacity to do in-house valuations.

As Ingle notes, these clients have their own formulae for valuing derivatives that they expect the custodian to apply. BNY Mellon has both strings to its bow. It will act as an aggregator and manager and it will provide in-house valuation services as well.

As with any outsource service there is the question of supplier liability to be resolved, and with derivatives, errors here can potentially be huge. In an ideal world, the client would want the custodian to be absolutely liable for any and all errors. However, the realities of life mean that no custodian is going to offer a service for x fee and accept either unlimited liability or a liability that is a massive multiple of that fee.

"The challenge we all face is that it is very difficult to get to a clean price for an OTC derivative in anything like the time frame that it takes to scrub equity or bond pricing from a Bloomberg or Reuters feed. We will take liability for the process of calculating a value, which means that if the formula says take A, add it to B and multiply it by C, we will do that process, but we won't guarantee the base feed information that gives you values for A, B and C. The client has to agree both the model and the inputs to the model. Moreover even if we get it wrong we will put a ceiling on the liability," Ingle explains.

What is it that makes valuing derivatives so tricky? As Ingle explains in highly volatile markets, even comparing yesterday's values to today's values can generate a very wide range. So the provider has to scrub the value to ensure that the range is sensible and is in the right direction. But the counterparty to the deal will almost never reveal the model that it is using to value the trade, so there is always the potential for breaks and mismatches that require more examination time and expensive human intervention to resolve.

"We perform common sense checks, but there are always counterparties to OTC derivatives deals that are outliers to the aggregated data. So when you perform a scrub and a comparison, there is about a two percent break, or mismatch, on average. So custodians and outsourcers have to do a great deal of work to make the price for an OTC derivative appear as clear and clean as the price for a bond or an equity," he comments.

Valuation time frames also vary widely. BNY Mellon provides everything from monthly valuations to intra-day valuations. The latter can be particularly important where, for example, the client has trading desks in multiple time zones

"The first thing to note is that you do not custody a derivative, since it is just a contract between two parties. So we act as the administrator and or accountant to one of the parties. If we are the accountant, the investment manager client needs a process internally that produces values. They cannot just rely on our figures since they have to have a risk process in-house that shows them what they are committed to," Ingle comments.

The custodian's figures then are there for transparency, independence and to show the client's auditors where the figures have come from. This means that the custodian's valuation process has to be fully auditable. "My point to any investment manager is that if they cannot calculate the value of an OTC derivative they are trading, they shouldn't be trading it," he says.

Kathleen Struye, Director, Derivatives Product Management at Euroclear points out that Euroclear's DerivManager product has been attracting sustained interest from investment houses to manage the exposure on OTC derivatives deals. "Accurately establishing and reporting the exposures that counterparties run bilaterally as a result of OTC derivative trading is critical to provide the basis for margin calls and other activities. Our clients are very interested in transparency and clarity as to what happens in the derivatives market. A key part of eliminating counterparty risk from these trades is by ensuring that the resulting exposures are fully collateralised at all times," she says. This is where the post-trade space that Euroclear specialises in, meets the trading area and day-to-day derivatives valuations.

Jonathan Davies, Vice President, Sapient Global Markets, which provides services to the financial and commodity markets, says that his firm has just completed a major survey of wealth managers about the operations and technologies they need to support the front office. With derivatives, what the survey showed was that the high net worth clients of the big wealth management houses want up to date valuations of whatever derivatives they have invested in, but they want to be able to view these valuations as part of their total portfolio.

"The problem the wealth management sector faces is that it has traditionally implemented a silo view of each asset class. This is not what clients want," Davies says. Instead, clients want to get a total view so wealth managers are now putting pressure on custodians to align their systems with the wealth manager's requirements to provide complete portfolio views.

Ultimately the derivatives valuation feeds and reports from the custodian have to come in a form that will enable the wealth manager to provide the investor with the right information on their portal without manual intervention in presenting or reconciling the data. "Custodians who can do this will succeed, those who can't or won't will lose business", he says.

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