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A Guide to **Custody** and **Outsourcing** in Asia



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A guide to custody and outsourcing in Asia

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Chapter 1

Servicing the securities market in Asia

Asia represents one of the world's fastest growing asset management markets. Years of government-sponsored local savings initiatives are now being upstaged by the increasing popularity of retail mutual funds, a modernizing insurance sector and a region-wide willingness for domestic institutions to invest offshore.

One of the fastest growing asset pools in the region is mutual funds. According to the International Investment Funds Association, Asia's mutual fund pool swelled by 9.5% in the first half of 2003 to \$1.142 trillion. Though these numbers are impressive, the growth figure for the first half of the year was unusually low for the region – lower even than the global average rate of 10% - due to the impact of SARS and other global events. Asia is used to experiencing much higher growth rates – more than double the worldwide average – and in the last five years has seen assets grow by 69%. There are now roughly 11,000 funds in Asia (not including China or India), representing about 21% of the world's total. Market commentators believe growth rates will now return to historic levels.

There are five Asian markets that rank among the world's top 20 in terms of assets under management for mutual funds. Hong Kong is number 12, with \$201 billion; South Korea is 14th with \$134 billion and Taiwan is 19th, with \$67 billion. Japan ranks seventh, with \$298 billion of assets in funds. Australia is fourth with \$433 billion. The global leader by a country mile is the United States with \$6.8 trillion of assets in funds; the silver medal goes to France with \$993 billion and the bronze to Luxembourg with \$913 billion.

While the mutual fund sector is growing, the biggest pool of assets in Asia is controlled by national institutions. These investors manage in excess of \$5 trillion (ex-Japan) according to an annual survey of central banks, pension funds, insurance companies, government agencies and commercial banks run by *AsianInvestor* each year. The top five central banks in the region manage just over \$1 trillion of these assets,

while the top five agencies control \$381 billion and the top five pension funds control \$249 billion (see table showing Asia's top five institutional asset managers). While most of these assets are invested in domestic markets, and therefore not offered to global custodians, the sheer size of funds in countries like China and South Korea is forcing them to diversify their investments overseas. Taiwan's insurance companies and Thai institutions, for example, have aggressively invested abroad as regulations have liberalized. Korea's national pension corporation has also made its first foray into global markets in recent years.

Of course, market participants are watching China closely to see how this potentially enormous investment pool develops. Qualified foreign institutional investor (QFII) licenses have been established and by early 2004 several of these licences had been granted to global securities houses. Nine domestic and foreign commercial banks received approval to act as custodians to the funds. While it is still too early to tell just how large this market will grow, the growth of the mutual fund market (for investment in domestic securities) gives some indication. In less than three years, the number of fund managers, including some Sino-foreign joint ventures, has quintupled and the market is now worth about \$20 billion. Assets in these funds are held in custody by the big Chinese banks with ICBC and Bank of China controlling the lion's share.

Other key markets in Asia like Australia and Japan have their own quirks. Australia has \$750 billion in funds under management and there are 13 banks actively seeking custody of these assets. While Australia's asset pool is mature, growth is evident as employees put away more in their compulsory superannuation schemes and the government steps in with initiatives like the co-contribution scheme for low-income earners.

Japan's asset pool is vast. The total pool of third party managed assets is reckoned to be \$2.3 trillion



Asia's top five institutional asset managers

	Central banks	Fund Size (\$m)	Country
1	SAFE / People's Bank of China	415,720	China
2	Central Bank of China	214,930	Taiwan
3	Bank of Korea	157,450	South Korea
4	Hong Kong Exchange Fund	129,945	Hong Kong
5	Reserve Bank of India	100,800	India
	Total	1,018,845	
Insurance companies			
1	Samsung Life Insurance	68,817	South Korea
2	Life Insurance Corporation	53,975	India
3	Cathay Financial Holding Company	43,413	Taiwan
4	China Life Insurance	30,535	China
5	Kyobo Life Insurance	25,580	South Korea
	Total	222,320	
Official institutions			
1	Chunghwa Post	106,287	Taiwan
2	Government Investment Corporation	100,000	Singapore
3	National Agricultural Cooperative Federation	76,739	South Korea
4	Public Capital Management Fund	52,694	South Korea
5	Brunei Investment Agency	45,000	Brunei
	Total	380,720	
Pension funds			
1	National Pension System	101,994	South Korea
2	Employee Provident Fund	56,097	Malaysia
3	Central Provident Fund	53,608	Singapore
4	Provident Fund Schemes	22,604	India
5	National Social Security Fund	14,516	China
	Total	248,819	

Source: AsianInvestor 150

including money from public funds, the postal system, financial institutions, retail funds and private investors. The mutual fund industry is also enormous, with about \$341 billion under management, though this figure has been on a steady decline for the past three years. Zero interest rates and falling equity markets have made it tough for asset managers to make money and investors have become disgruntled with returns. For institutional money managers these poor conditions mean corporate and public pension funds are grossly underfunded.

The safekeepers

Asia's growing asset pools have understandably attracted a number of institutions willing to offer trade processing and safekeeping services. In mature markets like Australia and Japan, foreign banks compete head to head with a strong contingent of domestic banks for the job of safekeeping cross-border assets. But in other, less

developed markets, there are about half a dozen key global custodians vying for cross border business (see table showing Asia's dominant custodians).

Over the years, these custody banks have consolidated their positions with several mid-sized operators bowing out of the trade. Each time such a merger occurs, the incumbent banks become more profitable and build larger barriers to entry for incoming players. In 2003, State Street surpassed its long-time rival Bank of New York to become the largest global custodian with the acquisition of Deutsche Bank's global custody assets. While this purchase didn't have a huge impact on State Street's business in Asia, acquisitions like this do make a difference to clients who have fewer providers to choose from every time one gets gobbled up.

The strategies employed by the various global custodians operating in Asia depend partly on their



origins as safekeepers and partly on mission statements handed down from global headquarters. Northern Trust's mandate, for example, is to focus purely on generating business from the government and pension segments, while Bank of New York has built its global franchise around institutional banking products such as cash and trade, and a very large depository receipt management business. Others have their origins in commercial banking such as Citigroup, while others have bought into the custody business as the result of an acquisition such as JPMorgan. Almost all of them now also operate funds management arms, though any doubts about conflicts of interest are met with claims that the banks keep their asset management divisions and custody divisions separated by Chinese walls.

Asia's global custodians are supported by a network of sub-custodians which provide local settlement and clearing in each domestic market. In Australia and Japan, domestic banks tend to be the first choice of service provider, but in other developing markets the global custodians use one of four regional players: HSBC, Standard Chartered, Citigroup or Deutsche Bank.

A quick review of the largest custody players in Asia reveals the following:

Bank of New York is a brand synonymous with global custody and has been active in Asia since 1958. Globally, Bank of New York has \$7.9 trillion in assets under custody, with \$2.2 trillion of this in cross-border assets. About 10% of these cross border assets are sourced in Asia where the bank has \$206 billion under custody from local clients with the bulk of this coming from banks, trust companies and central banks. Insurance companies also represent a reasonable portion of sourced assets followed then by mutual funds and investment managers, pension funds and broker dealers. In 2002, Bank of New York developed a daily net asset value calculation capability in Asia, designed to satisfy the needs of its client Great Eastern Life Assurance Company in Singapore. One of the bank's biggest Asian markets is Japan where Bank of New York was the first global custodian to receive approval from the Bank of Japan as a foreign indirect participant to BoJ's book entry system. This approval enabled the bank to offer eligible clients the ability to open tax-exempt accounts for their JGB holdings. Bank of New York is also a large securities lender with a speciality in

fixed-income assets. It has a global lending pool of over \$850 billion in assets where between \$185 billion and \$195 billion are outstanding daily.

Citigroup holds cards in two games – global custody and sub-custody – which both fall under the bank's global transaction services business. In Asia, the bank manages \$143 billion in third party global custody assets and in the year to September 2003 experienced a 23.4% growth in assets, making Asia one of the fastest growing regions for the bank. Within Asia, Korea and Taiwan were its fastest growing markets, though the bank sources assets from 15 countries. Citigroup custody uses Hong Kong as its base where it runs both an operations and customer service centre. The bank's clients initiate transactions, receive reports and make enquiries through CitiDirect for

Clients have fewer custodians to choose from as they get gobbled up

Securities, an online platform. Unlike other global custodians, Citigroup acts as its own sub-custodian in the region, using its proprietary branches to process and settle transactions. But the bank also handles domestic settlement for third party clients, specifically broker/dealers, and in 2003 picked up 27 new sub-custody accounts with its fastest growing markets being Hong Kong and Australia. It was one of the first to receive a QFII custodian licence from the Chinese government and settled its first transaction for a foreign client on the Shanghai Stock Exchange in July 2003. Citigroup has been increasing its revenues through the provision of fund administration, securities lending and compliance monitoring.

HSBC plays only in the sub-custody space with offices and local representatives in 16 Asian markets. In 2003, the bank grew its asset book by 20% to over \$300 billion in Asian-sourced securities with about 200 new institutional mandates across its regional network. About 80% of this is third party business. Its largest sources of growth last year were China and Japan. HSBC has been quick to move on China where last year it was appointed the QFII custodian bank for three large broker/dealer and global custodian clients. The bank's sub-custody division uses its influence in China to lobby the government and shape the guidelines for the country's institutional funds management market. It successfully lobbied for securities settlement to be moved from T+0 to T+1 and has been working with the CSRC and CSDCC to promote an agreed error-rectification procedure for QFIIs. HSBC has more than 900 staff across its Asian



network, with 690 of these people based in the bank's top 10 local markets. The bank acts as both agency and principal in securities lending transactions and has been expanding its suit of ancillary securities products targeted at issuers such as local depository services for ADRs and global deposit issuers, and escrow services.

JPMorgan re-entered the world of custody in 2001 following its purchase of Chase Manhattan Bank having originally sold its custody business to Bank of New York in the mid-1990s. Following the merger with Chase, the business was rebranded JPMorgan and the bank now holds a dominant position in the Asian market looking after approximately \$337 billion in assets under custody. JPMorgan sources third party assets from 12 countries in Asia with Greater China and India providing the largest growth in recent years. The bank does not handle broker/dealer business and in 2003 achieved about 10% of its asset growth from new clients with five notable wins from insurance and bank customers in Korea, Thailand and India. In the past 12 months the bank has rolled out transition management services in the region and was appointed by a Taiwanese client to restructure a significant portfolio of funds. Unlike its global custody peers, JPMorgan manages its own local clearing and settlement in Australia and Taiwan, the result of legacies in these countries. In other countries, the bank uses four main sub-custody providers. JPMorgan is also known to offer the best supply of lendable securities in the region.

Northern Trust is a niche player in Asia's global custody market, concentrating its efforts on Singapore and Hong Kong where it has established a local presence. But the bank is now positioning itself for emerging opportunities in China and surrounding countries. At the end of September 2003, Northern Trust had \$52.7 billion in assets under custody from Asia-based third party clients, an increase of 18% on the same period the year previous. About 94% of the bank's assets under custody come from the government and pension segments with the bank having a stated policy not to solicit business from broker/dealers and domestic retail mutual funds. Northern Trust is also a dominant securities lender in the region. Globally, the bank has \$584.1 billion in lendable assets, while in Asia it manages a pool of \$22.4 billion with more than 20% of these securities on loan at any one point. Customers can check global availability of securities first thing in the morning Asia-

time using a new server-based securities lending system that Northern Trust introduced in 2003. Northern Trust uses its pull in the business to influence regulation and has been instrumental in forming new securities lending rules in Korea and Taiwan.

Standard Chartered is another dedicated sub-custodian and regularly competes head-to-head with HSBC for institutional mandates around the region. The British bank claims to have a 25% plus share of the market in Asia. Towards the end of last year, Standard Chartered tallied a total of \$172 billion in third party assets under sub-custody with \$14.7 billion of these in local assets and the rest cross border. Most of its growth in the last few years has come from new mandates with its biggest growth markets being Korea, India, Japan and Taiwan. In March 2003, the bank was granted a licence to offer securities and cash clearing services to QFIIs in China. Standard Chartered has 400 staff servicing its sub-custody clients in Asia from 16 different locations. It processes cash and foreign exchange transactions for customers from its shared service centres in Malaysia and India. In the past 12 months, the bank has completed the roll out of its browser-based front-end system called i-custody which is designed to increase straight through processing rates for securities related transactions and thereby reduce failed trades and processing costs. Standard Chartered is now working

on a corporate actions monitoring system to give subscribers fast, accurate and complete corporate action information for the leading market index counters in Asia's key markets. The datafeed for this system is fully SWIFT compliant.

**Five main
global banks
vie for custody
business in Asia**

State Street took custody of its first mutual fund in 1924 and now, with the acquisition of Deutsche Bank's global securities services business completed in January 2003, has about \$9.4 trillion in assets under custody. In Asia, the Boston-based bank has a local presence in Hong Kong, Japan, Korea, Singapore and Taiwan and sources third party assets from 18 markets. In 2003, State Street picked up \$57.3 billion in custody assets over the 12 months period, made up of incremental business and 35 new client relationships. This brings the value of its total Asian book to \$363 billion. Its best performing markets for the period were Korea and Taiwan. The bank touts its investment in technology and last year dedicated \$550 million of its operating expenditure to building systems. It is in the process of introducing a new online information



Asia's dominant custodians

Bank	Assets under custody globally (\$ trillion)	Assets under custody Asia (\$ billion) (% of these assets that are third party)	Growth in Asian assets (2002 – 2003)	Asian market coverage	Fastest growing Asian markets
GLOBAL CUSTODIANS					
Bank of New York	7.9	206	NA	NA	NA
Citigroup	5.7	143 (100%)	23%	15 markets	Korea and Taiwan
JPMorgan	7.6	337 (100%)	36%	10 markets	China and India
Northern Trust	2.2	52.7 (100%)	18%	NA	Hong Kong and Singapore
State Street	9.4	363 (99.8%)	81%	18 markets	Korea and Taiwan
SUB CUSTODIANS					
Citigroup		436 (100%)	29%	14 markets	Hong Kong and Australia
HSBC		300 (80%)	20%	16 markets	China and Japan
Standard Chartered		172 (100%)	37%	15 markets	Korea, India, Japan and Taiwan

Source: Various banks Note: figures at end 2003

delivery system for its Japanese clients. The system is designed for non-SWIFT users who want real-time transmission of trade instructions in a secure and authenticated environment. The bank is making the same technology moves in China where in August 2003 it signed an agreement with Zhejiang University Innovation Technology Company to develop IT solutions for China's financial services industry. State Street's vanilla custody business is supported by other products including securities lending, fund administration and transition management.

Other players

There are other custody banks in the market whose presence is either small or in a nascent phase, but there are also some notable exceptions. **Mellon**, for example, is a big performer on international league tables with just under \$3 trillion in custody assets, but doesn't have a presence in Asia. While the Boston-based bank has signed a global custody alliance with **ABN AMRO**, the tentacles of this business do not reach as far as Asia. The Dutch bank operates as Mellon's sub-custodian in Indonesia and India but is not performing any local activities under the alliance. **Deutsche Bank** once had a global custody franchise in the region, but this was sold to State Street as part of a worldwide deal in November 2002. Surprisingly, Deutsche Bank decided to hang on to its sub-custody businesses in Asia and Europe. The retention of these businesses was painted as a strategic move by the German bank, but there are others who say that the sub-custody clients were carved out of the sale because they were not of interest to State Street.

Either way, Deutsche is still operating as a custodian in the region. **Brown Brothers Harriman** is another large global player with \$950 billion under custody around the world and a comparatively high proportion of these generated from Asia-based clients – \$125 billion. It has offices in Hong Kong and Tokyo and sources cross border business from several other countries. At the sub-custody level there is, of course, Deutsche Bank but also others with niche offerings. **ABN AMRO** provides sub-custody services in India, Indonesia, South Korea and Taiwan – operations that were established between 1996 and 1998. Its dominant market is Indonesia where the bank has a long commercial history and ABN AMRO is the only foreign bank selected as a payment bank for the Jakarta and Surabaya Stock Exchanges. In Singapore, foreign sub-custodians compete head to head with **DBS** which has a dominant position in the safekeeping of local mutual fund assets but also a number of key global custody clients. The domestic custody business in Japan is still very much controlled by local banks. Foreign banks like HSBC and Citigroup are working hard to penetrate this market but meantime global custodians are holding their accounts with the likes of **Mizuho**, **Bank of Tokyo Mitsubishi** and **Sumitomo Mitsui Banking Corporation**. Similarly, in Australia local banks play a dominant role in domestic custody. **ANZ**, **Westpac** and **National Australia Bank** have significant custody divisions, with National Custodians being the largest in the country in terms of assets. Commonwealth Bank was also in the game until mid-2003 when it sold its A\$75 billion book of assets to Citigroup. ■



Chapter 2

Outsourcing: the way forward

While the safe-keeping of assets and trade settlement remain the core focus of custody banks worldwide, such tasks are now considered plain vanilla services and are not enough to sustain a viable business. Custody banks are under constant threat of tighter margins on traditional products and consolidation of industry players. And banks in Asia are not immune to such threats. Banking liberalization in Japan, for example, has seen 20 or so big banks, insurance companies and trust banks reduced to five major groups. The Australian market too has seen a number of players bow out (most recently CBA), though there is still fierce competition in this market with between five and seven banks bidding for each piece of custody business.

These competitive factors have led many banks to offer new value-added services such as cash management, securities lending, compliance monitoring, risk management, proxy voting and corporate actions. So far, the diversification strategy has worked and the increased profitability of banks in recent years is some indication that these higher-margin services are paying off. The latest value-added offering is back and middle office outsourcing which custodians have identified as a business with substantial growth prospects (see table showing outsourcing revenue).

The outsourcing trend started in the US and Europe about three years ago when four large contracts were signed including: BoNY's contract with Julius Baer, the Swiss private bank; State Street's contracts with PIMCO and Scottish Widows Investment Management; and JPMorgan's contract with Schroders, the UK fund manager. The successful implementation of these relationships has encouraged others to sign deals.

Just what functions are being outsourced depends on the perceived or real benefits to the client and their

familiarity with using third party providers. It also depends on external factors like the relative maturity of the market and trading conditions such as settlement cycles and market automation. There is still some confusion, however, about what services are categorized as back office and what services are characterized as middle office. (Most agree that proxy voting and corporate action services are now considered mainstream custody products, as are transfer agency services and member record keeping at the retail end of the market.)

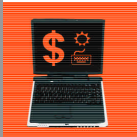
In its simplest form, back office outsourcing includes fund accounting and fund administration services. Fund accounting covers security pricing, general ledger bookkeeping, NAV calculation, data distribution, reconciliation, and daily, monthly and ad hoc reporting. Fund administration covers statutory reporting, tax, compliance and performance measurement. "Back office outsourcing contracts vary by degrees based on a client's willingness to let go of the accounting process," says Graeme Arnott, head of investor services at JPMorgan in Sydney. "It starts with basic NAV calculations followed by



Graeme Arnott

monthly accounting and then on to full-blown annual auditing. Ultimately all record keeping and accounting for individual fund vehicles is handled externally, meaning that a fund manager has no need to employ any accounting staff, other than one or two people to look after the management of the company as a corporate entity." Arnott says back office services in Australia have recently extended to include multi-class pricing across the different categories of units within a fund. In most cases, back office outsourcing contracts are signed with the bank that also has custody of a fund's assets.

Middle office outsourcing is different in that the third party provider does not necessarily retain custody



of the assets. Broadly defined, middle office outsourcing covers trade matching and confirmation which involves establishing interfaces and maintaining links between brokers and custodians. It can also cover cash flow forecasting and cash position reporting. "There are also certain performance services which can be defined as middle office," says David Travers, head of investor services for the Pacific region at State Street. "These functions occur pre-trade and involve providing fund managers with immediate feedback on whether a trade that they want to make is in compliance and analyzing what sort of impact it will have on a portfolio."

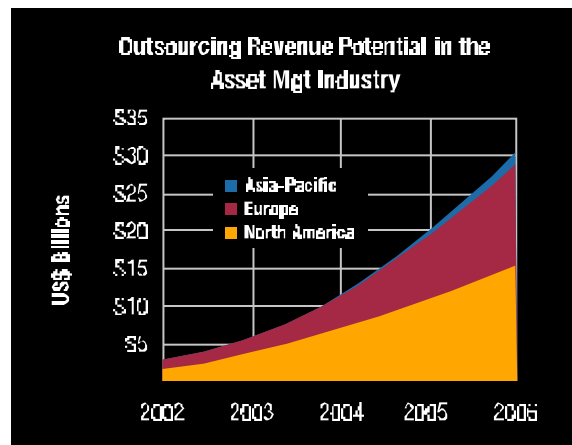
In many countries, middle office outsourcing has been driven by the shift to shorter settlement cycles. Unwilling to invest in new technology that will improve straight through processing, fund managers choose to outsource trade matching and confirmation to a third party. According to a research report compiled by Omgeo in October 2003, 89% of fund managers in Asia that still operate in a manual environment are considering adopting STP solutions in the near future. When questioned, however, few are prepared to spend a lot of money on the process. This raises questions about whether market participants are really committed to increasing same day affirmation rates (SDA), a simple measure which reduces a fund's risks and lowers operational costs. While SDA rates are relatively high in markets like Singapore and Hong Kong - due to the number of block trades conducted - most other Asian markets need improvement.

Trends in Asia's major markets

Back and middle office outsourcing in Asia is still very much in a nascent phase. While fund administration for unit trusts is reasonably commonplace, there are only a handful of examples where large institutional money managers have handed over their back office. And custodians say they are now prepared to start talking to clients about outsourcing options, though the proposition very much centres on the back office, not the middle office.

A review of specific markets in Asia turns up the following:

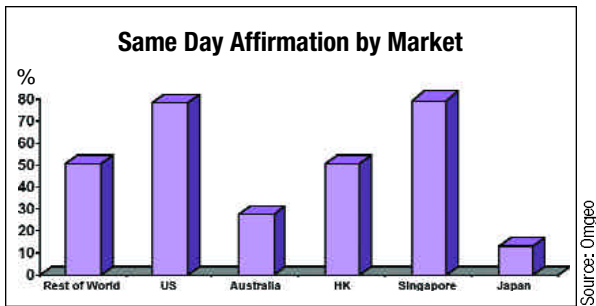
Australia is by far the most advanced country in Asia in terms of outsourcing. One figure has about two-thirds of the country's funds under management being administered by third parties. And the arrangements cover the middle office too where shorter settlement cycles have led asset managers to outsource their trade matching and confirmation to external providers. The trend leaders have been the insurance companies with the likes of AMP, Zurich, Norwich and



AXA all outsourcing the administration of their investment funds. On the service provider side, JPMorgan, State Street, BNP Paribas, Royal Bank of Canada and National Custodians are active in the market. Though these providers don't necessarily touch the retail end of the game.

The challenge for Australia's third party providers is to convert the remaining one-third of funds under management, though the full outsourcing of all assets is unlikely while Colonial First State, the country's biggest manager, remains committed to keeping its back office in-house. Travers at State Street says the fact that outsourcing isn't necessarily going to save managers money may be one reason why the stragglers are not converting. "The bear market of recent years has had fund managers looking for ways to cut costs, and outsourcing the back office gives results if it is aligned to other strategic priorities," he says.

Japan is a highly local market where 84% of trades are domestic. It is also a manual market where a lack of local industry standards has resulted in a hesitance in embracing automation. Though, the sheer size of the Japanese asset pool (approaching \$2 trillion under management) makes it a prime target for future outsourcing. Japan has the large asset managers, insurance companies and trust banks that other markets in Asia lack. To provide outsourcing services, third parties must have a trust bank licence which pitches local players like Mitsubishi Trust against a handful of foreign entities such as NikkoCiti Trust. The latter joint venture between Nikko Cordial Group and Citigroup was formed in 2001 to provide trust and fund administration services to clients. The entity now has a couple of customers on its books including CSFB. More recently, local master trust banks such as Trust & Custody Services Bank (TCSB) and Master Trust Bank have signed outsourcing contracts with companies in



the insurance sector. In most cases, these deals operate as lift outs where the banks are supervising processing staff on site at the investment manager's premises. Other global custodians operating in Japan without trustee licences are known to be supporting global outsourcing contracts attached to their cross border custody relationships. "Japan is a developing market," says Andrew Gordon, who oversees custody for Bank of New York in Asia. "The examples of outsourcing that currently exist don't follow the models established in the US and Europe, but they suit local needs adequately enough. The Japanese trust banks are certainly very familiar with the regulatory environment and can offer good advice on meeting reporting requirements, but they don't necessarily lead with first-class back office processing technology."

Hong Kong's outsourcing market is still very much focused on providing local unit trusts and Mandatory Provident Funds with trustee, transfer agency and member record keeping services. And in this segment there is one dominant player, HSBC. The Hong Kong bank's position was strengthened further by the purchase in October 2003 of Bank of Bermuda, the number two player in the market. Post merger HSBC claimed that it would control less than 50% of the MPF trust business in Hong Kong, but take into account other services and the combined entity touches some 80% of all MPF funds. The low-fee high-technology nature of MPF administration has meant that other custody banks have been reluctant to get involved in the sector. But, with the Bank of Bermuda purchase, HSBC is now competing with other custodians for a slice of the offshore funds business too. Many of the funds traded in Hong Kong are registered in markets like Luxembourg and Dublin, and this is the fund segment that is recognized as having outsourcing potential. Bank of New York, Citigroup, JPMorgan, State Street and Standard Chartered are all touting for business in Hong

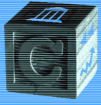
Kong now. So far, however, the Hong Kong based institutions which manage unit trusts or discretionary mandates registered in these jurisdictions are still handling back office tasks in-house, says Leow Chong Jin, chief executive for Asia investor services at State Street. "Most of the mandates that have been awarded are for the smaller unit trusts," he says, adding that, "if a fund is registered offshore then the regulations usually require that it be administered offshore too which is why the global custodians with offshore centres are lining up to administer these funds."

Singapore, like Hong Kong, is a regional trade hub with 77% of all trades transacted cross border. But again, the outsourcing market is limited to locally registered unit trusts, with HSBC (via Bank of Bermuda) and Dexia Fund Services having the biggest footprint. Like Hong Kong, global custodians have recognized the potential of the market and are now targeting their outsourcing offerings to larger fund managers and the insurance sector. There have been some developments in this arena with Deutsche Asset Management appointing State Street to administer its funds in line with a similar deal struck in Australia. Likewise, the insurance company Great Eastern Life uses Bank of New York for fund accounting services as an adjunct to its custody relationship.



Leow Chong Jin

Korea and Taiwan also present some opportunities to foreign firms looking to build outsourcing businesses. Administration of locally registered and invested funds in these countries is still very much controlled by local providers, though HSBC recently bought a majority stake in AMTeK, the Korean administrator with \$24.5 billion in unit trust and mutual fund assets on its books as at mid-2003. State Street also struck a deal with the fund administration arm of Korea Exchange Bank in February 2001. Though the memorandum of understanding between the two has been rehashed, toning down State Street's commitment due to concerns about management control and exposure. In an unrelated deal, State Street was awarded the global custody mandate for the offshore investments made by the National Pension Corporation, though, to date, this remains a pure custody relationship. Leow at State Street says outsourcing opportunities in Korea and Taiwan will grow as fund managers start to invest offshore. "A high percentage of assets in these markets are invested locally but there has been a move in recent years for fund managers to go offshore and this will give custodians a chance to offer up their back office services." ■



Chapter 3

Building an outsourcing business: Global and regional custody strategies

With the benefits of outsourcing now well documented and a number of successful relationships operating in the industry, global custodians are looking at how to crack the Asian market. Each of the large active custodians in the region has a strategy – a strategy dictated by the relative maturity of each Asian market and the regulations under which global custodians operate in those markets.

Outsourcing is likely to follow the same natural evolution that it has in the West, starting first with basic fund accounting, then moving on to more complex back office services like regulatory reporting, then performance attribution and finally middle office services like trade matching. Similarly, clients will be targeted based on their size and sophistication. Sizable asset managers tend to be limited in Asia, says Andrew Gordon who runs Bank of New York's custody business for the region. "The outsourcing deals that have been struck in the US and Europe have involved the administration of tens of billions of dollars. There really aren't that many ready clients in Asia with that kind of scale." Still, most custodians say they are targeting global fund managers, pension funds, offshore funds and insurance companies for their outsourcing services.

For the moment, domestic unit trusts in markets outside Hong Kong and Singapore are largely being serviced by local fund administrators. Though there are some global banks that have made a move into this space. HSBC recently acquired the dominant Korean administrator, AMTeK, for example, and State Street has a three-year-old alliance with Korea Exchange Bank though this agreement has been rehashed, toning

down State Street's commitment.

The other potential target is hedge funds – a business currently dominated by specialist administrators such as Citco, Fortis and Bank of Bermuda (recently bought by HSBC). Not all banks are prepared to tackle this market, however, due to the small start-up nature of many hedge funds and the different methodologies used to reach valuations. The other drawback is that the custody of hedge fund assets tends to sit with prime brokers requiring outsourcers to set up communication links with these firms and likely precluding them from ever gaining the custody business.

For now, the most interesting question facing custodians that want to enter the outsourcing business is, where will the outsourcing deals be struck? Deutsche Asset Management's arrangement with State Street in three markets – Australia, Singapore and Japan – is a case in point. While the decision to



Laurence Bailey

mandate one outsourcer offers the fund house some consistency in terms of service, Deutsche's satellite offices apparently struck each of the deals independently based on their local needs and State Street's stated capabilities in each market. Custodians say that since the satellite offices of global fund managers tend to run their own P&Ls, the relationship must achieve cost efficiencies at a local level.

Where deals are struck also depends on whether the mandate covers back office or middle office functions. Back office services are usually performed in the country in which the fund is domiciled – such as Dublin or Luxembourg for a lot of offshore funds sold to Asian investors – while middle office services are performed in the market where the investment decisions are made.



Pricing for outsourcing services is usually structured on a fee-for-service basis with some compensation for the size of assets under the arrangement. As new services are offered, new fees are charged, so there is not a lot of evidence of service bundling to date. What is becoming evident is the role that gatekeepers are playing in setting pricing and managing the pitching process. Mercers and Watson Wyatt are both active consultants in this field now.

Custodians say the biggest challenge in setting fees is pricing in liability risks while convincing the clients that they are getting value for money. While sophisticated clients appreciate that outsourcing is about more than just reducing headcount, most expect that their costs will be reduced over time. Managing a client's expectations in terms of cost savings is all part of the client education process.

The most lucrative deals are those where the service can be standardized. While messaging protocols such as SWIFT help to standardize communication and information feeds, clients usually require customized reporting based on how a fund has been structured, the valuation rules set by trustees and what the underlying investors want in terms of data and reports. The key to reducing the cost of customization is to ensure the integrity of the data and that core products are being updated, says David Travers, head of investor services for State Street in the Pacific. "We have about 15 core global products in our outsourcing tool shed which we spend a lot of time and energy updating. We find that if the global products remain relevant then adding local elements to them is not difficult or expensive."

A quick whip around Asia's global custodians reveals that most have developed a strategy for offering outsourcing services to local clients.

JPMorgan is a dominant outsourcer in Australia and is now providing fund accounting services to clients in other markets such as India, China, Taiwan, Hong Kong, Singapore and Malaysia. These clients are typically cross border investors in the bank, pension funds or insurance sector. "At the moment we don't do any real local business in Asia except in India and Australia," says Laurence Bailey, JPMorgan's head of investor services for the region. "But we definitely want to become a key fund administrator in the pension fund and insurance markets in each location.

State Street is also a key provider of outsourcing services in Australia, has a fund accounting operation

in Japan and acts as trustee and funds administrator for the Hong Kong government's \$4 billion Tracker Fund. So far the bank has yet to replicate these businesses in other markets but it is gearing up to do so. "We want to get into funds administration for authorized funds," says KK Tse, executive vice president of State Street for Asia Pacific. "We have capitalized our Hong Kong trust company so that we can roll out a trustee business in Hong Kong and then we will look at Singapore.

Bank of New York expects a lot of its global outsourcing mandates in the US and Europe will lead to incremental business in Asia. Gordon, the firm's regional head, says the bank is focusing on Hong Kong and Singapore initially, providing fund administration services to mutual funds and unitised products.

These global custodians compete for funds administration business with regional sub-custodians such as HSBC, Standard Chartered and Citigroup. HSBC is already providing fund administration services to domestic funds in Malaysia, Indonesia, India and Korea, and is servicing offshore funds in Taiwan. Its purchase of Bank of

Bermuda has given the bank the impetus to grow market share in servicing offshore funds such as those domiciled in Bermuda, Luxembourg and Dublin. Bermuda has also added hedge fund administration to HSBC's line up.

Despite having sold its fund administration business in 1993, Standard Chartered is ramping up again. It started offering fund administration services in Hong Kong and Singapore about two years ago and this year picked up its first two customers in Indonesia. "At the moment we are mainly targeting small to medium sized boutique fund managers and non-bank financial institutions like insurance companies," says Paul Hedges, the bank's global head of securities services sales.

Citigroup has an alliance in Australia, but also does trustee work, fund accounting and compliance monitoring in markets like Japan, Singapore, Hong Kong, Korea, India and Thailand. Citi's acquisition of Forum Financial Group at the end of last year has reinforced its commitment to the funds administration business in the region, says John Keffer, the former CEO of Forum and now president of Citigroup Fund Services. "We are looking at extending our trust business and our transfer agency operations in places like India and other Asian markets undergoing pension fund reform," he says. ■



Paul Hedges



Chapter 4

Case studies

The value proposition for fund managers

Four years ago there was talk of little else than a swift trend towards outsourcing. It was widely predicted that fund managers, facing growing pressure to deliver good investment returns for their customers, would choose to outsource everything that was peripheral to their core task of picking the best stocks. As it turned out, the speed of adoption was slower than expected as fund managers took a wait-and-see approach, watching to see how a handful of large outsourcing contracts signed in the US and Europe were managed over a period of a year or two.

Outsourcing requires a leap of faith from fund managers who understand the customer-sensitive nature of operating efficient back and middle office processes. End investors now want daily reporting on their investments and providing this in a timely and accurate manner is critical to keeping them happy. With the success of the first big outsourcing contracts now recognized, some of the anxiety that existed around letting go has evaporated. The wait-and-see club has been satisfied. The importance of peer approval is evident in Australia where adoption rates have increased incrementally as fund managers have watched other firms set up successful outsourcing arrangements.

So far, a lot of deals have been lift outs where the custody bank employs the back/middle office staff of their new client, takes over the systems and often operates out of the fund manager's own premises for a period. Alternatives models to this are: a business service provider where the outsourcer uses its own people and technology to support its clients remotely;

or an application services provider where the outsourcer hosts the applications that are run by the fund manager's own staff.

Fund managers choose to outsource their operations for several reasons, not least to improve efficiencies. Oddly enough a survey of European fund managers conducted by McKinsey & Company in 2003 found that small firms – with assets in the range of €44 billion – were the least efficient and spent more money on back and middle office processing than small or large firms (see table showing asset managers' cost base).

Graeme Arnott, head of investor services at JPMorgan in Sydney, says the catalyst for outsourcing is usually a need to spend money on updating technology. "Firms that have been running in-house legacy technology usually get to a point where their entire system needs overhauling to cope with increased volumes and to improve processing speeds," says Arnott. Other catalytic events leading to a decision to outsource can be a change in accounting standards, the introduction of a new tax, or milestones like the millennium bug, all of which require upgrades to accounting technology.

While it is said that fund managers choose to outsource so that they can focus their attentions on core competencies, Arnott says this is often more of a benefit than a trigger. "The other misconception is that outsourcing saves money when experience shows that, dollar for dollar, this is unlikely. The difficulty here is that fund managers are only looking at their variable costs, like staffing, when they calculate what it costs to run their back office. They don't factor in the historical investment

Asset managers' cost base (€ million per year)				
Firm size	AUM	Front office costs	Middle office costs	Back office costs
Small	€11 billion	6.0	3.7	1.9
Medium	€44 billion	5.3	5.0	2.6
Large	€102 billion	4.9	2.4	1.4

Source: McKinsey & Company 2003



Case study:

Portfolio Partners Limited (PPL)

Assets under management: A\$7.5 billion

Outsourced services: Custody, fund accounting, statutory accounting, unit pricing, tax reporting, trade matching.

Outsource provider: JPMorgan

Portfolio Partners Limited (PPL) is a Melbourne-based manager of unit trusts and is owned by the UK's Morley Fund Management, the asset management arm of Aviva plc. Portfolio Partners has been outsourcing several of its back and middle office functions since 1996 in a contract signed with Royal Bank of Canada to cover unit pricing, tax and regulatory reporting and trade matching. At the same time, the statutory funds operated by Aviva Australia have been administered by JPMorgan through an historic relationship with Bankers Trust.

PPL is in the process of shifting its outsourcing account to JPMorgan – a move that mirrors an initiative by Morley to consolidate its relationships and use a single global outsourcer. “Switching to a single provider of back and middle office services will streamline our processes and cut down on communication time,” says Tony Burrill, director of operations at PPL. “Once the transition is complete our business analysts will only have one set of business rules used to import and export files and write our client reports. It will save time and money.”

Burrill says while the consolidation initiative will see all Morley entities using the same outsourcer, the decision to switch to JPMorgan in Australia was driven at a local level. “The group operates a federation model where local management is given the autonomy to make decisions that best suit their local businesses. We would not have considered switching to JPMorgan if they hadn't offered a superior service.” Burrill admits, however, that operating on the same platform as the UK will be

beneficial. “We manage the Australian equity allocation for Morley's portfolios, so having a single back office provider will streamline the process of reporting into the UK.”

PPL's experience with outsourcing has been positive and has given the firm the opportunity to focus on developing technology to support front office functions. “By outsourcing our back office and some of our middle office functions, we have been able to redirect energy and spend to areas which help us to generate investment performance – in other words, areas of core focus,” says Burrill. “In the last three years we have implemented a new unit registry platform and we are now in the second phase of enhancing the front office system used by our investment professionals.”

The decision to outsource middle office functions such as trade matching was made when the Australian markets moved to a T+3 settlement cycle. Outsourcing meant that the responsibility of trade confirmation fell with the custodian, reducing the number of parties involved in the settlement process and ensuring that instructions were received on time.

Burrill says the advantage of outsourcing corporate actions is that all information is collated in the one area by staff specifically skilled in this field. “It is also a cheaper option because corporate action systems can be costly to maintain and keep up to date with market changes. Proxy voting poses a problem purely in relation to timing. The more parties involved in the process means shorter time frames for fund managers to determine their vote.”

PPL is now considering outsourcing some of its performance measurement functions. “We are talking to JPMorgan about the benefits of such a service,” says Burrill. “As with all things related to outsourcing, it is important to keep the lines of communication open with your service provider. This ensures that the relationship is working and gives you an opportunity to explore ways of expanding it.”

they have made in systems, or the cost of making mistakes. Outsourcers include these indirect costs in their fees which is why the first part of the outsourcing process is to educate fund managers about the real costs of running a back office before we present them with our fee schedule.” Arnott says ultimately the value proposition for fund managers is to have a system that is more robust, easy to upgrade and less prone to mistakes.

Boutique or hedge funds are driven to outsource by different events. These funds are often start-ups and

choose to outsource as an alternative to establishing capabilities in-house. The challenge here is maintaining the delicate balance between paying for support and keeping the fund ticking over until it starts to make money. “The amount of money a start up hedge fund has for management expenses is pretty small,” says a hedge fund incubator in Hong Kong. “If they get the wrong cost model from an administrator in the beginning it can prevent a fund from ever succeeding. More than a few start-ups have failed because they have



Case study:
Deutsche Asset Management Australia

Assets under management: A\$16 billion

Outsourced services: Custody, fund accounting, fund administration, tax reporting, unit pricing, unit registry, regulatory reporting, trade matching and routing, custodian reconciliation, corporate action processing, performance reporting and accounting.

Outsource provider: State Street

Deutsche Asset Management Australia Limited (DeAM) appointed State Street as the provider of DeAM's middle and back office administration services in September 2003. Under this agreement, State Street provides a set of services for A\$16 billion of DeAM Australian assets under management for their local unit trust and segregated mandate business.

The services include domestic and global custody, fund accounting, fund administration, tax reporting, unit pricing, unit registry and regulatory reporting for DeAM's back office function, as well as trade matching and routing, custodian reconciliation, corporate action processing, performance reporting and accounting for the manager's middle office.

To achieve the most efficient back and middle office model, State Street recommended a "lift out" of DeAM's processes to

create a single operating model within State Street. This involved Deutsche's middle office staff being employed by State Street to continue to operate the existing systems while remaining within the fund manager's premises – the idea being that this would minimize disruption to DeAM's front office staff and clients. State Street will migrate to its internally developed middle office systems, procedures and premises over the next 12 months.

The aim of the deal is to give the Australian division of DeAM access to State Street's global outsourcing model while providing some consistency and ability to integrate with other DeAM/State Street outsourcing arrangements from around the world.

The Australian deal coincided with the signing of a similar contract in Singapore, where State Street has been contracted by the Singaporean office of DeAM to provide similar custody and administration outsourcing arrangements to the Australian model. It is expected that other countries across the Asia Pacific will adopt the same model over time – again with the view to applying a consistent approach to meeting DeAM's middle and back office outsourcing needs.

While the regulatory and business environment in each country will necessitate some degree of customization for each DeAM business, introducing State Street's global operating environment to the region will derive opportunities for each country to leverage off a single and consistent approach.

got their management expense ratios wrong." For these reasons, hedge funds and boutiques tend to buy fairly basic outsourcing packages that aren't easy to customize.

Getting an outsourcing relationship right comes down to ensuring that both parties are clearly aware of what can be achieved through the partnership. Fund managers need to be prepared to break with their heritage systems and be flexible about what they receive. A flexible approach will often lead to the fund manager being pleasantly surprised at how the data being warehoused by custodians can be sliced and diced in so many ways – providing valuable historic analysis of a fund and helping to dictate future strategies.

The value that can be gained from an outsourcing relationship tends to be incremental with the number of functions that are farmed out. Outsourcing relationships tend to start with one or two services and then grow from there, though there are some practical considerations to contemplate when deciding what to let go of. Fund families can have complicated cross holdings which makes preparing speedy NAV calculations difficult unless the third party has access to information – one reason why a lot of contracts cover a full fund family rather than single funds. The other clear trend in the evolution of outsourcing

relationships is that they usually start with back office and then graduate to middle office services. The true value of data warehousing becomes apparent when a relationship has matured beyond a single service or a single product set.

Selecting a provider is a matter of shopping around and, in some cases, conducting a detailed RFP process with the assistance of a gatekeeper such as Mercers or Watson Wyatt. Not all global custodians offer the same outsourcing services in each market – Bank of New York, for example, doesn't offer outsourcing in Australia even though the bank is an active custodian there. It is common for a fund manager to outsource their back office with their existing custodian, though there have been cases where a fund manager has switched banks in order to take advantage of outsourcing services. One of the risks for fund managers is that their service provider will be sold or acquired as happened when State Street purchased Deutsche Bank's custody business in 2002. In these instances, clients can end up renegotiating contracts with third parties and must dedicate resources to aid a smooth transition, ensuring that they are still getting the same level of customer support and reaping the same benefits that led them down the outsourcing path in the first place. ■



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Chapter 5

The right fit : Solutions for custodian banks and outsourcers

As custodian banks pursue new revenue streams as outsourcers of mid-back office functions, they are increasingly seeking strong partnerships with solution providers in order to ease their transition into these new businesses. In emerging markets like Asia, where outsourcing is still in its infancy, the risks of offering outsourcing services are many, not least the considerable upfront capital expenditure required. Whilst some investment managers may have survived for a while manually affirming and confirming trades by fax or email, outsourcing providers are expected to offer the very latest, best of breed straight through processing (STP) solutions that stand the test of time. Short-term, band-aid alternatives that require human intervention are unlikely to cope with high transaction volumes once an outsourcing business becomes established.

Finding the right partners to provide technology, data and know-how is key to offering a high quality outsourcing service. Omgeo is one company that comes to mind, as it is one of the few experienced firms in the marketplace to offer STP solutions to both custodian banks and outsourcers. The company not only excels in providing tailored solutions to the custody and outsourcing market, it also has strong relationships with US banks, Japanese trust banks, the International Central Securities Depository and, of course, the Depository Trust and Clearing Corporation, a joint-owner in Omgeo, along with Thomson Financial.

Omgeo can add value to both outsourcers and custodian banks by offering them services that enable them to enhance their competitive edge and service their own clients more effectively. For custodians, this is achieved by streamlining communication between themselves and their investment manager clients through Omgeo Central Trade Manager settlement notification functionality – quite a mouthful, but essentially this service allows the two parties to communicate electronically rather than by fax.

Custodians are also able to make significant leaps in the sophistication of their operations by standardizing their data management through Omgeo ALERT. Omgeo ALERT is a huge global database of standing settlement and account instructions (SSI). These services ensure custodians reach higher levels of operational efficiency that cannot be achieved with current fax distribution methods, which are prone to error and lead to increased cost and risk.

Outsourcing arms of custodian banks and outsourcing firms can also benefit. Through one pipe, outsourcers can manage trade matching for multiple clients globally and at the same time access the vast community of brokers that Omgeo has established.

For example, National Custodian Services (NCS), a division of National Australia Bank (NAB) and an outsourcer of back office processes to fund managers, recently signed up for Omgeo CTM settlement notification functionality. Their strategy in implementing Omgeo solutions is to aggressively grow its outsourcing services, streamline its processes and dramatically reduce the risk of settlement failure. Through the automation of its trade processing procedures – from execution right through to settlement – it is now able to eliminate the errors that manual trade processing can bring.

Richard Coia, manager of sales and marketing at NCS, explains: “We sought a scalable solution that enabled our outsourcing business to grow. Through Omgeo CTM we can offer greater value add to our clients and differentiate ourselves in the marketplace. Automation greatly minimizes the risk associated with manual trade processing, and brings improvements in efficiency, speed and security of execution.”

NCS is not alone. The outsourcing trend is growing, and in this chapter, we talk to Darryl Mueller, managing director of Omgeo Asia, about Omgeo’s partnership with the global custodian community and his thoughts on the current successes and challenges the industry is facing.



WORKING TOGETHER

Darryl Mueller is the managing director of Omgeo in Asia. As part of his role, he oversees some of the company's longest-standing relationships with custodian banks and outsourcing firms. Here he discusses some of the challenges facing banks and outsourcing providers and explains how Omgeo is partnering with the custodian industry to find solutions for these challenges.

Why are solutions for custodian banks an integral part of Omgeo's business?

Mueller: Custodian banks play a fundamental role in trade processing and therefore to our business. The old adage "you're only as strong as your weakest link" is key here - true straight through processing (STP) involves all parties to a trade, and the settlement piece is key. We are working closely with custodian banks to provide solutions that are truly "straight through", that is straight through to settlement.

How are the needs of custodian banks changing?

Mueller: On a broad level, we see three main areas of focus for custodian banks: the need for transparency, the search for scale and the evolution of the outsourcing business. Technology can help with all of these areas. Custodians are increasingly seen as impartial holders of data and are required by both fund managers and pension beneficiaries to deliver more data around settlement status. Traditionally sitting at the end of the trade settlement cycle, custodian banks are now getting involved in trades earlier in the cycle. As you can imagine, without robust, auditable systems in place, they will be unable to answer demands for increased transparency as their businesses grow. Custodians are also constantly struggling with the need to be as cost effective as possible, through economies of scale; their trade processing and settlement systems need to be as streamlined and efficient as possible so that they are able to pass on the cost savings to their clients.

Most global custodians now view outsourcing as a number one priority for future client retention and business growth, and it's beginning to have a

significant impact in Asia. Custodians who are offering outsourcing services and outsourcing firms themselves are demanding reliable, flexible technology solutions that not only allow them to increase their competitive edge but also grow their business.

What is motivating custodians to offer these value added services?

Mueller: The custodian bank marketplace is becoming increasingly competitive, with large global players competing with smaller local banks. Custodians constantly have to find new ways to retain their client base and service them more effectively. Investment managers are not only doing large scale outsourcing but also asking their custodians to take on smaller functions e.g. reporting. The provision of such services is allowing custodians to entrench themselves further with their customers.



Darryl Mueller

How does outsourcing in Asia differ from deals struck in the US and Europe?

Mueller: In Asia there aren't that many fund managers with huge pools of assets so the outsourcing business looks very different - banks are chasing much smaller mandates. Despite this, outsourcing is taking off, particularly in the Australian market, where custodians work with smaller fund managers and can have up to a dozen relationships. This doesn't change the type of service they offer but it does mean that custodians are under pressure to get the best mileage out of their technology so that they are able to take on smaller clients in a cost effective way. Omgeo's solutions can help them achieve this. National Custodian Services, for example, the outsourcing arm of NAB, has recently signed up for Omgeo Central Trade Manager in order to service their clients more effectively.

How do you position your products to custodians?

Mueller: We add value to custodians in three main areas: through outsourcing solutions, through data management solutions and through automating the communication between custodians and their investment manager clients. Through these solutions



we can help custodians add value to their clients and deliver the required efficiency, transparency and reduced risk that is so critical. You have to remember that providing services to custodians is not a new business for Omgeo – custodians in the US, Europe and in Australia have been using Omgeo solutions for almost a decade to process trades that have been outsourced to them. Nearly 50% of our volumes in Australia come through outsourcing clients.

And what sort of feedback do you get from these outsourcing clients? Do they claim that using your systems adds value to their own offerings?

Mueller: We're encouraged by the feedback we are getting to date. In fact in response to this increased interest in our solutions, we have appointed regional resources solely dedicated to custodian and outsourcer clients. With many outsourcers being relatively new to the market, we can support them by contributing the knowledge and experience that we have in outsourced back office solutions. We are making good progress in building these relationships in Asia. We now have some of the custodian banks involved in our local advisory boards - a forum where market participants share knowledge on Omgeo solutions and industry initiatives.

What are some of the technological challenges that custodians face in offering outsourcing services?

Mueller: The major issue is how to develop scalable robust technology with client specific customization. Interfacing to different trade order management systems is a major challenge. This is where we really offer increased value. Omgeo Central Trade Manager offers reliable and scalable matching with links into front, middle and back office solutions. Outsourcers don't have to manage all of those interfaces themselves.

Do custodians recognise the risk eradication elements of partnering with Omgeo?

Mueller: Yes they do - it's a very important factor in our value proposition. Banks by nature are very risk averse and have been using technology to eliminate these risks for years, investing large sums each year to keep their systems up to date. Our solutions can mitigate operational risk to a large extent - particularly important when those custodians who offer outsourcing services are in effect taking on the risk of their clients. They can't afford to paper over

any cracks. Their systems must be as reliable and efficient as possible.

What are the motivating factors behind investment managers who choose to outsource?

Mueller: Cost saving is often quoted as a motivating factor but often the reality is different. During the initial transfer there's a desire to effect minimal change in systems, people and process so the cost savings are difficult to obtain. Therefore outsourcing frequently becomes a strategic decision to avoid future cost, to turn fixed cost to variable cost and to gain new capabilities, (new fund classes in new jurisdictions for example). By outsourcing their back offices, fund managers are also able to focus on their core competencies of picking stocks, asset allocation and growing their funds.

How much has the threat of shorter global settlement cycles influenced the trend for fund managers to outsource?

Mueller: Many larger fund managers have the STP technology to settle trades quickly and meet short settlement deadlines. These firms are motivated to outsource so that they can focus on their core competencies. However, for smaller fund managers, who are still processing trades manually by email and fax, the threat of shortened settlement cycles could present a serious issue. These firms can also benefit from outsourcing because they get the latest STP technology without having to implement and manage the technological infrastructures themselves.

How important are global industry standards in ensuring the success of outsourcing solutions?

Mueller: Any standardization of settlement instruction data and reference data is going to make the trade process much more efficient and reliable. Trying to interoperate proprietary systems has caused the industry continual headaches. Our global database of standing settlement instructions, Omgeo ALERT, goes a long way in helping to alleviate this by standardizing settlement instructions and providing cross-reference tools so that different securities codes can talk to each other. There's still some way to go but we're confident that the global custodian and outsourcing community will continue to embrace new STP technology and will go from strength to strength. And of course we hope to fully support them every step of the way. ■



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