Look to your custodian in times of change.

The asset management industry continues to evolve at a rapid pace. Here, we explore the custodian view to help you navigate change.

The asset management industry is now attuned to the fact that the market landscape and regulatory environment are constantly changing, which stretches both people and resources. However, the gradient appears to be steepening, with last year's introduction of the Central Securities Depositories Regulation (CSDR) Settlement Discipline Regime in Europe to be followed by a trade date plus one day (T+1) settlement cycle in the U.S. and Canada next year. Put simply, there is now more to do, with less time to do it and greater potential risks.

Custodians have done the heavy lifting with regard to CSDR and are already offering a solution to those clients that need it. Their constant technology upgrades leave them well placed to cope with the impending burden of the shorter settlement environment.

Although service providers have been quick to adapt, they recognize the danger in trying to do everything internally. Some have chosen to build up networks of strategic partnerships, adding greater flexibility and a layer of local expertise on top of their global knowledge. Just as asset managers and financial institutions look to outsource certain functions that are not core to their business, many global custodians have employed the same approach, which allows them to focus more on client priorities. The relationships they have built also give them valuable information channels, strengthening their role in helping clients understand and prepare for change.

How is a regional network strategy different?

Take, for example, the global network management function, where the following models exist in the marketplace today: a local presence in each market (direct network), or the hiring of local custodians in each of those markets. In the second model, your custodian could employ hundreds of banks, or a select few by region.

Providers with a regional strategy – centralizing their relationships with a few key players in each of the regions – can offer clients a more tailored service. Typically, this comes with greater leverage, as well as synergies for end clients. When it comes to a network provider strategy, less is more.

"We built our program to give us a lot of flexibility to focus on a select number of providers in the market," says Walter Barys, Head of Global Network Management at U.S. Bank. "Through this approach, we are deepening our relationships with key banks to offer differentiated services to our clients."

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WALTER BARYS
Head of Global Network Management

Is CSDR really changing behavior?

The CSDR Settlement Discipline Regime went live in Europe last year, introducing cash penalties for late matching and settlement fails.

A market-wide observation leading up to implementation was that CSDR was not a top priority for the asset manager community. The implementation then came with delays in receiving the necessary data, which in turn created delays with the reconciliation and billing functions for the custodian community that impacted their end clients. Many of the charges have been low dollar value, which has contributed to frustration among clients. Are managers spending too much time reconciling what appear to be small payments?

"Although they are often smaller in value, these penalties have been a topic at recent fund manager board meetings in Europe in terms of eliminating penalties," says Laura Cote, Senior Product Manager – Global Custody at U.S. Bank.

Our servicing teams recently noticed that CSDR penalties have been a talking point during the fail-resolution process, with clients mentioning when they are at fault and wanting to expedite trade settlement to avoid further charges. However, we also expected to see a change in trade confirmation timeliness from clients, which has not yet been significant.

The industry is awaiting new data from the European Securities and Markets Authority (ESMA) in Q4 2023 to compare equity settlement rates in Europe with the past few years, with percentages as high as 14% in 2020 and a one-year average of about 8% in 2021.[1]

T+1: An even bigger cloud on the horizon?

For managers still adapting to CSDR, more change is around the corner with the shift to a T+1 securities settlement cycle in the U.S. and Canada. This move is now confirmed for May 28, 2024. Regulators are shortening the securities settlement cycle from the current T+2, which was implemented in 2017.[2] The goal is to lower both credit and counterparty risk, particularly during periods of high volatility, as well as to moderate liquidity, margin, and therefore also capital requirements.

However, these benefits will take time to percolate through. The Securities and Exchange Commission (SEC) estimates implementation costs of almost $5 billion for the industry and more than $5 million per institution.[3] This comes just two years after all the effort and cost it took to comply with CSDR. From an implementation perspective, firms have been working to analyze the current operating environment, from processes to technology. Quicker settlement is forcing a greater reliance on automation, not on teams of people, which requires a redesign of current

1 Source: Global Custodian
2 https://www.dtcc.com/dtcc-connection/articles/2022/june/06/accelerating-to-t1-what-you-need-to-know#
3 https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-deloitte-sec-t-2b1-feb-2022.pdf

manual processes.

"T+1 brings another push toward standardization and digital tools to achieve greater levels of straight-through processing," says Cote. "Market participants need to review internal process flows and client behavioral trends in order to get ready."

The value in choosing the right partner

The burden of ever-increasing regulatory and compliance requirements has been piled on top of an already-full operational agenda, culminating in these latest overarching market changes to the way the financial industry transacts business and the role of the custodian within it.

The time that is available has gone down, while the penalty for mistakes has gone up in some cases, putting a greater premium on accessing the best solutions, in terms of both technology and people. Rely on your service provider to help you and your teams to navigate this ever-changing environment.

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LAURA COTE
Senior Product Manager – Global Custody

Disclosures

For more information and questions about our CSDR services, please visit here:
https://www.usbank.com/splash/investment-services/custody-solutions/csdr-faq.html