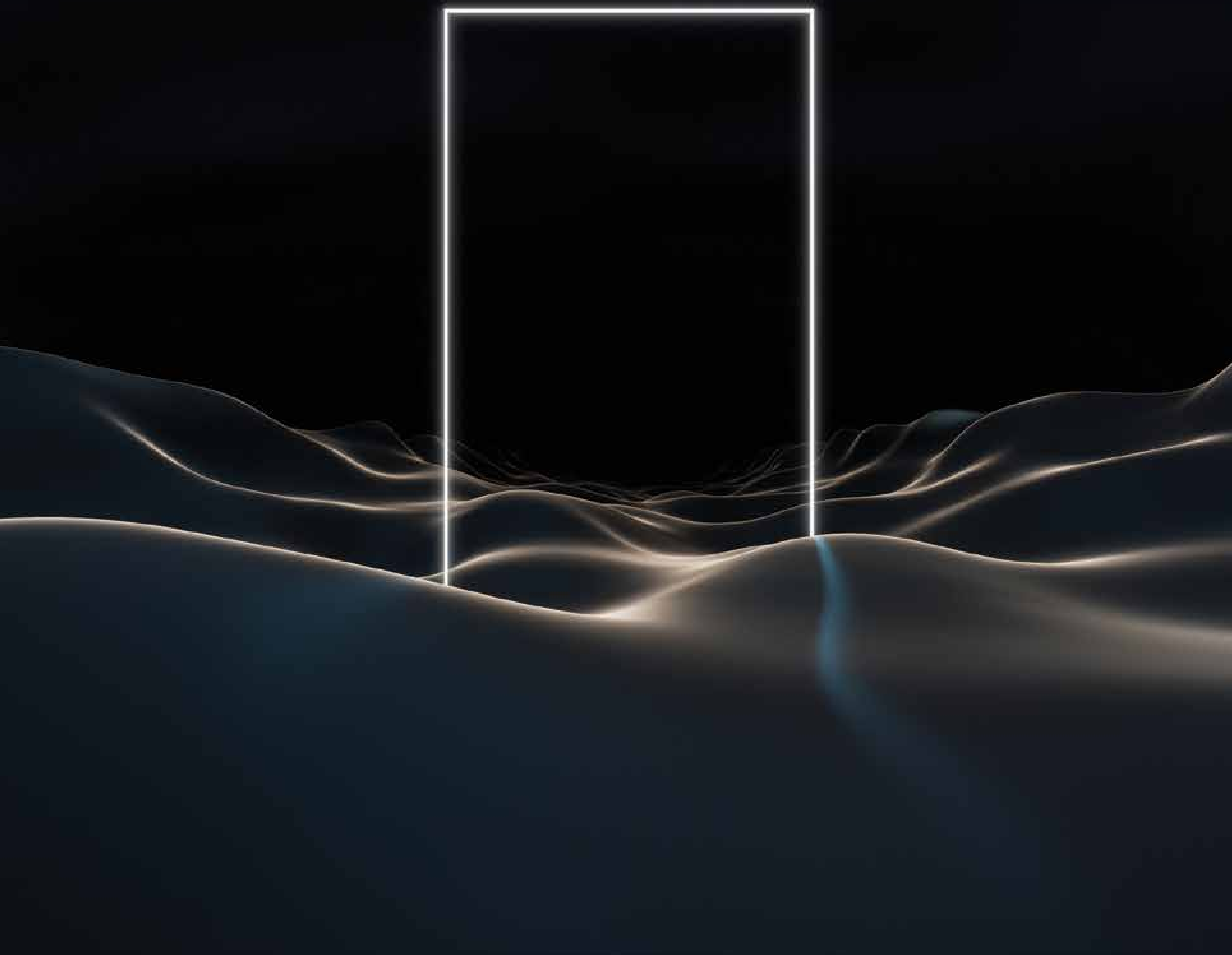
www.financialstandard.com.au
6 May 2024 | Volume 22 Number 08

SHIFTING SANDS



From grappling with regulatory overhauls and mastering complex data integration to enhancing customer experiences and leading the charge on sustainability, how are large custodians coping?
Andrew McKean writes.

The custody market has and continues to go through major changes with consolidation taking hold across the entire ecosystem – superannuation funds, asset managers, and service providers.

Rampant merger activity has led to larger asset pools and more complex management needs, driving demand for enhanced custody services, and resulted in a more streamlined industry landscape with fewer, larger market players.

Northern Trust head of Australia and New Zealand Leon Stavrou[01] says key reasons behind consolidation are competitiveness and regulators pushing for higher standards around the Your Future, Your Super performance test, costs, and operational processes for super funds.

"You start with the super funds because of the regulations there, but that does trickle down. So, those cost pressures, the need to be efficient and effective in your operating model, then flow to asset managers and other service providers in the value chain, including custodians and administrators," he says.

"That competitive pressure is always there and continues to increase."

Scale can be advantageous in addressing these competitive factors, but it's not the be-all and end-all, especially for super funds.

The pace of consolidation has decelerated somewhat in the past year, and although maintaining strong performance and effective cost management remains essential, the focus among funds and regulators is increasingly on member experience.

The government has also acknowledged the significance of member experience, with assistant treasurer Stephen Jones stating last year that as more than five million Australians are either at or approaching retirement age, they're expecting higher levels of customer service and responsiveness from their fund.

Jones remarked that there was an urgency to ensure that the super system is functioning for its members by "lifting the customer service standard," which he labelled "unresponsive," "slow," and "not-member focused."

Stavrou says if you think about the aging population, people nearing retirement or life events that trigger the need for financial advice, you could imagine the uptick in calls to call centres and the importance of having a good member experience – much of which can be done through technology.

"That's now becoming the battleground: client experience, how you're able to enhance that, know your customer, know your cohort of members, and be able to service them better," he says.

"Whereas before, you might've said scale gives you the best advantage, maybe if you're a little bit smaller, but know your cohort of members well and can tailor your service to them, I'm pretty sure your member engagement scores will be higher because of that, and those members will value that.

"So, it's not just about scale and performance; it's how the members are treated."

CPS 230

With the looming exit of NAB Asset Servicing (NAS) – which has triggered a flurry of activity in requests for proposals from its clients – the local custody market has arguably reached a sustainable position.

However, the consolidation of the industry can heighten

01:
Leon Stavrou
head of Australia and New Zealand
Northern Trust

02:
Nadia Schiavon
head of securities services Australia and New Zealand
J.P. Morgan

concentration and transition risks as providers retreat from the market.

If these risks aren't recognised and managed properly – particularly for essential operations – this could jeopardise a super fund's sustainability and inflict intolerable harm on its members.

J.P. Morgan head of securities services Australia and New Zealand Nadia Schiavon[02] says that in recent years, regulators globally have introduced more stringent operational resilience regulations.

Albeit varying terminologies to define operational resilience, the one common expectation for the financial services sector is to "maintain critical operations through disruptions," she says.

In Australia, APRA is going about replacing several existing industry-specific prudential standards with a new cross-industry operational risk prudential standard (CPS 230).

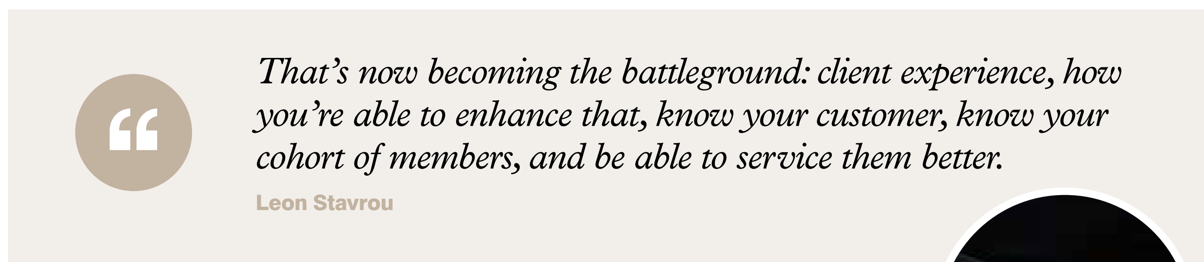
This new prudential standard will be mandatory for all APRA-regulated entities and will require them to effectively manage operational risks, maintain critical operations through disruptions, and handle the risks associated with service providers.

QMV Solutions says CPS 230 introduces important new requirements, like taking "reasonable steps" to determine if a material service provider is "systemically important" in Australia.

"Another new requirement for material service provider contracts would require the liability for any failure on the part of any subcontractor to be the responsibility of the service provider," QMV says.

"There is also a new power for APRA to review and require a trustee to make changes to a service provider arrangement where it identifies heightened prudential concerns.

"Also, they [funds] will have to stay on track with any potential fourth parties the service providers might engage. CPS 230 makes it a requirement to manage and mitigate all risk coming from third and fourth parties."



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Leon Stavrou

As funds become a systemic force, akin to the big four banks, good governance and control, and oversight from the executive level, from the board to operations – particularly the outsourced provision of services – is generally considered a good thing.

However, smaller service providers may find it difficult to comply with these standards.

That's because J.P. Morgan, State Street, and other global systemically important banks (G-SIBs) are already heavily regulated and have been compelled to invest significantly into their own oversight, error controls, resilience, cybersecurity frameworks, and oversight of third-party vendors.

State Street country head for Australia Tim Helyar[03] notes that clients, regardless of their size, can leverage the benefits of this investment. This is a good thing, he says, because custodians can respond to clients more effectively, and it also helps smaller firms that may not have the infrastructure or budget to implement similar measures.

"The role that we see we can play is effectively giving a reporting package around CPS 230 compliance; that allows our clients to take comfort and then do what they need to do to probe into certain areas," he says.

Table 1. Total assets under custody for Australian investors

Rank	Provider	June-23	Dec-23	% change
		$	$	%
1	J.P. Morgan	$1,082.4	1,080.6	-0.2
2	Citigroup	763.7	797.2	4.4
3	State Street	609.3	752.3	23.5
4	Northern Trust	758.0	674.0	-11.1
5	NAB Asset Servicing	475.7	448.5	-5.7
6	BNP Paribas	457.1	434.0	-5.1
7	Perpetual	0	245.0	100
8	Clearstream	115.4	115.9	0.4
9	HSBC Bank	60.2	84.9	41.0
10	Netwealth	70.2	78.0	11.2
11	Apex Group	25.8	29.4	14.0
12	BNY Melon	14.6	26.0	62.5
13	Artega	0	1.7	100%
TOTAL		**4,437.4**	**4,767.5**	**7.4**

Source: Australian Custodial Services Association, Februrary 2024

State Street is collaborating with the industry to devise a "fairly consistent response," which is important because if all the different custodians responded differently, and all the funds have different requirements, then that would render implementing CPS 230 an expensive and chaotic process.

"But given that we're all [custodians] working together through things like the Australian Custodial Services Association (ACSA) board and community, we can come up with a fairly standardised custodial services response, and we can hopefully get our clients also talking the same language and expecting the same things, because I think that's really important in order to be efficient with this," Helyar says.

Similarly, Schiavon says as a global financial institution and a service provider, J.P. Morgan has made enhancements to its global operational risk management, business continuity, and service provider service management frameworks in response to a series of key regulations over the years.

"Our intent is to leverage this global experience for the implementation of CPS 230," she says.

She adds that J.P. Morgan too is engaged in industry discussions regarding the application of CPS 230 and is collaborating with its APRA-regulated clients as they prepare for the standard.

Data management

According to BNP Paribas' custody outlook, data is the glue that binds everything together. Yet, the industry is still grappling with data management challenges related to data consumption, quality, and distribution.

These challenges are compounded by difficulties in user experience and secure data access.

The outlook said as reporting requirements become increasingly complex for both clients and regulatory authorities, there is a growing need for data standardisation and aggregation across asset classes, regardless of service providers.

Additionally, there's a need for the ability to process external data in alignment with a client's ecosystem's data standards while ensuring data security and protection.

"Given custodians typically hold a high percentage of clients' operational data, we have a significant role to play by working collaborative-

03:
Tim Helyar
country head,
Australia
State Street

04:
Daniel Cheever
head of securities services, Australia and New Zealand
BNP Paribas

ly to provide complete solutions for our clients," the outlook said.

BNP Paribas head of securities services in Australia and New Zealand Daniel Cheever[04] says clients face several data challenges, needing to manage data from diverse sources, in different formats, and across various systems, including listed and unlisted style assets.

"They [our clients] are trying to bring this data together to leverage the insights that can support a range of purposes, such as making trading decisions, analysing investments, understanding where sources of return are coming from, meeting regulatory reporting requirements, and ESG reporting needs," he says.

"Our data management solutions provide end-to-end models that incorporate a Core Data Management offering powered by software as a service (SaaS) and plugging in powerful analytics tools into that."

J.P. Morgan's Schiavon also contends that management of data in the industry is currently facing significant challenges due to the large amount of data originating from various sources and technologies.

She says the main challenge is to efficiently transform this diverse data into agile and responsive data warehouses that can process complex queries quickly.

"At J.P. Morgan, we provide a robust solution with our Investment Middle Office Service suite, coupled with the Fusion data management platform. This enables seamless integration of data from multiple sources into a unified investment data infrastructure, offering scale and cost efficiency," she says.

"Additionally, it empowers our clients with timely analytical capabilities and the flexibility to select optimal front office technology configurations."

Artega business development executive general manager Brad Massey emphasises the importance of flexible data access and manipulation. Like most, he believes that it's crucial for companies to be able to receive and format data according to their specific needs.

"Depending on how a company is structured, topics like middle office, unit pricing, and fund accounting can have varying implications. So, it's essential to push out complete data in a format that can be easily manipulated to meet individual or client requirements," he says.

Northern Trust's Stavrou explains that data product is probably the main area of focus for the firm and its competitors, and what clients are looking for in their needs to support their data journey.

"What we're seeing is very disparate models. So, every time we have a conversation with clients about data, there are different models they're entertaining, whether they have their own data warehouse that we feed files directly into and integrate into, whether we provide the data warehouse, and they pull from that, and we manage it, or whether it's SaaS; there are different flavours to this," he says.

The role that we see we can play is effectively giving a reporting package around CPS 230 compliance; that allows our clients to take comfort and then do what they need to do to probe into certain areas.

Tim Helyar

"Our approach has been 'here are the range of things that we can do', we're not going to tell you, 'this is the way that you need to do it'. If you're going to engage with us, we'll use the tools that we have and integrate with the partners that you want to leverage and that gives clients optionality."

He adds if there's a fintech out there that's got a new tool that Northern Trust can integrate with and can partner with, it'll facilitate that, the benefits being that you can be faster to market and you're not locking yourself into one operating model.

ESG

Efforts to advance decarbonisation across the globe remain in the early stages—providing an enormous opportunity for green-minded companies to innovate and make a difference. As such, J.P. Morgan expects sustainability to remain a priority for business leaders and policymakers in 2024.

"The finance sector can help to address some of the most pressing environmental and social ("E&S") challenges of our time, primarily by running a healthy and vibrant company; supporting its clients, and employees; and providing targeted capital to help scale solutions," Schiavon says.

"... we are leveraging our expertise, capital, data, and resources to advance inclusive growth, promote sustainable development, and support the transition to a low-carbon economy.

"Additionally, we strive to leverage the firm's governance structures to foster sound management and a culture of accountability on ESG matters. This includes defining oversight and management of ESG matters within and across our lines of business."

Helyar thinks ESG has been an ever-growing trend for a long time now, driven by certain societal trends and events that make it particularly important in the "S" space. He notes that super funds in Australia have been champions of change across all three legs of ESG, and this pressure is cascading through the industry.

State Street frequently receives ESG compliance surveys from funds, indicating that asset managers are likely receiving similar queries. It also purportedly regularly faces questions about its stance on gender equality and environmental efforts, including how it is reducing its carbon footprint from within both its asset management and investment services businesses.

"So, what we're doing is twofold. One, we're providing our clients with the ability to understand ESG factors within their portfolio. We build systems that allow our clients to produce ESG metrics, so they can see the carbon footprint of various investments and make ESG-aware decisions. This enables them to understand ESG metrics beforehand, supporting their decision-making process in this area," Helyar says.

"And secondly, we're doing all of the things you would expect as well. We're reducing our carbon footprint, taking active steps towards gender equality within our organisation, and embedding these principles into our culture, specifically in our hiring and promotion policies."

Given the evidence, perhaps unsurprisingly, a BNP Paribas survey of 420 asset owners and managers, hedge funds and private capital firms representing around $51 trillion in assets shows that institutional investors are mobilising capital towards investments that will deliver measurable positive impacts alongside financial returns.

This is despite data constraints posing the biggest barrier to ESG integration, especially in tackling financial risks posed by climate change, institutional investors are nevertheless incorporating ESG, notably in their portfolio management and investment decisions.

Stavrou shares he has many conversations with clients about new requirements, particularly regarding financial statements and climate reporting. Many clients are already engaged in this reporting, either voluntarily or as part of their business operations.

He says Northern Trust discusses with clients how they collect and report data, and unsurprisingly, technology plays a huge role. It's also driving technology adoption because of the need to aggregate data from different sources, normalise it, and then turn it into something reportable.

For example, one client uses the Snowflake data tool with a vendor to overlay their positions with carbon emission data and generate a report using analytics. However, a major challenge is ensuring the data is auditable for inclusion in financial statements, focusing on reconciliation, source referencing, timeliness, and accuracy. Technology aids in addressing these issues.

"The other big challenge lies in private assets. Unlike public assets, where information is generally available, accessing private asset data is more difficult. You might need to contact general partners for underlying information, conduct research, or use proxies," he says.

"One approach we're exploring is partnering with a firm called Novata Data. Their role in the ecosystem is to help general partners standardise their reporting and provide it in a format accessible to asset owners. The private market space is where much of the future work will concentrate." FS