

FOCUS ON: custody services

Stuart Lacey of Atree Custody Services discusses the changing face of African custody and securities services

Market sentiment continues to weaken amid increased uncertainty surrounding the European debt crisis, stalled efforts to control Chinese inflation and an overall lack of consensus surrounding the United States debt ceiling. Financial deleveraging remains a recurring theme and deflationary fears are again emanating throughout the developed markets. Market practitioners remain sidelined as returns erode and opportunities prove more challenging to access. Against this backdrop, investors have responded by diversifying into asset classes such as frontier and emerging markets in search of alternative alpha sources.

As one of the fastest growing regions worldwide, Sub-Saharan Africa ex-South Africa (SSA ex-ZA) is well positioned to attract significant interest from foreign investors over the coming years. The region has exhibited strong year-on-year growth as evidenced by a +5.82% average annual increase in total market capitalisation over the five-year period through December 2010. Furthermore, empirical data supports the potential for continued growth as evidenced by the growing number of cross-border transactions and consistently high rates of foreign participation in new issuance. It should be noted that Egypt and South Africa have historically received the lion's share of foreign investment with these two markets comprising roughly 16% and 46% respectively of the continent's securities markets (as at 31

May 2011). Yet recent investment flows have increasingly found their way into SSA ex-ZA as socio-economic change across the Mena region and speculative ZAR-related buying have caused emerging market managers to shift their allocations away from Egypt and South Africa. The shift in demand may be attributed to the large number of newly formed Pan-African investment funds; evidenced by the multitude of new account orders that we are receiving. This is being fuelled by expanding frontier and emerging market allocations, institutional interest in foreign depository receipt programs, and rising foreign direct investment from private equity investors and development finance institutions.

Regionalisation

The old adage "build it and they will come" is getting redressed, as investors are arriving and it is not yet built. While local exchanges, CSDs, central banks and regulatory authorities are demonstrating a strong willingness to invest in improved securities market infrastructure, implementation has proven time consuming and costly. Although regionalisation is often suggested as a means through which to offset the associated costs of implementation, we are acutely aware of the operational and regulatory difficulties inherent with cross-border execution, settlement and custody. Looking ahead, the adoption of cutting-edge technology and resulting benefits of interoperability should

improve market access, attract significant additional capital and greatly enhance liquidity conditions across the region.

Global regulatory limitations

Newly issued directives serve as a major impediment to foreign and global custodians seeking to enter or expand into the African market. The Dodd-Frank Act (US) and AIFMD (Europe) are affecting the vast majority of major global custodians by placing significant liability and operational risk on custody-related activities. Specifically, CSD or sub-custodian indemnification will no longer be permitted, and global custodians will be treated as the 'depository of record' in the eyes of their regulators. As such, a custodian regulated in the US or Europe must underwrite the liability of its underlying sub-custodial network and set aside significant sums of regulatory capital to offset the inherent counterparty risk.

In our view, large global custodians are less likely to set aside regulatory capital and pay the collateralization cost in frontier markets where income is low and market risk remains high. In fact, a number of large global custodians are exiting these markets and investors will therefore have limited options at their disposal.

Market infrastructure developments

Atree Custody Services (ACS) provides a broad range of custody and related fiduciary services to a global network of investors and fund managers. Over the years, we have invested significant resources toward development of proprietary African securities market infrastructure designed to assist our clients in more efficiently accessing investment opportunities throughout the region. It should be noted that the majority of securities market infrastructure across the region is presently under RFP for new technology. As such, we envisage rapid technological evolution occurring across the region. To accommodate this, ACS has adopted Securities Market Practice Group procedures and runs an award-winning, fully SWIFT-enabled securities system, that is ISO 20022 certified, SAS70 2-compliant and which interfaces directly with trade, capital markets, registrar and banking systems across



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Africa and employed world-wide in the global custody industry.

Differentiation is key

Looking ahead, we believe that four key differentiators will set apart service providers operating in the African custody arena:

Market access

Investors desire access to as many African markets as possible albeit on a consolidated single relationship basis. ACS delivers unrestricted access to 25 African securities markets, through both segregated and omnibus structures. This permits

Superior technology

Investors desire speed, transparency and control when making custody elections. Fully-automated SWIFT-enabled settlement systems with straight-through-processing and low trade-failure levels are critical to successful fund management. After extensive due diligence, ACS acquired the award-winning IMSecurities™ global custody and settlement system. IMSecurities™ currently handles approximately 55% of all global securities market transactions, 45% of all global corporate actions and manages operational risks and improves efficiency for 17 of the 20 leading global custodians and financial mar-

kets participants. At present, ACS is the only Pan-African custodian operating IMSecurities™ industry-leading securities market architecture. The system increases portfolio efficiency while

reducing operational risk; by allowing investors to securely enter trades via an online SWIFT compliant gateway, access reporting, corporate actions and account information over real-time secure portals via HTML and an iPad application, and by integrating the power of real-time surveillance; permitting ongoing counterparty risk analysis and benchmarking.

Foreign exchange and cash management solution

Investors desire a solution to foreign exchange and cash management which allows for net settlement in all African currencies. Two of the greatest challenges faced by African investors are wide FX spreads and unreliable fund transfers. From a logistical perspective, settlement remains a time-consuming and expensive proposition for investors looking to access opportunities across the region. In response, ACS has developed a wholesale foreign exchange and cash management

solution which permits net local settlement in all African currencies and leverages the continent's largest local and international banking footprint.

A changing landscape

Investors are increasingly focused on counterparty diversification and regulators now require investment managers to hold their assets externally with third-party oversight of valuation and record-keeping. Fund managers are increasingly looking towards custodial banks for the provision of critical middle and back office services.

The evolution of custody business models in anticipation of Target 2 Securities (T2S) and other regulations are likely to result in lower settlement fees and netting of cash transactions as global custodian revenues come under increased pressure over the medium-term. Furthermore, CSDs are likely to move up the value chain by providing value-added services as they seek new ways to differentiate and monetize their in-house assets.

Competing in the custody and securities services market requires centralised solutions capable of providing a consolidated view across multiple accounts, geographies and time zones. These solutions should enable rapid response to opportunities and issues while complying with new changes in regulation. Since the recent global crisis, companies have had to review their business models to stay profitable, especially in light of rapidly increasing US and European regulatory burdens. These changes are forcing more deeply entrenched legacy players to review their business proposition; resulting in closures and acquisitions.

Looking ahead, the environment favours dynamic, technologically proficient service providers who operate independently from the debt and regulatory restrictions of the developed world. Such players are critical to securities market development and will enable a broader range of investors to participate in the continent's future growth.

“ACS delivers unrestricted access to 25 African securities markets, through both segregated and omnibus structures”

managers to diversify their counterparty risk and cost-effectively add new markets on an as-needed basis. By leveraging its fully integrated sub-custody network, clients are afforded access to the best provider in each market, based on independent assessments of service, local footprint, cost, risk management, financial strength and technology.

Best price

Investors desire cost efficiency when accessing individual securities markets. Because no single bank offers a complete Pan-African custody platform, investors are exposed to layered fees and sub-standard coverage when accessing non-core or presence markets through custodian hub and spoke networks. In contrast, ACS negotiates freely and aggressively with the leading local custodians in each market. As a result, it consistently delivers best price in terms of safekeeping, transactional and fund transfer fees.

200 million years later...

...Africa takes centre stage again

- Market leader in African custody and safe-keeping
- Nearly two decades of African securities market experience
- SWIFT-enabled with full STP settlement and processing
- Industry-leading technology, infrastructure and risk management systems
- Wholesale foreign exchange desk and net position settlement
- World-class fund structuring and portfolio administration services

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"ACS has independently negotiated access to each of its core African markets... thus passing on to its clients the surety of efficient processing, competitive pricing and preferential service."