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# J.P. Morgan wins Palmer Square mandate

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J.P. Morgan has been selected by Palmer Square Capital Management, a manager of hedge fund-of-funds partnerships and customised alternative investments, to provide prime custody solutions for its recently launched Absolute Return Fund. This fund is Palmer Square's first open-ended mutual fund, a fund that, according to Palmer Square, seeks capital appreciation with an emphasis on absolute (positive) returns and low correlation to the broader equity and bond markets.

Palmer Square further indicates that the fund utilises a concentrated group of seven institutional managers who operate a broad range of hedge fund-type strategies, including global macro, long/short and event-driven credit, long/short international and domestic equity, and convertible bond arbitrage.

J.P. Morgan will provide a range of capabilities: global custody, equity and FX prime brokerage, interest rate derivatives, OTC, and futures and options.

Angie K. Long, chief investment officer of Palmer Square Capital Management LLC, said: "The ability to partner with J.P. Morgan across the breadth of the Palmer Square Absolute Return Fund trading and custody needs regardless of investment strategy and regulatory requirements is a huge benefit to us – both from an ease of execution and operations perspective. J.P. Morgan was able to structure a solution across the firm

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## J.P. Morgan wins Palmer Square mandate

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in a seamless way that enabled our fund to get to market quickly."

Devon George-Eghdami, managing director and head of Prime Custody Solutions, said: "We are seeing ever increasing demand from hedge fund managers who are offering alternative strategy mutual funds. Our ability to offer integrated capabilities across prime services, global custody and other securities services to these complex fund structures that must also meet '40 Act requirements is unique in the market. We are excited to be able to work with Palmer Square as it launches this new fund."

## Citi extends relationship with Mirae

**Continued from page 1**

Global asset management companies are distributing products in a growing number of domiciles and are seeking to create efficiencies that reduce the costs of duplicate operations. Responding to this need, Citi created a custom solution of global custody, fund administration and middle-office operations to enable Mirae Asset to launch new funds without significant investment in operations infrastructure.

This mandate extends Citi's partnership with Mirae Asset where it has provided global custody services to Mirae Asset's Korean-domiciled overseas funds since 2006, as well as providing global custody and fund accounting to its Luxembourg SICAV's and Brazil-domiciled products.

"Citi's unique ability to provide an exceptional level of service to all of our firm's global locations makes it an ideal partner as our firm expands globally," said Jay (Hun Jun) Jang, president and CEO, Mirae Asset Global Investments (USA) LLC. "Citi's knowledge of our business as well as their local presence around the world allows us to enter new markets efficiently while optimising in the capabilities of our investment operations staff and technology resources."

"We were able to quickly prepare for Mirae Asset's roll-out in New York because we had the implementation, technology and operations resources available to support Mirae Asset in all of their operating locations," says Neeraj Sahai, global head, Securities and Fund Services, Citi. "We were able to help Mirae Asset ensure a consistent service globally and help them connect their geographically dispersed offices."

## Claymore selects CIBC Mellon

CIBC Mellon Global Securities Services has been selected by Claymore Investments to deliver global custody, fund valuation and a suite of recently-expanded exchange traded fund (ETF) servicing capabilities.

"CIBC Mellon's experience providing ETF solutions played a large role in our decision to appoint them as the service provider of all of our existing and future exchange traded products," said Som Seif, president and CEO, Claymore. "Working with CIBC Mellon provides both Claymore and our investors the opportunity of working with a global leader in custody, fund valuation and value-added investment services."

"The ETF industry is rapidly increasing in complexity, scale and popularity across Canada, requiring tailored solutions to help fund managers meet their strategic objectives and benchmarks," said Tom Monahan, president and chief executive officer, CIBC Mellon.

"CIBC Mellon's appointment by Claymore – the second largest ETF provider in Canada and one of the fastest growing Canadian asset management companies over the last five years – clearly demonstrates the quality and reliability of our ETF services. We look forward to continuing to lead the Canadian market in delivering innovative products and solutions for investment fund providers and to working closely with Claymore to support its marked growth and success."

## BNY Mellon extends subaccounting service to 529 plans

BNY Mellon Asset Servicing has expanded its subaccounting services beyond mutual funds to include 529 plans, a type of tax-advantaged college savings plan.

This service is expected to help fund sponsors increase the distribution of 529 plans because it automates much of the processing that formerly was a paper-intensive procedure, which made it cumbersome for broker dealers and advisers to track client information.

"This is now a much easier product for broker dealers and advisers to sell," said Michael DeNofrio, head of US investor services within BNY Mellon Asset Servicing's Global Financial Institutions business. "This first step in expanding subaccounting services beyond traditional mutual funds will open the door to a growing number of investment products, including fund-sponsored individual retirement accounts."

BNY Mellon's first 529 client is a broker dealer, which can now benefit from rolling up the trades of its 529 plan clients into a single omnibus account for each 529 plan in which its clients participate. The creation of the omnibus accounts is expected to benefit the broker dealer with more efficient transaction processing and other cost savings.

Broker dealers utilising this service will be able to self-clear trades, including trade placement, trade aggregation, trade settlement and reconciliation.

## Phoenix chooses Revolution

**Continued from page 1**

The deal follows StatPro Revolution being successfully trialled by Phoenix, which provides a comprehensive range of investment administration services to specialist and boutique investment management firms. Phoenix has now decided to offer the StatPro Revolution platform to all of its clients.

StatPro Revolution is a cloud-based portfolio analysis service offering performance, attribution, risk management and reporting for portfolio managers around the world. It was created to answer the industry's priorities - improving communication, transparency and distribution, whilst cutting costs.

Steve King, founder of Phoenix Fund Services, commented: "StatPro Revolution enables Phoenix to provide our clients with access to the most sophisticated portfolio analysis and reporting at a great price. Our clients will be able to see a complete picture of their portfolio asset allocation, risk performance and attribution. We opted for Revolution because of the simplicity and quality of the StatPro proposition, in addition to its outstanding value for money and the ease with which Phoenix has been able to integrate it into our comprehensive service proposition. Revolution provides real added value to our clients, who are sophisticated boutique and specialist investment managers that in the past would have struggled to justify the costs of accessing such a quality service."

Philip John, finance director of Unicorn Asset Management added: "We are delighted that Phoenix has been so proactive in delivering Statpro Revolution to its clients. The ease with which it has been possible to implement the service, the quality of what Statpro Revolution delivers and the price provide a compelling combination that can only enhance the performance we deliver to our clients."

Justin Wheatley, CEO of StatPro Group plc commented: "We are really delighted to provide Revolution to Phoenix Fund Services and its clients. Thanks to StatPro Revolution, investment firms of all sizes can now afford to provide accurate reporting and analysis to their clients. We call it 'analytics for the people' and we're proud to be helping the industry to become more transparent."

## Sentinel selects Nomura

Nomura Asset Management has gone live with Sentinel, Fidessa's investment compliance solution for the buy-side. Nomura Asset Management will use Sentinel as its new tool for investment compliance and guideline monitoring.

Fidessa's Sentinel is a compliance solution for institutional investors that automates real-time pre- and post-trade compliance for mutual and institutional funds, and helps businesses meet their requirements for regulators and client mandates. Sentinel is a core module of Fidessa's LatentZero suite – a complete set of front-office solutions for institutional asset managers. The product is used by around 100 institutions, including many of the world's top asset management companies.

Sentinel features high-performance data processing capabilities to handle the huge transaction levels of large asset managers, sophisticated functionality and a user-friendly GUI fine tuned for compliance users. Fidessa already has a strong track record for supporting domestic sell-side clients and projects in Tokyo and is committed to do so for the domestic buy-side community in Japan also.

Ian Chilton, chief executive of Fidessa in Japan, commented: "It is our great pleasure to announce that Nomura Asset Management, our first domestic buy-side client, has successfully gone live with Sentinel. Having completed the initial phase of the roll-out, we are now moving into the next phase of the project by expanding the coverage of asset classes. Fidessa is committed to move forward with solutions for the Japanese buy-side marketplace by providing extensive product localisation of our LatentZero suite and also by reinforcing our internal structure to support domestic buy-side clients."

## Hedge fund association publishes guide on institutional investment

The Alternative Investment Management Association (AIMA), has published a guide for investors and managers, written by members of AIMA's Investor Steering Committee (ISC), that reflects preferences and priorities for institutional investors and investment allocations.

The aim of the guide is to outline investor views, expectations and preferences on a variety of important operational and organisational issues, which are increasingly the focus of due diligence reviews and discussion among investors and fund managers.

The authors of the guide are Kurt Silberstein (CalPERS), Luke Dixon (USS), Michelle McGregor Smith (BA Pension Investment Management), Andrea Gentilini (UBP), and Adrian Sales (Albourne Parners). AIMA's ISC is jointly chaired by current AIMA Chairman Todd Groome and former AIMA Chairman Christopher Fawcett of Fauchier Partners.

AIMA chairman Todd Groome said: "AIMA is very pleased to sponsor this paper, outlining institutional investor views regarding a number of important areas of operational and organisational 'infrastructure', which are receiving increased industry focus. AIMA has supported and provided publications related to a wide variety of educational guides and best practices throughout its 20-year history. In light of the ongoing 'institutionalisation' of the hedge fund industry and the growth of institutional investor participation, we hope that this paper, authored by some of the most influential investors and advisors in the industry, will be a useful reference guide to both investment managers and investors in hedge funds."

The paper, entitled A Guide To Institutional Investors' Views And Preferences Regarding Hedge Fund Operational Infrastructures, begins with a discussion of "Governance", authored by Luke Dixon of Universities Superannuation Scheme (USS), which outlines the fundamental importance of good governance, key constitutional documents and the role of boards of directors.

The second section focuses on "Risk" and is authored by Andrea Gentilini from Union Bancaire Privee (UBP). It focuses on a variety of reporting practices concerning the investment portfolio, operations, counterparties and liquidity.

The third section, covering "Investments", is authored by Kurt Silberstein of the California Public Employees Retirement Scheme (CalPERS) and discusses performance reporting, terms and conditions, control of assets, and transparency.

The fourth section addresses "Capital" and is authored by Michelle McGregor Smith of British Airways Pension Investment Management. It discusses issues related to a firm's ownership structure, investor relations, and related sales and marketing activities.

Finally, the fifth section, "Operations", authored by Adrian Sales of Albourne Partners, focuses on a variety of operational issues, including valuation, business continuity planning, compliance and relationships with service providers.

## RBC Dexia implements AAM's pan-Asian transfer agent

RBC Dexia Investor Services has developed and implemented a pan-Asian automated transfer agency platform specific for Aberdeen Asset Management's Thailand fund operations.

RBC Dexia's proprietary automated transfer agent platform is the only global TA platform that now meets Thailand TA requirements.

"The strength of our existing relationship with RBC Dexia was evident and with a Thai specific transfer agency platform now in place, RBC Dexia can provide Aberdeen with consolidated business data across the Asia Pacific region and potentially open doors around the world," said Matthew Yong, head of investor Services - Asia Pacific, Aberdeen Asset Management Asia Limited.

"Throughout the tenure of this process, RBC Dexia's level of commitment and collaborative approach were crucial to the success of this unique project, particularly given the complexities of the Thai funds industry,"

For fund promoters active in the region, the lack of automation in the Asian fund market creates significant operational challenges, increased risks and costs. It is estimated that today over 95 per cent of fund orders in the region are still processed manually via faxes. RBC Dexia is working with clients like Aberdeen to find ways to increase automation and help pioneer the way for the benefit of the global fund management community. RBC Dexia is currently the only transfer agent provider across the Asia Pacific region with capabilities in Thailand, Australia, Taiwan, HK and Singapore.

"Due to our long standing partnership with Aberdeen Asset Management, we have a comprehensive understanding of their needs," said Brent Reuter, managing director of RBC Dexia Investor Services in Hong Kong. "Our extensive local market knowledge, on the ground capabilities and ability to adjust to the complexities of global transfer agency platform within a localised market give us the edge on other providers looking to service asset managers with international activities."

## Gulf Bank goes live with Path Solutions' investment product

Gulf Bank has gone live with Path Solutions' investment product for its fund administration and transfer agency operations.

Path Solutions' technology allows fund administrators with operations in several countries to meet their registry and distribution requirements through a combination of multi-currency, multilingual, multi-entity and multi-instance functions.

"Due to the quick implementation time and ease of use, Gulf Bank will profit from a high user adoption and quick ROI," said Khaled Al Mutawa, general manager - international banking & investments at Gulf Bank. "We particularly appreciate the efforts of the Path Solutions team in the flawless implementation of the project including installation, workshops, training and UAT. The initial hours of preplanning were key to the successful completion of the project."

Gulf Bank is a Kuwait-based financial institution engaged in the provision of financial and investment services.

“Clients are looking towards using leading edge technologies with a very aggressive go live objective. Path Solutions provides enterprise-wide software solutions with rapid implementation cycles and shortened time to production,” commented Osama Ezzeldin Mohamed Touny, SVP at Path Solutions. “Our system will help Gulf Bank reduce overall operational costs and enhance its ability to design innovative financial products while maintaining extreme performance.”

## KAS BANK appointed by Haywood Securities

KAS BANK has been appointed by Haywood Securities (UK) Limited to provide clearing, settlement and back-office processing services across multiple markets and asset classes.

In 2005 Haywood Securities Inc, a private 100 per cent employee-owned North American based investment dealer established its presence in London with the creation of a wholly-owned subsidiary, Haywood Securities (UK) Ltd. The firm is focused on the institutional marketplace and has the capability to service customers internationally. Haywood’s collective passion for the natural resource sectors, particularly mining and energy, is unmatched amongst its peers. Its commitment to quality and performance and expectation of the same is paramount.

This appointment is in line with KAS BANK’s strategy of focusing on meeting client needs across the post-trade value chain, through a comprehensive range of securities services and the provision of key management information.

Robert Blanchard, president, stated, “We are very pleased to have embarked upon this strategic partnership with KAS BANK, a well-recognised and long-established European bank. Knowing that our clearing and custodial needs will be well looked after allows us to focus confidently on our clients and building our business.”

Laurens Vis, managing director, KAS BANK UK, “We are naturally very happy to have been selected to support Haywood Securities (UK) in the post-trade arena. We have no doubt that this relationship between two dedicated, specialist firms will become a long-term partnership based on a mutual ethos and shared goals.”

## Euroclear to provide Chilean access

Euroclear Bank will launch in June settlement, custody and related services for cross-border Chilean domestic debt transactions.

Simultaneously, Depósito Central de Valores (DCV), the Chilean Central Securities Depository (CSD), will offer similar services involving foreign securities transactions for its clients through Euroclear Bank. A bilateral transaction-processing link between DCV and Euroclear Bank is nearing completion. At the same time, the Chilean peso will become one of 54 settlement currencies in Euroclear Bank.

Euroclear Bank will be the first and only international CSD to link with DCV and offer services for Chilean securities, which will be provided to Euroclear Bank clients located in more than 90 countries. The link with DCV will allow Euroclear Bank clients to settle transactions in Chilean government bonds with local Chilean financial institutions that have accounts in the Chilean CSD. All Euroclear Bank clients, except those domiciled in Chile, may deposit these Chilean securities for safekeeping with Euroclear Bank. Chile will be the fourth market in Latin America for which Euroclear Bank offers services for cross-border domestic securities transactions, following Argentina, Brazil and Mexico.

Fernando Yáñez, general manager of Depósito Central de Valores, commented: “We welcome the new relationship between Euroclear Bank and Depósito Central de Valores. The proven safety and reliability of Euroclear Bank’s links with depositories and its relationships with sophisticated investors around the world will help


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United Kingdom | Luxembourg | Poland | Australia | New Zealand | South Africa | Hong Kong | Thailand to further Chile's objective of attracting more international investors to invest in Chilean government debt. Moreover, DCV's link with Euroclear Bank will ease the processing of foreign securities transactions for our Chilean investors and provide them with access to a wide range of securities and counterparties worldwide."

Frédéric Hannequart, chairman of Euroclear Bank, said: "Euroclear Bank's expanded portfolio of services for Latin American domestic securities creates new opportunities for investors worldwide. Our long-standing relationship with Chilean issuers of Eurobonds and other international securities provides a natural and logical extension for us to process cross-border transactions involving Chilean domestic debt securities. As client demands and the capital markets continue to evolve, Euroclear Bank is committed to easing access to the types of securities in which our clients want to do business with both local and international counterparties."

Upon launch of the Chilean CSD link, Euroclear Bank will have links with CSDs in 44 major countries.

In December 2010, the total Chilean government debt outstanding was valued at EUR 21 billion. In June 2010, the total outstanding of Chilean international debt reached EUR 15 billion, of which EUR 470 million were Eurobonds.

## Northern Trust adds unit registry services in Australia

Northern Trust has enhanced its fund administration capabilities in Australia through the addition of Unit Registry solutions. The service, provided through an agreement with Computershare, a global provider of unit registry, share registration, employee equity plans, proxy solicitation and stakeholder communications, combines local expertise with a broad range of global capabilities.

"The agreement with Computershare allows Northern Trust to provide local expertise, scale and operational excellence in unit registry services," said Nadia Ivanova, head of Northern Trust Global Fund Services in Australasia. "Combined with Northern Trust's leading technology and innovative product line, we are able to offer investment managers a best-in-class solution to their needs."

"We are delighted to be working with Northern Trust and extending the capabilities of Computershare's broader infrastructure and proprietary technology, Trust Architect, to meet the markets unit registry needs," commented Warwick Angus, managing director, Computershare Fund Services.

With Unit Registry capabilities, Northern Trust can offer investment managers in Australia a multiple product, single platform, one-stop-shop solution combining unit registry, unit pricing, tax, accounting, investment operations outsourcing, performance, risk and compliance services.

Paul Cutts, managing director of Northern Trust Australasia, said: "With the addition of Unit Registry capabilities, Northern Trust is now a full service provider for Australian Fund Administration and Fund Accounting. Along with our addition of Australian Investment Accounting capabilities last year, we continue to enhance our commitment to the Australian market and build upon the capabilities we provide from our Melbourne office."

## J.P. Morgan appointed by Första AP-Fonden

Swedish pension fund provider Första AP-fonden, with SEK 218.8 billion net assets under management, has appointed J.P. Morgan as sole provider of global custody services, including CLS, compliance monitoring, trade matching and fund accounting.

"We are delighted that Första AP-fonden has appointed J.P. Morgan as global custodian following an extensive tendering and evaluation process where candidates were assessed in terms of delivering services with high quality, a high degree of straight through processing as well as competitive pricing" said Bo Thulin, branch manager of J.P. Morgan Worldwide Securities Services in Stockholm. "Full support will be provided through our Stockholm Branch and we believe that our local expertise and knowledge, coupled with our global presence, will provide Första AP-fonden with the comprehensive support they require"

"The Nordic region is a strategic market for J.P. Morgan and we continue to commit significant resource to grow our branch network to support our pension fund clients locally" said Benjie Fraser, Pensions Practice Lead for J.P. Morgan Worldwide Securities Services EMEA. "We look forward to working with Första AP-fonden to ensure their specific requirements are met through the combination of our local solutions and expertise and our global capabilities and reach"

## Amaces appointed by PPF

Amaces Limited has been appointed by the Pension Protection Fund to provide custodian benchmarking services.

The contract will run for an initial five year term. Tony Child, director of Amaces said: "we are extremely pleased that the Pension Protection Fund has mandated Amaces to provide the ongoing custodian monitoring that will bring greater clarity and transparency around the services that they receive from their provider."

## Pirum releases new reporting for SEC rule 17a-13

Pirum has released new reporting to facilitate compliance with SEC rule 17A-13, which requires borrowers to regularly confirm their on-loan positions with their lenders. This will benefit market participants looking to reduce the risk and burden of manual compliance with this requirement.

Pirum's solution automates the secure delivery of monthly, quarterly and year-end position reports to counterparties. Pirum's new reports automatically highlight any positional differences between a pair of market participants and are in a format ready for ready for sign-off by an authorised individual, eliminating the need to manually identify any discrepancies.

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# Croatia

## Not only a former communist state, Croatia has had to recover from a devastating war. And it has done so in style

BEN WILKIE REPORTS

When Croatia became independent in the early 1990s following the collapse of the former Yugoslavia, it was in a sorry state. A devastating war with its neighbour left the country deeply in debt and nursing the wounds caused by the five-year conflict - hundreds of thousands of homeless refugees, tens of thousands dead or missing, and a severely depleted infrastructure.

Less than two decades later, however, and it's hard to see any damage at all. The country has patched up its damaged buildings, restored national confidence and rebuilt its economy. It punches above its weight in sport, with success in football, tennis and skiing, and has become one of Europe's most popular tourist destinations. It's on the fast track to join the European Union and plays a major role in international affairs.

Although the newly independent government began fiscal reforms at the start, little was done immediately as the war became the priority. Real financial changes began at the turn of the millennium, when companies were privatised and foreign investors started to build their confidence in the ravaged land. Unlike many former communist countries, there was little in the way of corruption leading to the creation of an oligarchy - although no-one will say the transition was perfect, there were opportunities for everyone, both local and international.

### Finance

Croatia didn't do too badly during the downturn - some of its exports were hit and tourism fell slightly, but compared to some of its neighbours, it remained fairly stable. That doesn't mean all is rosy in the garden, though. It still has a high trade deficit and still carries significant debts. As part of its accession pathway for the EU, due to be completed in the next few months, the Government still has some work to do, much of which will not be popular with the local populace.

The country's banking industry is in good shape, however. International firms snapped up some of the local players to create a trans-continental network and institutional provision is on a par with that on the rest of continental Europe. Custody fees are comparable with those in Italy, and the infrastructure means that settlement rates are high.

There isn't a huge amount of fund activity, however. Mutual funds have not made much of a mark, and while international investors will often have a Croatian aspect to their portfolio, the country is not a major investment hub. Where the business thrives, though, is from its domestic pension funds.

In the 1990s, the Croatian pension system underwent similar types of reforms to those of most other former communist states. The war had one major consequence for the country's pension provision - a dramatic increase in the number of pensioners and a drop in the size of the active workforce.

The PAYG system in place until 1998 was not able to deal with these shocks due to low retirement age, a weak link between contributions and benefits, and generous benefits. This is why major pension reforms were initiated in a gradual, step-by-step manner. The Croatian government implemented parametric reforms of the PAYG system in 1999 and introduced mandatory and voluntary pension funds in 2002.

Demographic development in Croatia is comparable to that in the rest of the region. The old-age dependency ratio is projected to rise from 25.6 per cent today to 49.6 per cent in 2050. This means that Croatia will be doing only slightly better than the forecasted EU-25 average of 52 per cent. According to a study from the Institute of Economics in Zagreb, public pension expenditure will fall (in the baseline scenario) from currently 13.1 per cent of GDP to 6.3 per cent in 2050. The EU-25 average will increase from 10.6 per cent of GDP to 12.8 per cent over the same period.

Pension assets in Croatia currently add up to EUR 2.2 billion in the second and EUR 54 million in the third pillar. Until 2015, we expect to see annual growth of 19 per cent for second pillar and 24 per cent for third pillar pension assets.

## Public pensions

The pre-1998 system was purely PAYG. It was organised in three different funds for workers, the self-employed and farmers; benefits differed for each group. What's more, certain groups, among them World War II veterans, former political prisoners, academics, police and military personnel, enjoyed a privileged status; their benefits were determined by a special law. In the late 1990s, almost 200,000 people belonged to these privileged groups. Retirement age was low at 60 for men and 55 for women. Early retirement was fairly easy and there were various supplements for years without contribution.

In 1999, Croatia reformed the public pillar and aimed at financial sustainability and cost containment. The retirement age has gradually been increased, reaching 65 for men and 60 for women. The minimum early retirement age has also been raised, as have benefit deductions for early retirement.

The current contribution rate is 20 per cent of gross salary, paid by employees alone. Minimum earnings for contributions are HRK 2,270 (EUR 309), maximum HRK 37,194 (5,066). For people who joined the mandatory pillar, 5 per cent of contributions are directed into their individual accounts. For those who had to or chose to stay in the old system, the full contribution is used for first pillar pensions. Initially, 10 per cent of contributions were to be re-directed into the mandatory pillar, but the amount was reduced to five per cent due to fiscal problems.

Just like in most other CEE countries, Croatia applies investment limits and a minimum rate of return to the mandatory pension funds. A special characteristic of Croatian regulation is that a minimum of 50 per cent of assets has to be invested in Croatian government bonds. Maximum investment limits include the following:

30 per cent for Croatian shares; for shares of domestic open investment funds; for Croatian municipal bonds, for Croatian corporate bonds traded on organised exchanges in Croatia 15 per cent for foreign securities issued in OECD countries and for bonds issued by OECD countries
10 per cent for corporate bonds and shares issued in OECD countries

five per cent for shares of open domestic investment funds or foreign investment funds that are primarily invested in bonds issued by governments of OECD countries, and for cash and bank deposits

Investing in real estate and derivatives, self-investment (investing in the pension fund management company) and investing in related companies of the pension fund management company is prohibited. Croatia has a limit for international investments: 15 per cent of pension fund assets can be invested abroad.

Pension fund management companies must credit a minimum rate of return to the individual accounts. The reference rate of return is defined as a weighted arithmetic mean of all mandatory pension fund average rates of return in the previous three years, reduced by two percentage points. Each mandatory pension fund member is guaranteed the rate of return that equals one third of the reference rate of return, if the reference rate is positive. If the reference rate of return is negative, each pension fund member is guaranteed a rate of return that equals a triple reference rate of return for the last three years. To offset losses if the pension fund falls below the minimum rate of return, it must have a guarantee fund, which is funded with part of the “success” fee.

If the fund's actual rate of return falls below the minimum rate, the shortfall must be covered with assets from the guarantee fund. If these assets are insufficient, up to 20 per cent of the pension fund management company's own capital must be used. If both sources are insufficient to compensate for the low rate of return, the state guarantees the remainder.

## Asset management and allocation

The initial take-up rate of the mandatory scheme was very high. Between November 2001 and the end of 2002, nearly one million people joined the mandatory system. By the end of 2006, the system had 1.3 million participants and assets worth EUR 2.2 billion. The mandatory pillar now covers 83 per cent of persons in employment.

Four mandatory pension funds are operating on the Croatian market, and all of them are linked to international financial institutions. In terms of members, the two biggest funds share 71 per cent of all members between them.

Assets are allocated in a fairly conservative way, even considering the restrictive investment limits. 91 per cent of assets are invested domestically. Of these, over 70 per cent are invested in domestic government bonds, seven per cent in open-end investment funds, five per cent in domestic shares and three per cent in corporate bonds. Foreign shares amount only to 1.4 per cent of assets. Croatian pension funds do not exploit the 15 per cent limit on foreign assets; only nine per cent are invested outside Croatia.

## Taxation

Taxation of the mandatory pension scheme is of the EET type. Contributions and investment income are tax-exempt, whereas benefits are taxed. The tax allowance for pensioners is 1.7 times higher than for employees, meaning that pensions are only modestly taxed.

## The third pillar – voluntary pension funds

Voluntary pension funds were also introduced in 2002 and complete the three-pillar system. These schemes are DC plans based on voluntary pension savings. Voluntary pension schemes are either offered by voluntary pension funds, or can be set up by trade unions and employers, making open and closed funds possible. Voluntary pension funds need to have at least 2,000 members two years after being established.

Participants in voluntary schemes benefit greatly from tax incentives. The state provides an annual subsidy of up to HRK 1,250 (EUR 171) and allows a tax deduction of up to HRK 1,050 (EUR 151) per month. Employer contributions are not subject to tax breaks; they are treated like salary payments. Benefits are paid as annuities or as periodic payments. Contrary to the mandatory pillar, voluntary pension fund companies can offer more than one fund.

There are currently six open pension funds on the market, provided by four pension companies. Voluntary pension companies overlap strongly with the mandatory pillar; three of the four pension companies offering mandatory funds also provide voluntary funds. 65,300 members participate in voluntary pension funds, which have assets of EUR 54 million under management. The two biggest voluntary funds have a market share of 80 per cent; the biggest fund alone has a share of 53 per cent. Investment regulation of voluntary pension funds is very similar to that of mandatory funds, but slightly more liberal. For example, the limit for international investments is 20 per cent rather than 15 per cent.

In geographical terms, voluntary pension fund asset allocation is slightly more conservative than that of mandatory funds: 94.5 per cent of assets are invested domestically. Investments in domestic bonds are lower (51 per cent of assets) than in the mandatory pillar, corporate bonds and open-end funds account for 12 per cent, deposits for six per cent. Foreign assets (5.5 per cent) are almost exclusively invested in open-end funds.
Closed voluntary funds are offered by three companies, which are also active in the mandatory and/or open voluntary pension fund market. There are currently 10 closed pension funds with 10,700 members and HRK 60.3 million (EUR 8.2 million) in net assets.

In terms of market attractiveness, Croatia has the biggest pension market among the smaller CEE markets, and the fourth largest pension market in the region. It will therefore remain an attractive market with considerable growth potential. **AST**

**Next issue:
Asian fund administration**

## European custody panel debate

### Philippe Ruault
**BNP Paribas**

Head of product management - clearing, settlement and custody BNP Paribas Securities Services

BNP Paribas Securities Services offers one of the most comprehensive product ranges. We operate across the entire investment cycle, giving us in-depth knowledge of the buy side, sell side and the issuer segment. We bring together local insight and a global network enabling our clients to maximise their market and investment opportunities worldwide. With us, clients have a one-stop shop for all asset classes, both onshore and offshore, across the globe. We provide the best quality of service and the best people who continuously innovate to meet the needs of a changing world.

### Lilla Juranyi
**ING Bank**

Global head investor services ING Commercial Banking Securities Services

ING Securities Services is highly committed to the custody business in Central and Eastern Europe. As one of the largest custodian banks within the region ING has developed a reputation as being the pre-eminent provider. ING has been providing investor services in Bulgaria, Czech Republic, Hungary, Poland, Romania, Russia, Slovak Republic and Ukraine since 1994. ING offers a full range of investor services, through direct operations in each market. In addition to servicing the international financial institutions ING offers foreign securities settlements, custody, safekeeping and other value added services for domestic clients.

### Elizabeth Fortier
**J.P. Morgan**

Managing director, J.P. Morgan Network Management

J.P. Morgan Worldwide Securities Services is a premier securities servicing provider that helps institutional investors, alternative asset managers, broker dealers and equity issuers optimise efficiency, mitigate risk and enhance revenue. Worldwide Securities Services leverages the firm's unparalleled scale, leading technology and deep industry expertise to service investments around the world. It has $16.6 trillion in assets under custody and $7.5 trillion in assets under administration.

### Laurens Vis
**KAS Bank**

Managing director, KAS BANK UK

KAS BANK is an independent European specialist in securities and investor services. Offering a comprehensive range of post-trade services, from clearing and settlement to full back-office outsourcing, KAS BANK delivers integrated end-to-end solutions to financial institutions and institutional investors.

### Göran Fors
**SEB**

Global head of GTS Banks

SEB is a leading Nordic financial services group. As a relationship bank, SEB in Sweden and the Baltic countries offers financial advice and a wide range of financial services. In Denmark, Finland, Norway and Germany the bank's operations have a strong focus on corporate and investment banking based on a full-service offering to corporate and institutional clients. The international nature of SEB's business is reflected in its presence in some 20 countries worldwide. On 31 March 2011, the Group's total assets amounted to SEK 2,118 billion while its assets under management totalled SEK 1,372 billion. The Group has about 17,000 employees.

## European custody panel debate

### AST: The slogan for this year's NEMA event is 're-establishing investor confidence' How confident are your clients feeling?

**Elizabeth Fortier:** Our clients are feeling more confident than they were after the collapse of Lehmans and during a few different periods of heightened economic or political instability since then. In fact we would argue that our clients feel better equipped to weather some difficult times given the number of challenges that they have faced in the past three years. At the same time, I don't think we will see a period of absolute confidence in the near term. With regulatory change in the wind and countries still in economic and political distress, this is not a time when investors are feeling completely at ease.

**Laurens Vis:** There is no doubt that the credit crisis elevated the often-overlooked issue of cash and asset safety to the top of many investors' agendas. But since KAS BANK is a pure play custodian, we weathered the downturn remarkably well, and were able to reassure our clients at every stage. So a significant drop in confidence was not a challenge we faced. But following the downturn, we have observed a renewed demand for professionalism, transparency and solutions that support more effective governance. There has also been a shift in focus away from performance-seeking investments, to a more nuanced appraisal of the balance between risk and reward.

**Lilla Juranyi:** Confidence, commitment, trust, reliability, long term relationship and joint thinking in risk mitigation are really the key words nowadays in our industry. In a competitive environment as CEE clients can get more or less similar products and service levels from the two or three top rated agent banks. It is not easy to find a way how we can differentiate ourselves. The basic service offering is definitely not a differentiator. An example of a success factor is when the clients feel that we are not only a service provider, but we fully understand their needs and we work together to improve their service level. It is noted positively when we give some special human factor in addition to the strong market knowledge and stable automated operations. "Giving our heart as well" when servicing clients can be interpreted as a human factor. It might influence the decision by a client in a positive way which happened recently when ING won important mandates in three CEE countries.

Showing our commitment is more important today than it was a few years ago. It was always a question in the RFPs and during business discussions and it was sufficient to say: Yes, we are committed. It was rare that anybody has asked: How can you prove it? Proving our commitment with the long-term strategy, continuous investments in our systems and our people will make our clients confident about ING's long-term service in CEE. In addition to the strong investment in our securities services business and product development the fair business approach positively impacts the view about a service provider. Under fierce competition sometimes the spreading of rumours about the competitors can be heard. I am always saying that it is rather the weakness of an agent if they start questioning a competitor's commitment instead of focusing on their own strengths.

### AST: How has your risk monitoring service changed?

**Vis:** Greater complexity and attention from regulators has led to increased demands for an innovative approach to risk management. In response we have invested heavily in our risk monitoring services, and developed solutions to sit at the heart of a broader governance framework. In this vein, we have extended counterparty risk services more usually associated with the sell side to the buy side. And we now offer real-time reporting on compliance, performance and risk to pension scheme trustees and sponsors, for example, delivered through a web dashboard and iPad app. Integrating liability valuation into these tools also directly addresses the need to monitor the balance between risk and return.

**Göran Fors:** The services to clients have changed in the aspect that we receive a lot more questions about risk practices in the markets where we operate. Collateral management services have become more important and we continue to build on the products we have in this area. Discussion also come up on a regular level about the cash accounts, which in practice is the major counterparty risk as cash is not separated as the securities are. We are also asked to assist in monitoring risk for trading counterparts.

**Fortier:** We are pleased with how well our sub custodian and risk management protocols have succeeded over the past few years, but we have made enhancements along the way. We have implemented a contingent provider structure and developed a rapid transition protocol with a goal of optimising our ability to react in the event that one of our sub custodian banks is in distress. We have also enhanced our 'crisis playbook' in order to incorporate lessons learned from various events including natural disasters in Chile, rapid regulatory changes in Indonesia, Brazil and India, economic concerns across Europe and political unrest in the Middle East and Africa. Our process involves gathering information from a vast supply of sources, which allows J.P. Morgan to monitor evolving issues. We also convene to discuss strategies as appropriate so that in the event we are required to react, our ability to make fully informed decisions is finely tuned.

**Juranyi:** Risk has become more important in the post-crisis period than before. Enhanced risk monitoring includes the proper understanding of the environment we and our clients operate in. It means having a good knowledge and best interpretation of the regulatory changes as well as the ability to match such market knowledge to the expectation of your clients and the "clients of clients". It is better if we are thinking further in the chain, than servicing only our direct clients.

The efficient risk monitoring and the timely communication of the potential impacts of certain risks is a key element of our services. Immediate announcements of the market changes are a core service. However, we have to find a good balance between rushing out with the facts only about some changes or rather release our newsflashes with a short delay but adding more value with the impact analysis.

> Juranyi: CEE clients can get more or less similar products and service levels from the two or three top rated agent banks

In the past few months we have carefully reviewed our processes and made the necessary changes or implemented additional control points where it could add higher safety of the settlements but, more importantly, the higher safety of our clients' assets. In 2010 we ran a special project for bankruptcy safety analysis of our clients' assets.

ING's Regional Risk Brochure helps our clients to have a full overview and properly understand the various risk elements of the eight CEE markets where we are present.

**Philippe Ruault:** Operating in a risk aware environment is part of our DNA, significant effort in systems and training are dedicated to mitigate our operational and credit risk. So no real change, just continuity in our obsession to protect client assets. The financial stability and strength of BNP Paribas is increasingly becoming a real competitive advantage. Access to infrastructures and close monitoring of the infrastructures is essential. This is what we do and will continue to do in 102 markets across the world, 22 of which we service via our own branches.

## European custody panel debate

### AST: What are the main additional products and services that clients are expecting from their European custodians?

**Ruault:** Clients expect us to operate more and more sophisticated corporate actions, in shorter timeframes. Clients are also buying more value added solutions to support their post trade processes; middle and back-office outsourcing are definitively on top of the agenda from both our sell-side and buy side client base. Liquidity provision and collateral management are key requirements as well. In addition, we need to continue doing what we do today to the highest standards.

**Vis:** As mentioned above, clients are increasingly expecting innovative governance and reporting solutions. By providing accurate and insightful information through appropriate channels we aim to keep investors and intermediaries alike in complete control. The increased fragmentation of the markets has also created a burgeoning need for compliance solutions that independently monitor third-party mandates in line with investment guidelines.

**Fors:** As mentioned risk monitoring is on demand but I believe the major area being asked from a European custodian is the ability to offer regional services in Europe as well as adopting to changing infrastructure. Business models will change during the next years and we will see for example a clearer separation of asset servicing and transaction processes. We are being asked to provide account operator services, which means that we will make it possible for our clients to be direct participants of the infrastructure as we support with other services in for example asset services

**Juranyi:** I would like to emphasise that it is not just the "additional" product or service that the clients expect. First of all, they value the proactivity in connection with the traditional services they get from us. Thinking jointly is really valued by them. When for instance we propose to them how to save costs at their side as well by proposing some changes in procedures this is a real benefit to both of us. A good example is discussions we had with our clients about changing the frequency of statements of the dormant accounts. It results in cost saving in the end for the whole industry. Of course, it is important that we shall also be flexible at a later stage when a current dormant account will be re-activated due to activity.

In addition to continuously improving service levels with the currently offered services the product development and launching new services is also considered as a proof of commitment. More and more clients appreciate the enhanced MIS reporting which gives a good overview about the clients' and our operational performance. We had some discussions the other day with one of our highly respected clients about the reports. During the discussion we fully agreed that the content of the MIS should be reviewed from time to time: STP rate is a compulsory element of the MIS reporting, it gives a good understanding about your performance on less developed markets. However it does not give too much information about the performance on the matured markets where 97-98 per cent STP has been reported continuously for three or four years.

If you ask us about the most attractive products in these days I would mention the liquidity management and cross border pooling among the value added services.

### AST: How tough is the competition? Do you expect further consolidation?

**Fors:** Competition is fairly tough and it is panning out to be a fight between a number of regional providers that cover all of Europe or parts of it. During the next few years we see increasing competition from regional competitors but at the same time single market providers will disappear through consolidation or exiting the business. I believe it quite possible that we will see further consolidation between regional providers as well

**Fortier:** Competition is undoubtedly tough. There is a battle in the industry for client assets, which is compounded by margin compression and a challenging rates environment. Custody providers are all very focused on increasing their book with organic growth and new clients. Could there be further consolidation? Quite possibly. As we have seen in the past few years, some of the larger players in the industry are buying smaller regional custodians in order to round out their product sets. There could be more of this.

> Vis: The increased fragmentation of the markets has also created a burgeoning need for compliance solutions that independently monitor third-party mandates

**Vis:** It must be said that with a vast majority of the world's assets under management in the hands of a small number of firms, we are already dealing with a virtual oligopoly! But we remain convinced that there will always be a need for focused specialists. As investors spread their reach across geographies and asset classes, they will need expert providers who can offer independent and transparent oversight across their portfolios.

**Juranyi:** It is tough, but it is even more valuable when we can win a mandate under the fierce competition. Consolidation is one way how the number of strong providers might change the landscape. Yes, I expect that some institutions will decide about consolidation, some others might make a strategic decision to quit. But there are a few "newcomers" as well in CEE. When one of the biggest global custodians decided that they wanted to establish a full fledge custody operations in Russia it was a surprise to the market. Such a decision might fit into the strategic view of a global custodian but at the same time it is also a question if the service would focus on the internal requirements and the existing clients or if they have the ambition to gain significant market share. This latter strategy would be a different story with several question marks. Russia is a special market when in addition to the international players a few local state owned institutions have recently also made big efforts to step into the competition.

I am fully convinced that some smaller or midsize markets will not allow long term sustainable business for so many agent banks as we see today. I expect changes in a few years time and the custodian market should be restructured in Central and Eastern Europe.

**Ruault:** Very tough indeed as we are all competing for the same mandates. CSDs are also planning to enter the battlefield leveraging T2S (or will be obliged to in order to survive). We believe local access / local excellence in asset servicing will be the key differentiating elements. Yes, we do expect further consolidation with only providers able to combine global reach, local touch and relentless innovation to survive.

### AST: T2S seems to be the next big thing on the agenda. How important will it be?

**Juranyi:** T2S will be and even today is an important part of our life. There are a lot of questions and debate all around the market but there is no doubt that it will come. Everybody is working hard on having a good understanding of its impacts and developing the best strategy in relation to T2S but there are only a few banks that have a clear vision so far. Most of the banks are in the phase of analysing the potential impacts and working on options. Due to the uncertainties of T2S at this stage nobody can be blamed for the slow progress with the making a decision but the few ones who have already made their milestones will be in the best position.

## European custody panel debate

ING as an agent bank focusing on Central Eastern Europe has somewhat relaxing situation in most countries, first of all on the non-EU markets like Russia or Ukraine. It is most likely that the other CEE countries with the local currency will not move to T2S prior to the EUR adoption except Romania as being one of the first members that announced its decision to join. It gives some grace period to us in several countries but the sooner we decide about the way to join T2S, the better we can be prepared for the changes. The opportunities of asset servicing are not questioned but the full picture about the future of custody still requires more analysis. The first step of publishing our White Paper has happened in 2010.

> Fors: T2S will be a driver for harmonising Europe in the area of legal, taxes and processes

**Ruault:** T2S is a key change in the European settlement infrastructure landscape and will definitively impact our operating model. We nevertheless strongly believe that local touch with on the ground experts in each market will remain a key requirement from clients, as asset servicing and specific settlement transactions will remain at local CSD level. Continued innovation around premium custody services will also put some people ahead of the game.

**Fortier:** T2S is an important step forward to removing some of the barriers that securities markets in Europe have been facing, to integrating settlement horizontally across Europe with settlement in central bank money, and eliminating differences and barriers between the settlement of domestic and cross-border transactions. In addition to the eurozone central banks and their CSDs, non-eurozone central banks and their CSDs can also connect to T2S.

It's the intention of T2S to increase efficiency, bring costs down and eliminate barriers related to securities settlement in Europe. However, at the same time, CSDs are forced to move up the value chain to replace the settlement revenues they are likely to lose as they have to outsource their settlement functionality to T2S. In addition, several important success criteria still need to be clarified such as the costs of users to connect to T2S, the number of markets/CSDs joining the platform as a matter of fact, the ability of local CSDs to decommission their platforms and reduce their costs and the governance of the platform.

**Vis:** As long as Europe continues to operate without a single securities law, we believe the impact will be limited, especially at the investor level. It may be perceived as a giant leap for the infrastructure, but will result in a small step for the end investor. Whether T2S will drastically reduce the cost of cross-border transactions remains to be seen, as this will depend on national CSDs reshaping their settlement platforms and significantly shifting their cost bases.

**Fors:** T2S is extremely important for many reasons, the first is obviously that if it is successful it will create a completely changed infrastructure. T2S is also very important as it will drive harmonisation. The success in harmonisation has been a bit limited so far but overtime T2S will be a driver for harmonising Europe in the area of legal, taxes and processes. T2S will also drive consolidation amongst CSDs and custodians and in the future we will see a more consolidated Europe even though it will take many years. One of the issues is that in short term this will increase cost and this is going to be a challenge for the industry. T2S is complicated in many aspects and will face a lot of issues in order to be a success. One important question is of course to get the European markets to join. A number of markets are today in very difficult discussions to evaluate if it makes sense to join T2s

### AST: How is the changing regulatory environment in Europe affecting custody provision?

**Fortier:** The changing regulatory environment and the different new regulations are affecting custody in several ways, including:

- The way custodians are organised and the way we source services
- The services and products we provide to clients
- The impact on clients' business
- The competitive landscape in which we and our clients operate

The changing regulatory framework requires custodians to assess several aspects, including:

- Increased costs of doing business without the need to reorganise the business
- Increased costs and liability that may require re-organising the business
- Regulatory arbitrage and regulatory differences that may impact global products and global businesses
- Increased costs and liability for our clients
- The opportunity to provide new services
- The opportunity to provide existing services to new client segments

And this is of course broader than Europe, with the US also developing a significant level of new regulation.

**Vis:** The key pieces of legislation here are MiFID (I to II) and UCITS (IV). With its emphasis on best execution – ie, the total cost of trading a given stock, rather than merely finding its best price – MiFID is likely to shift the spotlight from the trading level to the post-trade arena. Clearing and settlement will feature as a key, cost-sensitive part of efficient transaction processing, and custodians will be required to offer detailed reporting in this area for regulatory purposes. This will also lead to much greater competition here, as settlement will become a critical element in process efficiency.

UCITS will have a significant impact on the way the industry is structured. With custodians potentially becoming liable for claims at the agent bank level, there is likely to be upwards pressure on costs and therefore fees. It will be very interesting to see how competition here develops, and whether there will be any impact on custodians' capital bases or risk frameworks.

**Fors:** The Changing regulatory environment is a global phenomenon even though Europe seems to be in a top position when you look at the number of regulatory initiatives. These regulatory initiatives like CSD regulation and SLD is going to directly change the environment for sub custodians. To be added is then all other initiatives like EMIR, UCITS, AIFMD that will affect all custodians in various degrees. Demands will increase on custodians and this is will overtime drive how services are delivered, how legal agreements are set up, how price models will develop and it will most likely also drive consolidation as some providers will not be able to develop in line with the new regulations

**Juranyi:** No doubt that the ever changing regulatory environment requires a lot of efforts and resources both from the business and the support units of the financial institutions including legal and compliance. The top management should also pay special attention to meet all the new requirements. The current situation puts pressure on all of us no matter on which side of the business we sit. In addition to the higher costs of compliance, risk and legal services we should pay special attention to train the people about the new regulations. If you do not have a good understanding of the risks we run and if we do not pay sufficient efforts to the new challenges it will increase the risk of our business.

**Ruault:** UCITS, Basel II, MiFID II, creation of ESMA and EGMI - regulation is becoming more prescriptive and detailed in its approach to managing the risk generated in the safekeeping process. Coupled with a clear need for harmonisation there is much work to be done to ensure continued compliance and transparency whilst maintaining service levels and adding value to asset servicing.

## European custody panel debate

### AST: Is there a difference in services available in newer financial markets compared to more established countries?

**Juranyi:** Yes and no. There is no significant difference in the basic services and the product offering in the matured and the "emerging" markets. Asset servicing is quite similar in both regions. The difference is more visible between the services offered to global clients and local ones. The depository service offering for the local clients include Net Asset Valuation and limit monitoring which is not required of the agent bank by the global clients. Lack of securities lending in CEE is an evergreen topic and the current lending-borrowing is related to the settlement failure in Central Europe rather compared to the well established lending-borrowing on the established markets.

I would differentiate between the What? and the How? The big difference in the emerging or less matured markets is quite often the How? and not the What? A good example is the account structure in CEE versus the matured European markets: omnibus or nominee account is not acknowledged in several CEE countries or if it is possible the operations might be totally different than in West Europe. Market infrastructure, lack of CSD and SWIFT communication are different and these are the major elements where we expect further market developments in the near future.

> Ruault: In terms of product innovation and complexity, established countries still dominate. However, we can be sure this situation will not last for long

**Fortier:** Yes, but it could be argued that it is less about the services and more about the depth of the market and maturity of the infrastructure. When we look at the fully developed markets there are well-developed settlement and payment systems, there is an absence of stringent controls around currency, there is a level of flexibility around how trades can be dealt, lending is available, and there is obviously a healthy level of liquidity. In the newer financial markets access can be difficult; there are a limited number of available providers so service can be to a lower standard. The market infrastructures in many cases are also still evolving, so basic settlement and payment processes may take close handholding. Also, as we saw across this past winter, local political issues can quickly translate into market disruption, which is not what one would expect from developed markets.

**Ruault:** Newer markets are looking at Europe and learning from the fragmentation that has occurred. This can be seen in the Asian debate concerning the necessity of a 'Super CSD' for the region. Wherever the debate ends up, the lessons are clear to them. In terms of product innovation and complexity, established countries still dominate. However, we can be sure this situation will not last for long - the energy, drive and growth potential of the newer markets is huge.

**Fors:** The newer markets normally have a more efficient structure as it can start from a more modern thinking and not struggling with old structures that have a lot of inefficient features. At the same in a number of the new markets have legislation issues that hinders an efficient build up of a market. For very sensible reasons products might not be as advanced in new markets as in established countries. Examples of that is the development of derivatives markets and securities lending. It does make sense for the market to develop before it introduces some of the features that you can find in mature countries

### AST: What are the key issues you feel the European custody market will face in the future?

**Fortier:** As per the previous response (how is the changing regulatory environment in Europe affecting custody provision), in the short to medium term the key issues will be monitoring, managing and acting on regulatory change and industry developments to be able to serve our clients in the best way possible.

**Vis:** Most important will be whether competition or regulation win out in shaping the European infrastructure. The European Commission favours the former approach, but it may transpire that more regulation is forthcoming. Secondly, will Europe be able to rival the other major financial zones – the US, Asia – in attracting newly issued capital. There are certainly many challenges to overcome for governments and market participants alike in the years ahead. Europe simply cannot afford to continue with a fragmented market, split into numerous jurisdictions, as has been the case to date.

**Fors:** Most of the issues have been mentioned already but regulatory initiatives and T2s will the key issues going forward. We will see a completely changing custody world during the next 5-10 years. Products and services will change and consolidation will continue. When I retire in 10 years time I will leave a completely different European custody market.

> Fortier: in the short to medium term the key issues will be monitoring, managing and acting on regulatory change and industry developments

**Juranyi:** I would start my answer about the trading platform which is also going through a lot of changes, consolidation and quite a big part of the trading is done on alternative platforms. Custody as a "post-trade" service comes after it. That is why the future of the stock exchanges will have an impact on the custody world as well. In CEE it is definitely a question mark for a longer period now.

Getting to the custody business my list of the key items is:

T2S, the expected change of competition, the change of fee structures that should obviously cover the increased risk and higher responsibility. The last item is how we adopt ourselves to the increasing regulatory changes. Those who want to stay in the business for the longer term have to have a clear strategy how to confront these challenges and to decide which way we want to grow together with our clients.

**Ruault:** The biggest issue we will face is the discrepancy between the level of fees charged and risk taken. Structure of the fees for certain types of activities will have to change to reflect more accurately the services offered - clients need to understand better the service elements being more than a technical exercise and more about the responsibilities of each partner. An extension of this is the revenue pressure being put upon CSDs. In order to survive and maintain risk robust systems - an absolute necessity for core services - they will need to create revenue models focused on increased custody fees. **AST**

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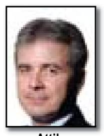

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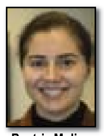

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# Unrealised Returns

## As dividends return to a battered market, the need to ensure withholding tax is reclaimed grows ever more important, says Goal Group's Stephen Everard

EQUITY ANALYSIS

During the equities market's crisis of confidence in 2008, investors had sought refuge in the fixed-income market, prompting the value of domestic bonds listed on global markets to rise to over $63 trillion at the end of 2009. However, equities have recovered strongly over the last two years. Although the total market capitalisation of stock exchanges around the world in early 2011 has yet to regain the peaks of $60+ trillion reached in late 2007, growth is getting more robust and prognosis on growth rate has also been more sustainable these days as they tend to be logically based on solid results rather than unrealistic projections. Institutional investors are now rebalancing their portfolios back into equities, capitalising on the stellar growth of stocks and shares during 2010 to offset at least some of the losses they sustained in the previous couple of years.

Since the late 1990s, equities investment has been through significant peaks and troughs, but earnings from dividend payments have continued to grow throughout the first decade of new millennium. Even taking into account the natural suppression of dividends paid after the financial markets crisis, in line with suppressed profits, the culture of the dividend is far more pronounced now, compared with the nineties, when returns were often predicated solely on capital growth.

Given that dividend payments and bond yields have become increasingly significant elements in investors' portfolio, it is all the more astounding that up to $17.39 billion (£10.72 billion) of global investors' rightful returns from their foreign shares and bonds were lost in the latest financial year because withholding tax on dividends and income is not being properly reclaimed, as revealed by GOAL Group's latest research report. This represents an increase of over 50 per cent in the annual amount lost compared with 2006 when GOAL last examined the situation. In other words, of the total $64.4billion (£39.69 billion) of reclaimable tax in 2010, around a quarter is currently being left unreclaimed.

The United States ($3.16 billion/£1.95 billion) is the biggest annual loser from unreclaimed withholding tax on foreign securities, followed by the UK ($1.65 billion/£1.02 billion), Japan ($1.33 billion/£820 million), Luxembourg ($1.25 billion/£770 million), France ($1.14 billion/£703 million), and Germany ($982 million/£605 million). The magnitude of the current losses is overwhelming, but if fund managers and custodian banks do not take actions to reclaim withholding tax for their investor clients, higher losses might yet be in store for investors in coming years in view of the increasing popularity of dividend payments and cross-border securities.

## Increasing trend of dividend payouts

Over the past decade, dividend payouts have grown in popularity until the financial markets crisis, after which many companies were forced to slash their dividend payments. However, dividend increase announcements were in decline even before the liquidity crisis as companies relied on the greater flexibility of share buybacks to return cash to investors. One commentator has noted that in reality, dividend increases are driven not by excess cash, but instead by a good economic and market environment. Yet to award dividends only in good times creates the least favourable impression on investors. Analysis of dividend reduction during the recent liquidity crisis reveals that investors indiscriminately punished companies cutting dividends during the panic in the second half of 2008 but rewarded dividend reductions in the first half of 2009 as they became comfortable with companies shoring up liquidity buffers in the tough economic and funding environment. Learning from this experience, an increasing number of astute corporates are now starting to use their dividend payments as a proactive tool to manage investor opinion and enthusiasm – in other words, as an investor marketing tool.

In a bull market, investors are inclined to focus on capital growth and thus run the risk of overlooking dividends as a vital component of company return. Indeed, the Barclays Equity Gilt Study 2010 has exemplified that receiving and reinvesting dividends is by far the biggest source of an investor's return in the long term. The study shows that £100 invested in equities and gilts at the end of World War II would have been worth just £5,721 at the end of 2008 in nominal terms. But by reinvesting the gross dividends, the same £100 would have grown to £92,460.

Indicators are now showing a major resurgence in dividend payments as the markets gather strength. One major index provider in the US has reported that across the 7,000+ publicly owned companies whose dividends it tracks, only 30 decreased their dividend payment during the first quarter of 2011 versus the 48 that lowered their dividend payment during the first quarter of 2010. Dividend increases were up 27.8 per cent in the first quarter, with dividend decreases off 92 per cent from the record setting first quarter of 2009. Whereas dividend investors lost $43.8 billion in the first quarter of 2009, US companies added $19 billion to dividend payments in the first quarter this year. The index provider also expects more dividend increases across all sectors in 2011 as companies are eager to demonstrate to investors that they are well into recovery mode.

Similarly, investors in the UK also enjoyed the return of healthy dividend payouts last year. The FTSE 100 accounted for almost 90 per cent of UK dividends paid in 2010, but mid-cap companies have increased their payouts at a faster rate. According to a report published earlier this year by Capita Registrars, dividends from the FTSE 250 rose 16.3 per cent last year, while dividend growth from the FTSE 100 was only 6.8 per cent across the same period. Nevertheless, companies in the FTSE 250 only paid out £5.1 billion last year compared to a colossal £49.8 billion shared out by corporate behemoths in the FTSE 100.

## Cross-border investing

Not only are equities back in fashion, but cross-border investing has also charted an upward trend. According to the statistics from the International Monetary Fund and from global stock exchanges, the market capitalisation of global equities rose 79 per cent between 2001 and 2009, whereas the value of cross border equities investments rose 163 per cent over the same period.

So cross-border shareholdings have risen at something around double the market rate, showing that fund managers have increased the proportion of foreign shares in their portfolio from around 20 per cent in 2001, to more like 28 per cent in 2009. The market capitalisation of the global equities markets is currently around the $59 trillion mark. By comparison, the average proportion of foreign shares in a fund manager's equities portfolio is in the region of 20-30 per cent.

The United States has the largest, most diversified debt securities markets in the world and a substantial amount of global capital is being invested in the US annually. Even though both US and foreign investors had cut down their holdings of cross-border securities and foreign deposits during the financial crisis in a flight to safety, the adjustments in cross-border portfolio holdings were relatively minor compared with the substantial valuation losses that investors faced. As of June 30, 2010, foreign holdings of US securities have again risen to $10,691 billion from $9,641 billion from June 30, 2009.

## Growing appetite for bonds

As banks remained reluctant to lend following the financial markets turmoil, companies competed to raise funds in the bond markets by taking advantage of historic low interest rates since at least 2005. A shift in funding strategy has been slowly emerging among companies as they begin to realise the need to diversify funding sources in light of tight credit lines. According to Investec, about £350 billion of investment-grade loans mature during 2011-14 in the UK, a gigantic volume for the bank loan market alone to cover. The uncertainty around companies' ability to refinance this record amount of debt they issued during the boom years has further prompted them to seek diversified funding channels.

Unlike US companies which have a liking for bond market funding, European companies tend to raise the majority of their finance from bank debt. However, 2008 has seen a mounting proportion of European corporate funding coming from the bond market, heralding a change in European companies' attitude towards bond market funding. A massive surge in European bond issuance was observed in 2009 with an increase in the average size of the offerings. Non-financial issuer bond offerings were 75 per cent bigger at $1.1 billion from $600 million whereas financial issuers sold an average $1 billion, a 56 per cent increase on the $645 million average size of offering seen over the same period in 2008.

Growing appetite in the bond markets for smaller issues, from higher risk or so-called junk-rated borrowers, has facilitated the participation of a broader swathe of mid-market companies in the bond market frenzy. Indeed, the UK Treasury has already been examining ways to improve access to sterling bond markets for more speculative grade borrowers.

## Outlook on securities investment

As 2010 has seen a healthy upswing in dividend policies, this trend is likely to continue in 2011 amid enhanced corporate confidence and economic recovery. Capita Registrars has recently raised its forecast on this year's dividend payments from listed UK companies to £64.2 billion, nearly eight per cent higher than the total £56.6 billion payout in 2010.

The return of the oil giant BP to the dividend list has also boosted the prospect on dividend increase in the UK. The oil group has reinstated investor payments in February this year after its suspension of dividend payout following the wake of the Deepwater Horizon accident. The oil group's importance to income investors is substantial since it was the seventh-largest dividend player in the UK last year despite the fact that it made only one payment in 2010.

As the equity markets crashed in 2008-09, funds poured into the debt markets. With the huge and sudden demand, prices on the secondary market soared, and yields on the primary market plummeted. According to Barclays Capital indices, the average yield for US investment-grade bonds has fallen from about six per cent in June 2007 to 3.75 per cent in September 2010. Euro investment-grade bonds also showed a similar trend, with average yield falling from more than 5 per cent before the financial crisis to about 3.25 per cent. But the desire for yield has not disappeared against the background of low interest rates. Investors are continuing to receive a high premium for owning corporate bonds relative to government bonds. At the peak of 2009, investment-grade bonds were offering a six-percentage yield spread over government bonds.

## Conclusion

2010 has seen a resurgence in equity dividend payment as markets grow. This trend is likely to continue in 2011 amid enhanced corporate confidence and economic recovery. In parallel, the value of bonds listed on the global markets has escalated across the decade. At the same time, savvy investors are increasingly pursuing a global investment strategy to maximise their earnings from securities. Therefore, if the reclamation of withholding tax is not treated with the due attention it deserves, global investors will be bound to give up even more of their rightful returns in the future.

As investors become more rigorous in their scrutiny of investments and are putting fund managers under mounting pressure to provide greater transparency, many leading custodians have already recognised the market opening represented by effective tax reclamation services, both for their FM clients, and as an inter-bank services opportunity. But with around 25 per cent of reclaimable withholding tax lying unreclaimed in foreign tax regimes every year, clearly there is still market potential for custodians to increase the scope and efficiency of reclamation services.

Since each country has its own tax reclamation rates, rules and timings, reclaiming withholding tax requires the incorporation of up to date information, formats and procedures from a multiplicity of various legislatures around the globe, making it a highly complex process. However, automated reclamation facilities are widely available today to keep the process as cost efficient and simple as possible. There is thus no more pretext for fund management and custodians not to take advantage of these technology-based services to help curb the escalating losses on withholding tax in order to enhance the returns of their investor clients. AST

# Industry Appointments

Northern Trust has named **R. Peter Sanchez** as chief executive officer of Northern Trust Hedge Fund Services LLC upon the closing of Northern Trust's acquisition of Omnium LLC. Sanchez currently is global head of business development and client service for Omnium and has more than two decades of experience as an executive in capital markets and complex operational businesses.

Northern Trust Hedge Fund Services will operate as a division of Northern Trust's Global Fund Services business following the acquisition of Omnium from Chicago-based Citadel LLC. The acquisition is expected to close in the third quarter of 2011.

**Jeff Nason** has joined Butterfield Fulcrum as managing director, global and strategic relationships. In this newly created position, he will be responsible for further developing Butterfield Fulcrum's relationships with large, complex alternative asset fund groups.

Nason will be responsible for developing client relationships on a global basis, as well as strategic relationships with asset management groups whose fund offerings require service providers with deep experience in difficult trading strategies, illiquid assets and complex fund structures.

In Nason's new role he will work closely with a team of client integration professionals with accounting and project management qualifications and experience in on boarding complex funds; a risk and valuation team adept at pricing difficult and illiquid assets; and a team of CAs and CFAs to deliver robust and timely portfolio and investor reporting.

J.P. Morgan has appointed **Dinkar Jetley** to the position of CEO of its Worldwide Securities Services (WSS) business.

Jetley will report to Mike Cavanagh, CEO of J.P. Morgan Treasury & Securities Services (TSS), and will be a member of the J.P. Morgan Chase and TSS Executive Committees.

Jetley joins J.P. Morgan from Deutsche Bank in London, where he was global head of trust and securities services and cash management for financial institutions, and a member of the Global Transaction Banking business leadership team.

**Conrad Kozak**, the current CEO of WSS, has been named vice chairman of TSS. In this role, Kozak will be responsible for senior client coverage of select clients and will continue to report to Mike Cavanagh.

Northern Trust has hired **Clive Bellows** as country head, Ireland.

Bellows, who will be based in Northern Trust's Dublin office, will have responsibility for leading the company's Irish operations. He will also play a key role in ensuring the smooth integration of Bank of Ireland Securities Services, which Northern Trust announced it intended to acquire in late February this year. Bellows will report to Toby Glaysher, head of Global Fund Services in Europe.

Omgeo has appointed **Clare Fraser** as managing director of strategy. In this role, Fraser will be responsible for identifying new market opportunities and overseeing the global marketing function, while providing strategic guidance on the firm's business worldwide. Fraser is based in London and reports to Marianne Brown, President and CEO, at Omgeo.

Penson Futures has named **Steve Leone** as chief operating officer (COO), a new position. As COO, Leone will have responsibilities over global clearing, information technology, finance and accounting.

BNP Paribas Securities Services has appointed **Sam Shi** as sales director, Greater China for asset owners & asset managers, as the firm continues to expand its Asian team to drive regional growth.

In this new regional role based in Hong Kong, Shi will lead the business development activities targeted at key institutional investor clients in China, Hong Kong and Taiwan, working closely with the BNP Paribas teams in these countries.

Technology consultancy Capco has appointed **Alex Corsi** to lead the company's UK technology services domain. As a partner in Capco's London office, Alex will specialise in setting up and managing complex delivery models in the Capital Markets sector.

Alex joins Capco from Accenture, where he was an executive partner, responsible for Capital Markets in select European geographies. He has over 15 years' experience working with global financial institutions on complex transformation and outsourcing projects.

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## ISLA 20th Annual International Securities Lending Conference

Date: 28th-29th June 2011
Location: Penha Longa (Lisbon/Sintra)
Website: www.afme.eu/isla2011

ISLA is pleased to announce the date and venue for its 20th International Securities Lending Conference. The event will take place between 28th and 30th June 2011 in Penha Longa (Lisbon - Sintra).

## European Clearing and Settlement

Date: 29-30 June 2011
Location: London
Website: www.icbi-events.com/ecs

An expected wave of European regulation; more competition; pressure on costs and fees; a new focus on risk – all this and more will covered at ICBI's flagship 17th annual clearing and settlement event.

## 12th Annual Collateral Management

Date: 7-9 September 2011
Location: London
Website: http://www.marcusevans.com

This collateral management event, brings together senior figures from the collateral world in order to address key topics including regulatory reform, automisation, optimisation and how to attain best practice in operational procedures.

## The Finadium 2011 Conference

Date: 20 September 2011
Location: New York
Website: www.finadium.com

Themes for this year's conference include ETFs in securities lending, transparency in financing for hedge funds and their investors and the impact of CCPs on collateral management. Lunch is provided and networking is encouraged.


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