

*Much of the potential of global custody is still untapped.
The first custodian to grasp its full potential will dominate
an increasingly pivotal industry.*

An alternative vision

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The global custodians who come to dominate their industry will be those that have the vision to take the initiative in the settlement area, redefining the global custodian's role in this process. Indications of the appropriate direction are given in the Group of Thirty's report, which emphasizes the need for post-trade communication to ensure matching and affirmation of trades well before settlement.

The profitability of the undemanding global custody operation accounts for the popularity of the global custody area amongst commercial banks: it also contains the seeds of far-reaching changes. Global custody, if it is to survive, will have to be redefined via the emergence of a more explicitly custodian-centered international settlement system.

International clearance and settlement is inefficient, risky, and expensive. International cooperation by official institutions is unlikely to resolve all the problems. CEDEL, Euroclear, and SWIFT, all once considered possible fulcrums for an effective international settlement system, are clearly going to keep low profiles. That said, it remains obvious that a much more efficient international settlement system can emerge; the technology is available, and what needs to be done is known.

Redefinition of global custody is needed where most client dissatisfaction exists, in the process leading to settlement of the trade. One of the recommendations of the Group of Thirty is that by 1992 all fund managers should be in a position to confirm trades positively by T+1. This is the only one of their recommendations on which no progress is yet in sight. It is not difficult to see why: a fund manager may trade in 25 different markets, so that if each

market had its own client-side trade comparison system, major fund managers would have to participate in 25 of these.

Imaginative approach

Here is where there is room for an imaginative approach by custodians. A standard part of processing a settlement instruction should be to send out confirmations to the counterparty and its agent by fax, telex, SWIFT, electronic mail, or even voice mail. Systems exist which can do any or even all of these automatically without manual intervention. The same systems today could receive and process an answer by any of these communications methods. Thus a universally accepted communications system is not necessary to confirm and match trades effectively; standardization of formats would be helpful, but there is no need for universal membership of an international ID or its equivalent.

If a global custodian were to provide an electronic instruction entry system to its customers, then as this system captured the data on a trade it could send out confirmations to principals and banks on the other side of the trade. If responses could be sent back via any convenient communications medium, serious professionals in the market would surely respond, and a significant portion of the international trades of this bank's clients would be confirmed or D/Kd prior to settlement.

One custodian making a move toward instituting this type of communication will force others to follow suit. The technology can be bought or licensed—massive resources are not needed to make this move.

The scene is set for a change in the global custody industry and its prod-

ucts, and for the industry to play a more pivotal role in the settlement process. These shifts will make the successful custodians much more profitable than the leaders now, because active involvement in settlement will lead to more floats, more intermediation, and the ability to offer delivery versus payment and the associated risk reduction. Ultimately it will be possible for two or three industry leaders to settle trades between their customers through reciprocal accounts on their own books, bypassing the local settlement processes altogether. There will be decentralized international book-entry settlement: the management of this will be a franchise really worth competing for.

Geographic shift

There will also be changes in the geographical balance of the industry. Japanese firms will clearly take a more prominent role, and so will Europeans. 1992 will also lead to a dramatic increase in demand for custodial services in Europe.

In sum, leadership of the global custody industry is going to become immensely valuable. Leadership requires appreciating what a global custodian can really contribute to processing its clients' trades, and the right technology to implement this. First movers will probably be winners, and winners, as in other walks of life, will take all.

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