Retail Distribution Review: the hidden costs

Wealth managers and private banks have had to deal with inefficient back office processes for far too long, says Neil Wise, Vice President, Investment Fund Services at Clearstream. However, there is growing belief in the market that the Retail Distribution Review (RDR) provides a line in the sand which will force practitioners to opt for better operating and processing models.

Third-party fund processing can be a considerable drain on any company’s profitability. However, in the pre-RDR world, this was largely hidden from the wealth management community as their platform providers covered the cost of processing by taking a cut of their full trailer fee entitlement. The historical benefits of using a platform are clear: free order routing, settlement, custody and asset servicing, all of which are very appealing, along with access to a broad range of funds. Traditionally, the charging arrangements tended to be quite simple: a fund platform which took a share and passed the rest back to their wealth management clients. For years, private banks and wealth managers have been broadly happy to run with this bundled fee structure, often having little idea (or interest) in how much they were actually paying for their fund processing and custody.

However, when you consider that this sales commission often amounted to 0.75%, or 75 basis points, and the custodial component was very much a后台 arrangement, you’re seeing (or not) quite a chunk of your ‘entitlement’ being eaten away. Twenty five basis points for custody? Not even in the 1970s were fees so high for bonds and equities. Although custodians returned fees, the remuneration to custodian – and truly offering the highest standards of asset protection and operational processing expected from financial regulators.

For example, though fund platform providers may claim that they offer high levels of back office processing, this may extend little beyond the order routing component. Downstream of the order routing, processing activities may rely on heavy manual and paper processing. The post-trade component, including fund settlement and reporting, corporate action processing, the handling of tax vouchers and cash and securities reconciliation, may all be highly manual with large teams of staff in processing centres churning fax, telephone and email communication across the investment value chain. In practice, the risk management benefits may be of even greater significance. When handling large order sizes and large investment portfolios, the risks presented by a failed settlement or a misprocessed corporate action may be extremely large – resulting in late delivery of funds, sizeable claims or even a potential exclusion from the market should you face issues in the CSD. Faced with these risks, it is unlikely that wealth managers should continue to settle for sub-optimal levels of processing efficiency from their service provider.

The benefits of this service cannot be expressed simply in terms of cost savings, important though these are. In practice, the risk management benefits may be of even greater significance. Given the size and complexity of these risks, wealth managers are now recognising the high levels of risk across the investment process. Fund platform providers will now see a sizeable chunk of revenue disappear that they previously received as a share of the trailer fee paid to the distributor. As this component disappears, platforms will come under pressure to rationalise their processing models and to operate more efficiently.

Indeed, they will also have to make genuine services which were previously perceived as free. In all likelihood, it will no longer be practical to maintain a sizeable processing and manual staff performing highly manual activities.

About Clearstream
Clearstream is a global leader in post-trade securities services with more than GBP 10 trillion in assets under custody, of which over GBP 1.1 trillion are fund assets. Over 2,500 banks, wealth managers and financial institutions around the world use Clearstream.

As a specialised fund-custodian, Clearstream delivers state-of-the-art solutions to standardise investment fund processing and to increase efficiency and safety in the investment fund sector.

With more than 125,000 mutual funds and 23,000 hedge funds from 37 fund domiciles, Vestima is the world’s largest cross-border fund processing platform.

Through its Vestima platform, Clearstream offers an integrated fund solution that can handle fund transactions and post-trade processing with a high level of automation. Clearstream recognises with its fund customers on a daily basis as it feels this is crucial to eliminating risk and to ensuring that cash and securities are where Clearstream think they are. Fund managers and transfer agents typically hold accounts within Clearstream, so the fund settlement can be managed via an internal DVP settlement, ensuring the safety of legal ownership and of cash payments simultaneously with cash credited to the seller’s account at 8:00 on settlement day.

As an AA-rated bank with a tradition in providing fund custody and asset servicing, Clearstream offers a one-stop shop through which customers can meet all their settlement and processing requirements for multiple instrument types, including fund shares and units, from a centralised platform. Clearstream continues to grow organically and through strategic acquisitions to extend the range of assets supported by its central processing hub. This is exemplified by Clearstream’s recent agreement to acquire Cito Global Securities Services’ hedge fund custody infrastructure based in Cork, Ireland. This will reinforce its ability to service financial institutions investing in the hedge fund sector.

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