ALL CHANGE IN IRELAND

A panel of asset servicing experts examine how new regulations and a march towards automation has changed the way they do business. Chaired by Nicholas Pratt.

THE PANEL

Clara Dunne
Senior country officer, Caceis Investor Services (Dublin)

Neil Wise
Vice president, investment fund services, Clearstream

Mike Hughes
Global head of fund services, Deutsche Bank

Keith Hale
Executive vice president, client and business development, Multifonds

Clive Bellows
Country head, Ireland, Northern Trust

Susan Dargan
Head of global services, investment servicing, State Street

Donard McClean
Managing director, UBS Fund Services, Ireland

» THE PROBLEM WITH AUTOMATION LIES NOT WITH THE TRANSFER AGENTS BUT THE DISTRIBUTORS, ESPECIALLY IN ASIA. «

Keith Hale, Multifonds

Funds Europe: How is Ireland's march towards automation proceeding in the transfer agency area?

Keith Hale, Multifonds: The European Fund and Asset Management Association (Efama) stated that Ireland has 85% automation compared to 75% in Luxembourg in terms of fund orders received by transfer agents, and that is consistent with our client base. But the problem with automation lies not with the transfer agents (TA) but the distributors, especially in Asia. There have been industry initiatives to improve automation but as a software provider we want the entire process to be as efficient as possible, not just getting the trades input.

Clara Dunne, Caceis: One of the things that's been driving investment in TA systems has been Foreign Account Tax Compliance Act (FATCA). We've all had to do some development to support FATCA and if we

can encourage distributors to automate at the same time, it makes a lot of sense. What Caceis has done in Asia is to put in a local distribution support team so that even though the trades are automated, we still have a local presence there to assist the distributors. We have found that this has worked very well for us.

Neil Wise, Clearstream: The Efama statistics show a steady rise and that is good for Ireland. But these statistics are slightly misleading because they refer to one part of the process – the order routing but not anti money laundering (AML), nor any of the post-trade processes such as settlement, reconciliation or corporate actions of income. A lot of the problems facing TAs and distributors come from the fact that the post-trade world is not quite there in terms of automation.

Clive Bellows, Northern Trust: Over the last three or four years we have made a significant impression on automating in the TA space. Our volume of trades in transfer agency just in Ireland is up 20% this year and the only way you can deal with that type of growth is by having automation. But there are many parties in the equation that need to work with us and a good distribution support team that work with distributors in Asia or other locations is an important function to have and we're all investing in making sure we have the right people interacting with industry counterparts.

» CONSOLIDATION WILL CONTINUE. SPECIALISED PROVIDERS WILL STRUGGLE TO OFFER THE SERVICES REQUIRED FOR THE NEW REGULATORY ENVIRONMENT AND THEY MAY END UP BEING THE FIRST TARGETS.«

Donard McClean, UBS Fund Services, Ireland

Funds Europe: What about the hedge fund world? Is that just as automated as the mutual funds world?

Mike Hughes, Deutsche Bank: The alternatives world is miles behind in automation. The mutual world has been forced to automate because of volume, complexity and the number of distributors. There's also a difference between non-bank and bank-based asset managers. The latter have armies of technology staff and they all rely on Swift as the means of electronic communication. In the alternatives world, the problem is at the point of data capture. Most TAs do a great job in trying to make their processes as efficient as possible but for the most part alternative managers are just not ready and this is something we as an industry have to address.

Donard McClean, UBS: We are seeing a huge increase in the levels of activity in our alternative investor services department, the types of volumes more closely associated with mutual funds. This is due to the fact that Ucits funds have now become mainstream in the alternative space. Alternative Ucits interface with platforms, booking centres and distributors rather than a direct investment channel. While that brings benefits in terms of automation it also brings new challenges.

Susan Dargan, State Street: In reality, we don't see the same level of automation in the hedge fund world as we do in the mutual fund world. The big challenge is to provide the scale to deal with the volume of trades and then marry that with the high touch needs of some hedge fund investors.

Dunne: The technology is not the problem, we need to focus on persuading the managers to engage with us.

Wise: I think times are changing and certainly with regulations coming, such as AIFMD, people looking to reduce the risk and I think automation is where we want to go. I agree it will take time. It's that herd mentality but as long as we are heading in the right direction, that's a good thing.

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Funds Europe: How has your relationship with the Central Bank of Ireland (CBI) developed with themed inspections?

Bellows: We had our inspection nearly two years ago now and it was thorough and well run by the central bank. The relationship between both parties is in a fairly sensible, pragmatic place and having consistency with contacts at the central bank for the last three years has helped tremendously.

Hughes: Their engagement model has been constructive, they understand the regulatory environment that we all work in and they understand where the industry needs to go. They are treating us collectively as partners.

Dargan: I think the difference now is the new oversight unit. It's much more structured and the areas they are looking at are well publicised in advance. Outsourcing is a large part of every major custodian's infrastructure at this stage and it is also an area of focus for the regulator. Governance is another area they are reviewing and they require certain structures to be in place. As the largest administrator and custodian in this market there is significant interaction, but that's no different to any other market we operate in and our people have adapted well to the new environment.

Dunne: It's been helpful that at the start of each year the CBI publishes its enforcement priorities and what their themed reviews are going to focus on. That is not to say they won't address other issues but it is helpful for us to know where their focus is likely to be.

Bellows: We've all invested in the resources to work with the central bank. I have people who are purely focused on making sure that our outsourcing arrangements are robust and properly documented. We take these subjects seriously and the central bank can see that when they come in.

» A LOT OF THE PROBLEMS FACING BOTH THE TA AND DISTRIBUTOR ALIKE COME FROM THE FACT THAT THE POST-TRADE WORLD IS NOT QUITE THERE IN TERMS OF AUTOMATION. «
Neil Wise, Clearstream

Hale: As a software provider we experience the regulation second-hand, although the central bank might check that we're a reliable vendor through our customers. The biggest issues that we see are AML and moving to a proper risk profiling process which looks at more than just investors' country of residence. Our job is to build all of these controls into our platform and to make it as exception-driven and automated as possible.

McClean: Since the crisis, regulators all over the world, not just Ireland, have come under increased public scrutiny. As a result regulators including the CBI, SEC, FCA and FINMA are placing greater demands on financial service providers including greater supervision and more detailed reporting. The Prudential Risk and Impact System (Prism), the CBI's risk rating framework, allows the regulator to concentrate resources in activities they consider to be higher risk. We have found themed inspections to be thorough and professionally executed. They have actually gone outside Ireland to visit some of our operations in Europe as part of an outsourcing inspection which demonstrates how the CBI is adapting to industry developments.

Funds Europe: In what areas are you seeing growth both in terms of fund types and also the services provided?

Dunne: A really interesting area for Caceis in Ireland is real estate. We are seeing real estate funds investing in Irish property through QIAFs as well as Real Estate Investment Trusts, some of which may be subject to AIFMD and thus need a depositary. We lost out in this sector in the funds market in the past but there are more and more US and European managers looking at Ireland as the domicile of choice for real estate funds, investing in both Irish and overseas properties.

Dargan: It is pretty positive at the moment. We are a leading service provider to ETFs in Ireland and we're seeing a considerable amount of growth within this asset class. Our loan servicing business has also grown significantly over the last year on the back of the move into non-bank finance. And we are seeing renewed interest in liquid alternatives.

Bellows: We're seeing a strong demand for anything that can help clients cope with regulatory challenges. Particularly in the OTC derivatives space, collateral management is a hot topic with lots of activity and interest. We recently enhanced our liquidity and collateral services to help address the anticipated collateral squeeze. As we look forward past the AIFMD implementation deadline, I think we'll see Ucits V regulation becoming a focus and this will bring with it a demand for evolving fund services.

McClean: The most interesting area is the new single manager alternative space. We now have front-office capabilities offering portfolio management, risk, and middle-office services including trade reconciliation, settlement and collateral management. The back and middle office are moving closer together so we're seeing risk services and profit attribution services linking up with prime brokerage and depository services, including depo-lite. There is also an increasing demand for management company (manco) services as part of the governance of funds. As an asset servicer, it is about building these set of capabilities to meet the demands of a spectrum of clients.

» WE'RE IN THE EYE OF A STORM WITH AIFMD. WE'RE OVER THE THEORY AND INTO THE PRACTICE AND THIS IS PUTTING PRESSURE ON SERVICE PROVIDERS TO BRING THEIR PRODUCTS TO MARKET. «

Mike Hughes, Deutsche Bank

Wise: There has been strong growth in the hedge fund space which led Clearstream to expand its hedge fund offering and to acquire Citco's financial institutions hedge fund sub-custody business bringing 300 experts based in Cork into the Clearstream world. For us, it is part of the industry which has been left untouched. A lot of the local wealth managers and private banks have a fantastic sub-custodian network for their equities and bonds but do their hedge fund processing themselves without having any clue about the operational risk or the cost of processing. So we see that the intermediation of the third-party hedge fund processing as crucial given that Ireland is the servicing centre for the hedge funds industry. What's key is that with the neutrality of Clearstream, this service can be offered to global custodians who were unlikely to outsource this to a competitor.

Hughes: There's definitely a trend for long-only managers moving towards the alternatives space and blurring the lines between the two. There are some highly complex illiquid structures coming through Ireland now where you've got managers looking again at side pockets and the like and how they structure those to provide value for investors. On the custody side, both financial instruments and the non-financial instruments, certainly we're seeing some growth there and clearly the AIFMD value chain is providing an opportunity. Regulatory reporting is also another massive area of interest. It is not about NAVs [net asset values] anymore, › it's about being able to provide modular services across the entire value chain which may or may not include the technology, and bringing that to bear from day one.

Hale: In the liquid alternatives space, we're being pushed to provide the daily capability with all the controls and efficiencies necessary for traditional structures, combined with the flexibility required for alternatives such as performance fees equalisation and asset class coverage, on a single software platform. The other growth area we see is middle office outsourcing. The challenge for administrators is that they need to have one system that can provide the accounting book of record, in other words the financial accounting view of the business, as well as the investment book of record, which is the investment view of the portfolio. One system, with one database that can supply both views of the portfolio is significantly beneficial from an operational efficiency perspective.

Funds Europe: What has been the impact from the AIFMD and what do you expect that impact to be once it goes live in July?

Hale: last year the big worry was depositary liability and the possible cost, but we're seeing much more of a concern now about regulatory reporting. It presents some significant data management challenges because you are not just talking about accounting data or TA data. You're talking about multiple data types, collected from different parties and multiple systems and then getting it all aggregated, signed off and passed to the regulator.

Bellows: If anyone is worrying about how they're going to do the regulatory reporting now then they're in big trouble. Clearly this year is an important milestone in AIFMD development, but in our discussions with fund managers, their focus is around the workload required to implement the directive rather than the strategic opportunities it presents.

» THERE ARE MORE AND MORE US AND EUROPEAN MANAGERS LOOKING AT IRELAND AS THE DOMICILE OF CHOICE FOR REAL ESTATE FUNDS, INVESTING IN BOTH IRISH AND OVERSEAS PROPERTIES. « -

Clara Dunne, Caceis Investor Services (Dublin)

Dargan: Regulatory reporting under AIFMD requires significant development and needs to be in place. The work we have done on Form PF in the US has helped because we are able to build off that capability to provide AIFMD regulatory reporting services.

Wise: I agree with Keith because some of the little guys are taking a wait-and-see approach, rightly or wrongly. We launched the trade repository, Regis-TR, this year for the reporting of derivatives trades as required by the European Market Infrastructure Regulation. And even though everybody had ages to get the work done, everybody was waiting to see what all the others would do. And I see exactly the same thing happening with the AIFMD.

Hughes: I actually think we're in the eye of a storm with AIFMD. We're over the theory and into the practice now and this is putting a lot of pressure on service providers as a whole to bring their products to market. But unfortunately we are just weeks away from going live as an industry and there are still issues around naming conventions, the holding and segregation of assets and a delegation model versus a true custody model. The work has been done to deliver the products but how each individual manager or prime broker interprets the directive is likely to vary and that makes things more difficult.

Dunne: The prime broker community is giving its views on where it stands on contractual discharge or indemnities. There › has been a lot of effort and negotiation taking place in recent times to ensure that opinions are clarified and crystallised.

McClean: The impact that it's had in Ireland, in our business has been enormous. And the opportunity it affords our whole industry is huge. We can bundle offerings and develop capability modules. The offering starts with cleaner and better data in a controlled environment and ends up in modules of capabilities which are bundled to the tailored demands of our clients.

Funds Europe: Can AIFMD be profitable for asset servicers?

McClean: It is about reducing and controlling cost as well as generating revenues. A cost-efficient scalable global framework is the essential starting point from there we introduce clients to the platform and build sustainable additional services, including front middle and back office. By bundling those capabilities we generate additional revenues and provide better client services. AIFM reporting is a must have. Clients, recently, are also interested in our depo-lite, front office, Swiss representation services and manco offerings.

Dargan: We are providing depo-lite services for traditional hedge fund managers who are looking at getting into more regulated Ucits funds. Service providers need full end-to-end efficient, scalable, global, regulated hedge fund servicing capabilities.

Hale: One leads to the other. If you get the efficiency and the controls right, profitability will follow because non-European managers will see an asset gathering opportunity in Europe. Managers may have been happy to avoid setting up an AIF and continue with a Cayman or Delaware fund, but if they see that servicers are investing time and effort to make their AIFMD services efficient and cost-effective, they will bring more funds into AIF or Ucits structures.

» THE LANDSCAPE WILL CHANGE OVER THE NEXT COUPLE OF YEARS. IT WILL BECOME HARDER FOR SMALLER ORGANISATIONS TO GATHER ASSETS BECAUSE THERE WILL BE QUESTION MARKS OVER THEIR RISK-TAKING ABILITY. «

Susan Dargan, State Street

Dunne: As a consequence of AIFMD, the world of the specialist administrator is under threat. The investment in technology which is required, along with the onerous responsibilities placed on the depositary, means that you need the backing of a strong well-capitalised custodian to be a serious player in asset servicing.

Bellows: No one should underestimate the resource implications incurred by asset servicers to prepare for AIFMD.

Funds Europe: Does all of this mean that consolidation will continue and what effect will this have on the service provider landscape in Ireland?

McClean: Industry consolidation will continue forever. Without the backing of a global presence and depository function, specialised providers will struggle to offer the services required for the new regulatory environment and they may end up being the first targets.

Dargan: The landscape will continue to change over the next couple of years. It will become harder for smaller organisations to gather assets if there are question marks over their size and scale.

Bellows: And even if they have the risk-taking ability and appetite there'll be a question mark as to whether the regulators will let them because of the capital question. Anyone who hasn't got a strong balance sheet is going to struggle to survive.

Hale: There is continued

preference for a bundled service model in Europe, compared to the US, and this distribution driven model will continue in the EU. Increasingly the big asset managers look for administrators to give them as global administration and distribution support capabilities as possible. Equally hedge funds might also want that global distribution support particularly following AIFMD. As a result it will be tough for niche, typically alternative, administrators, covering a few offshore jurisdictions, to remain competitive and stay independent in the medium to long-term.

Funds Europe: Should managers be concerned more consolidation among service providers means less choice?

McClean: No. New capabilities offered by service providers will create greater choice for managers. Consolidation means depositaries buying niche service providers thereby creating enhanced investor security.

Bellows: I don't think you need to go to a niche provider to get specialist services. There's nothing that the providers around this table can't do as well as the niche providers – and we bring the technical sophistication and reach of a global organisation.

Wise: But that comes from the growing space between the alternative and the long-only funds and as that progresses and gains speed, the niche players will not be niche anymore as even big players have that capability.

Hughes: It is never going to be an anti-competitive situation just given the vast number of banks that service the custody and depository space. The number of providers is very significant in terms of the core NAV service and for that to consolidate would probably be a good thing.

Bellows: I'm not convinced I see any of the major depositories stepping in and helping somebody who doesn't have the balance sheet to be a depository and provide all those other services. The liability you take on depends on someone else doing their job properly and I want us to be in control of our destiny. More and more global clients are going to want a global provider as well so just being strong in Ireland is not going to be good enough in the long-term. You're going to have to be strong in Luxembourg, you're going to have to be strong in the UK and whichever domicile need these services.

Dunne: And the more reporting they're looking for from you, the more visibility you need to have over the whole operation.

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Clive Bellows, Northern Trust

Funds Europe: Does that mean that the asset servicing model in Ireland will be pretty much the same as in any other jurisdiction, save for some sort of regulatory specifics?

Dargan: It's already at that stage, we have uniformity right across our operating model. However, we will always tailor our model to reflect our client's needs, location and regulatory requirements.

Wise: A lot of it depends on how people define "global". I see some firms that have an operation in Luxembourg or Dublin and the UK and then call themselves global. That's just two countries.

Hughes: Nobody is completely ubiquitous and brilliant in every location and that's why some of the big asset managers will go to multiple service providers based on their strength in a location and different product. But that is why consolidation will continue as one way to address a weakness is to build out your capability. fe