



# Meeting custody needs of platforms and wealth managers

**Platform**

clearstream

DEUTSCHE BÖRSE  
GROUP

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## About Platforum

Platforum is a research consultancy that analyses the trends in retail investment distribution. Our work covers the wealth management, financial adviser and direct-to-consumer distribution channels across the UK and Europe.

Our syndicated and bespoke research inform product, proposition and distribution strategies for asset managers, platforms, banks, insurance companies and technology providers. Insights include the latest industry trends and business opportunities.

This whitepaper represents the findings of a research project commissioned by Clearstream. A wide range of platforms, wealth managers and technology providers were interviewed between December 2020 and March 2021 to establish business models used and their comparative merits.

## HARD ECONOMICS BUT AN EASY DECISION

Foreword by Philippe Seyll,  
Chief Executive Officer, Clearstream Banking

It's tough to run a business, and sometimes it's completely understandable to concentrate so hard on customers, prospects and revenues that we forget some of the key basics of economics. Yet that's exactly what's happening in hundreds of wealth management and platform organisations in UK and around the world. *Revenue is vanity; profit is sanity!*



Retaining their third-party funds custody operations in-house – or even partly in-house – overlooks the key advantages of focusing on what these businesses are best doing rather than trying to carry out a whole range of activities where they are not specialists. It is Economics 101, the law of comparative advantage, that the pioneer economist Ricardo first identified in the early 1800s. Focus on what you are best at and let others focus on what they are best at – and both will end up richer.

We know that plenty of wealth management and platform organisations have grown up with their own custody operations, even though this is an activity that is quite different from their core skills and activities. Custody requires huge scale and administrative focus, relying on economies of scale for processing, security and efficiencies, which smaller organisations cannot hope to achieve.

Opportunity cost lies at the heart of the law of comparative advantage. If a business's senior management diverts its attention away from its core competence to areas of high potential risk but lower potential returns, the chances are that they will miss out on much more valuable opportunities.

The apparent cost savings from in-house solutions are in many cases illusory – even more so when the risks are factored in. Not only does top management save time and the worry of overseeing a very different type of activity from their mainstream business, but outsourcing can save internal resources and provide direct and tangible savings.

What's the explanation for sticking with subscale in-house third-party funds custody operations when the economic logic for outsourcing is so clear?

Partly, they are prisoners of a history that's hard to break free from. But it also is the overconfidence that comes from retaining apparent control – an insight from the more recent economic theories of behavioural finance. Many of us have the illusion of greater safety when we, rather than an expert, are at the wheel of a car.

The fact is that DIY third-party funds custody introduces all kinds of hazards for businesses – especially regulatory: think CASS. It is much safer to outsource to trusted specialists with the scale and expertise to do the job safely and compliantly.

This Platform study shows just why the senior managers of wealth management and platform organisations need to take a long look at their current third-party custody arrangements to see if they can cut costs and increase security.

## EXECUTIVE SUMMARY

Pressures on platform operators' and wealth managers' margins have created a point of inflection in the market for back-office outsourcing services:

- Costs need to be controlled and reduced by increasing operational efficiency and simplicity. Scalability is important to platforms and wealth managers which are looking to grow organically or by acquisition.
- Changes in capital markets can place greater strains on in-house services than large and well-resourced outsourced providers.
- Regulatory and market pressures are reducing platforms' and wealth managers' appetite for risk in non-core activities. As their AUA increases, platforms and wealth managers increasingly need to achieve and maintain time-critical compliance with the FCA policy statement on client assets.<sup>1</sup>
- Platforms and wealth managers can maximise value provided to clients by focusing on their core business, rather than using their own management and strategic resources on third-party funds custody issues.
- New capabilities for outsourcing have fundamentally changed the opportunity for finding efficiencies.

Platforms and wealth managers have evolved three main solutions for third-party funds custody and other back-office functions:

- **In-house solutions**, which allow firms to retain control of their systems, but which lead to higher costs and some potential inefficiencies.
- **Hybrid solutions**, which can help improve access to a wider fund market, but can also involve higher costs and inefficiencies.
- **Fully outsourced solutions**, with specialist providers of third-party funds custody and other services.

Fully outsourced solutions can provide the following to platforms and wealth managers:

- More time and resources to focus on front-end innovation, while passing the less glamorous back-end processes to a specialist.
- Greater control of the cost base and efficiency gains.
- Added value through the facilitation of true net settlement, reducing the risk of CASS client money breaches, while enhancing the speed, accuracy and frequency of reconciliations and providing better liquidity management, especially where DvP is used for settlement.
- Annual AML/KYC checks on instruments and accounts with transfer agents.
- Leverage of a custodian's distribution arrangements with asset managers to benefit from the attractive commercial and operation terms.
- Reduction in the level of capital employed by platforms or wealth managers.

Vestima bundles Clearstream's entire suite of investment fund services, providing order routing, settlement and asset servicing for mutual funds, exchange-traded funds (ETFs) and alternative funds, to achieve:

- Efficiency gains.
- Asset safety.
- Highest safety standards – including asset segregation and DVP settlement.
- Coverage of all fund markets.

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<sup>1</sup> PS14/9: *Review of the client assets regime for investment business*, FCA, June 2014



# 1 KEY ISSUES FOR PLATFORMS AND WEALTH MANAGERS TODAY

Platforms and wealth managers have an opportunity to examine their current arrangements for third-party funds custody and related services to see if they could be significantly improved for lower risk and higher profitability.

Scalability is important to companies looking to grow organically or by acquisition. Those with manual back-end processes may ‘throw more FTE at the problem’ but this is likely to store up problems for the future. In addition, as AUA increases, it becomes more important to achieve and maintain time-critical compliance with the FCA Policy statement on client assets.<sup>2</sup>

## 1.1 Controlling costs

Some platform providers and wealth managers have embraced the full self-administration route and accept the higher costs as part of their value proposition. But where businesses use a hybrid model, there is a compelling case to leverage an outsourced service provider. The streamlining of operations through an outsourced model gives them the opportunity to provide scalability, growth, cost control and better management of risk.

*“Scalability is very important to us. We quickly discounted the DIY route because we wanted more STP. A composite route was difficult because there was not enough take up of connectivity with Crest by fund managers. That left us with full or partial third-party funds custody outsource model and we wanted a partner who ticked boxes around scalability, coverage and commercials as well as specific functionality requirements we had.” UK adviser and direct platform*

Much of the cost of in-house or hybrid solutions come down to staff costs. They can vary considerably between organisations, with larger companies typically achieving greater economies of scale and lower staff costs as a proportion of AUA. However, both regional location and the operating model also have a major impact.

For standalone platforms that publish staff costs in annual accounts:

- Smaller platforms operating a hybrid model are often paying 12-16bps of AUA on staff. For adviser platforms this looks increasingly unsustainable, as pricing pressure pushes platform charges below 20bps.
- Larger platforms with in-house models – such as Hargreaves Lansdown and Transact – are paying 9-10bps on staff.
- Staff costs at one larger platform running an outsourced third-party funds custody model only account for 7.4bps of AUA.

*“We value the simplicity of working with an outsourced third-party funds custody provider versus the complexity of going direct. The cost is offset elsewhere with 10-20 people saved.” Direct platform*

## 1.2 Regulatory risk – client money

Looking after client money is one of the most serious issues facing platforms and wealth managers and the implications for mistakes are serious in terms of fines and reprimands under the CASS rules set out in the FCA’s Policy Statement 14/9. The regulator requires providers who are allowed to handle client money, to do so with due care. If at any point there is a shortfall, the provider must make this up from its own resources creating financial risk on top of the regulatory risks.<sup>2</sup>

Platforms and wealth management services substantially reduce those risks if they provide immediate clear checks on client assets and proceeds. The importance of this need to eliminate risk has been heightened by wealth managers’ long-term increased use of funds.

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<sup>2</sup> PS14/9: Review of the client assets regime for investment business, FCA, June 2014

*“The benefit of an outsourced fund custody arrangement is that on a daily basis, we know where we are... what’s settled and what’s outstanding” Wealth manager*

The platforms and wealth managers that outsource fund custody retain their ultimate regulatory responsibilities, but outsourcing can help to control the risks. Service providers are therefore increasingly questioning whether they should hold client money. Some larger companies have told us that they are re-thinking how they should manage their CASS responsibilities while still retaining overall control.

*“We are responsible for client records regardless of who has custody of third-party funds. It is possible to outsource CASS but very careful operational oversight is required which is why we do it in-house at the expense of higher FTE.” Adviser platform*

One company which partnered with an outsourced third-party funds custodian told us that their solution greatly helped them meet their CASS obligations. More recently during the pandemic, outsourcing the custody of funds enabled them to handle the disruptions of remote working, market volatility and trading volumes.

## 1.3 Transfer issues

Transfers of funds has become a priority area for the FCA because it has a direct bearing on consumers’ propensity to switch service providers and obstacles to transfers can reduce the competitiveness of the market. The industry has substantial issues with transfers that a global custodian can help solve.

*“Multiple share classes create problems, and they can double or even treble transfer times. Customers don’t understand that. Company-specific share classes – like specials for Hargreaves Lansdown – are a good example of this. Account transfers are the second biggest resource drain in terms of headcount (after our contact centre).” Direct platform*

*“Transfers take time. Dematerialisation involves sending around bits of paper, which is error prone and time consuming. There are also problems with bespoke share classes which are quite widespread. There is a push to electronic re-reg with TRIG [Transfers and Re-registration Industry Group].” Adviser platform*

## 1.4 Checklist for deciding on the future model

Platforms and wealth managers that use the in-house or the hybrid approach to third-party funds custody and related services should consider the merits of switching to an outsourced strategy. We think that the drive to make the change would be especially valuable for businesses that have adopted the hybrid approach – which offers the worst of both worlds in many respects.

The alternative to either the in-house or hybrid approaches is to partner with a back-office service provider that can offer a scalable, full market distribution solution with controlled costs – either based on assets or transactions. This can reduce risk and processing errors, and also enable better control of ongoing costs.

The key issues for platforms and advisers to consider when deciding on their future model are:

1. What cost savings could they achieve from re-designing the operating model?
2. Is the current back-office solution holding back expansion because its scalability is limited?
3. How far would the efficiency gains improve service quality and resilience?
4. What reputational and regulatory risks of administrative errors and managerial shortcomings does the organisation currently carry? Would these risks be materially reduced by moving away from a hybrid model with several in-house and outsourced operations?
5. How many of the business’s servicing partners are now owned by competitors?
6. If they did not have to spend so much senior management resources on third-party funds custody and other administrative issues, could platforms and wealth managers focus on their core competencies to improve their propositions? To what extent is the back office an unnecessary distraction that provides little real added value? Would a reduction in FTE reduce management issues?
7. When were the alternative solutions last seriously considered?

Several major platform providers told us that they had a long-standing relationship with an outsourced third-party funds custodian and couldn't see any circumstances where they would change to an in-house administration arrangement.

We spoke to one platform provider that had re-evaluated its operational set-up in the last two years and considered all three of the models described in this paper. The firm quickly discounted an in-house administration route. After trialling the hybrid option, they realised that they could achieve more cost efficiencies with an outsourced model. They chose Clearstream as its fund custodian because of its scale, strength and resilience. The commercial reality ultimately made sense for their business.

## 2 WHY THE TIME IS RIPE TO LOOK AT THE BACK OFFICE

- Platforms and wealth managers are under pressure to cut their fees to users – especially if distributing via advisers. This has a knock-on impact on margins and costs may need to be cut to maintain them.
- Efficiency gains will improve service quality and resilience.
- Platforms and wealth managers should focus on their core competencies to continually improve their propositions. Administering the in-house back office may be an unnecessary distraction that does not add meaningful value.
- New capabilities are now available for outsourcing that fundamentally change the opportunities to save costs and improve efficiencies.

### 2.1 The evolution of the back office for platforms and wealth managers

The evolution of platforms and wealth managers over 20 years of expansion explains why back offices have developed as they have. These businesses have focused on their key functions and used the most readily available infrastructure. Building from the ground up has not been an option and the result is a patchwork of workarounds. But the time has come to explore whether there may be better solutions.

For both platform and wealth managers, AUA has increased through positive flows, new clients, favourable market conditions and M&A activity. What started as a cottage industry is reaching a level of maturity characterised by consolidation and transformative technology investment. Larger players seeking competitive advantage through economies of scale are driving others to develop efficiencies in their operations.

Meanwhile, investors' and intermediaries' needs continue to evolve, especially around digital behaviours, driving service providers to match rising expectations. Proposition delivery influences the business models chosen by platforms and wealth managers and they need to have optimal operational processes in place.

### 2.2 The back office's place in the value chain

We wanted to understand platforms' and wealth managers' back-office arrangements across the entire value chain and whether they are maximising efficiencies in their third-party funds custody arrangements. We were looking at platforms' approach to outsourcing their custody and related services rather than outsourcing their IT requirements to businesses like FNZ, Pershing, Platform Securities or SEI (as a complete back-office solution).

We conducted in-depth interviews with platforms and wealth managers to identify the incumbent third-party funds custody models and the benefits of each of them. The conversations focused on the following areas:

- The key drivers when selecting providers of third-party funds custody services.
- The advantages and drawbacks of each model.
- The circumstances that would trigger a review of incumbent structures and providers.

## 2.3 Service models for provision of third-party funds custody

We found three main models in use by platforms and wealth managers:

1. Full in-house servicing model – end-to-end self-manufacturing where the platform or wealth manager retains full responsibility for third-party funds custody.
2. Hybrid outsourced partnership model – this has typically evolved through client migrations where third-party funds custody arrangements may (or may not) be retained in whole or in part.
3. Fully outsourced partnership model for third-party funds – where the platform or wealth manager uses an external fund custodian with whole market distribution reach.

We have taken illustrated the models that are in common use today and investigated the potential for further efficiencies to provide sound foundations for growth as the sector matures.

# 3 THIRD-PARTY FUND CUSTODY SERVICES IN THE UK

Platforms and wealth managers have evolved a range of different solutions for third-party funds custody and other back-office functions. The results are typically the outcome of a series of pragmatic decisions and historical accidents. The three main outcomes of this ongoing evolutionary process are broadly:

- In-house solutions.
- Hybrid partnership solutions.
- Fully outsourced partnership solutions.

We found that some companies have reviewed their operating models on a continuous basis, while for others the catalyst has been technology changes. Adopting a more proactive approach will become increasingly important as the industry matures.

## 3.1 Full in-house servicing

Under a full in-house model, all the platforms' or wealth managers' services are operated internally, from dealing through to communicating with transfer agents via an internal custodian.

### Key features of full in-house models

- Control over end-to-end operational servicing – less reliance on external service providers.
- Higher operational cost base.
- Premium service proposition pricing.
- A cost base that is generally higher and harder to flex with service demand fluctuations.

### Rationale for the full in-house approach

The in-house approach allows platforms and wealth managers to retain close control over every part of their operational functions. It invariably requires them to employ more full-time-equivalent staff (FTE) than an outsourced model, because they have to manage and operate all the processes internally.

### Advantages of the full in-house approach

- **Organisation** – In a 'functional' operating model, sub-teams typically have highly specialised roles in their own single areas. As a result, the number of FTE staff is likely to be higher than in a cross-functional model where teams that cover multiple functions can provide cost-saving efficiencies mitigating the risk of resource gaps in some structures. Several companies discovered the advantages of this approach when it came to adapting to the coronavirus pandemic.
- **Retaining control** – The full in-house servicing model suits companies that prioritise control of all functions above achieving FTE-cost efficiencies. They provide a premium service at a premium price. Two of the adviser platform providers that we interviewed cited this reason for choosing the in-house servicing model.



*“We are our own custodian and see it as core to our brand. We can do more aggregation and deal across all wrappers for all clients at the same time. We only use third-party custodians for certain assets e.g. fractional assets, non-Crest and certain types of assets that underpin structured products.” Adviser platform*

### Potential drawbacks of the full in-house model

There are several specific constraints in the full in-house servicing model:

- Fund dealing and aggregation require multiple order-routing systems – there is no centralisation of consolidated fund holdings.
- Settlement processing, monitoring and management is done through multiple systems. It is typically on an actual settlement basis requiring high volumes of manual reconciliations.
- Transfers are processed through multiple liaison points with transfer agents – becoming a time-consuming and resource-heavy function.
- Stock and cash reconciliations are time-consuming and time-sensitive. The platform or wealth manager retains the liability for processing and safekeeping.
- Distributions and corporate actions involve multiple liaison points with transfer agents, which can make the provision of tax vouchers and similar administrative functions laborious.
- The drawbacks become especially apparent when activity levels change. When market activity drops and revenue falls, operational costs remain and reduce profitability. When market activity rises, increasing capacity while maintaining service levels is challenging.
- Future-proofing – most companies want to enable efficient scaling with service quality maintained.

*“We didn’t want to manage all the interaction with fund managers.” Direct platform*

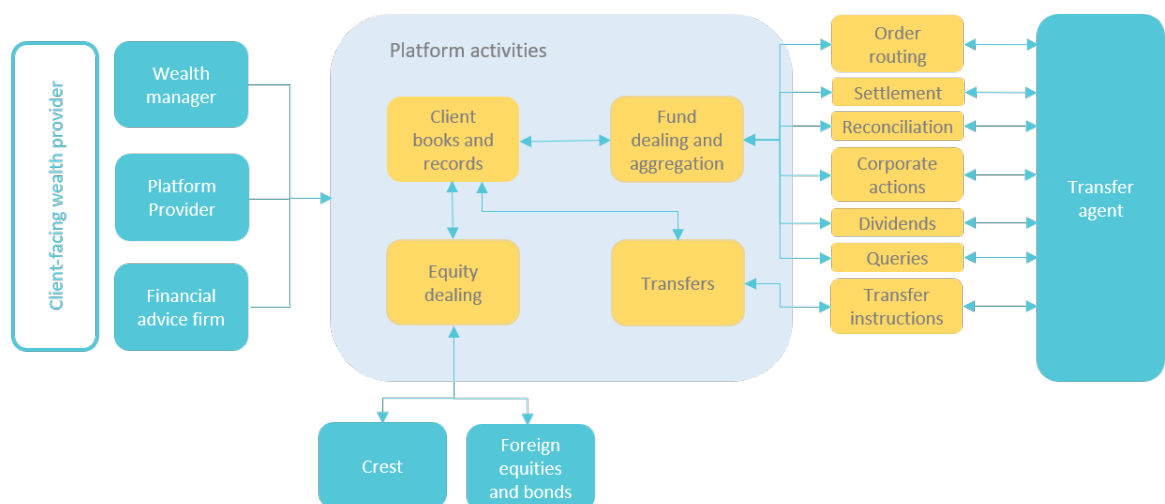
- The main drawback of the fully in-house model is cost. Based on company reports and industry conversations, we estimate that operational costs – primarily staff – run at approximately 2bps of AUA higher than an outsourced model.

*“We migrated to an outsourced model for the simplicity of routing all transactions through one channel and a 10-20 FTE saving.” Direct platform*

*“While we have an in-house servicing model, it’s streamlined and our quest for operational cost savings is continual.” Adviser platform*

**Firms with full in-house service models are often unaware of the potential cost savings that could be achieved in processes such as cash management, reconciliations, corporate actions and query-chasing.**

Diagram 1: The full in-house model



### Example of the full in-house model

In the full in-house model client-facing providers use a range of systems to acquire and hold investments for their clients. In-house activities include:

- The core function of maintaining client books and records.
- Equity dealing – supported by additional external systems (third-party order management systems).
- Fund dealing and aggregation – supported by additional external order routing systems (e.g. Calastone).
- Transfers – supported by additional external transfer instructions systems (e.g. Altus Transfer Gateway).

## 3.2 Hybrid outsourced arrangements

A hybrid outsourced arrangement is typically a split third-party funds custody model. A full custodian service is used for some assets, and either the company's own custodian or a third-party custody-only service for the rest e.g. third-party funds custody for non-UK funds, CREST for listed securities and UK funds routed through Calastone or EMX.

### Key features of hybrid outsourced model

- Flexible option for companies to continue their existing arrangements or adopt new systems as they acquire or merge.
- Duplication in technology, service providers, processing routes and activities i.e. using multiple firms for different areas, such as Calastone, CREST, EMX etc.
- Higher levels of FTE to cover multiple operational points.
- Dealing and settlement probably continuing to be managed by the platform's operations team.

### Rationale for the hybrid approach

Hybrid outsourced arrangements are likely to have arisen for pragmatic historical reasons rather than as a result of planning and design. They are common where the platform or wealth manager has grown through mergers and acquisitions. The evolution involves complicated technology integrations and companies often end up using several operating models, as well as duplicate business process outsourcing (BPO) and software as service (SaaS) arrangements.

*"We acquired a competitor that used an outsourced third-party funds custody provider, and we followed that profile." Adviser platform*

### Advantages of the hybrid approach – coverage

Historically, some platforms and wealth managers have found that using multiple service providers was the only way to achieve access to the whole fund market. But most custodians' distribution cover has greatly improved over the last decade, so this hybrid approach is no longer necessary except possibly for the most niche funds.

### Potential drawbacks of the hybrid model

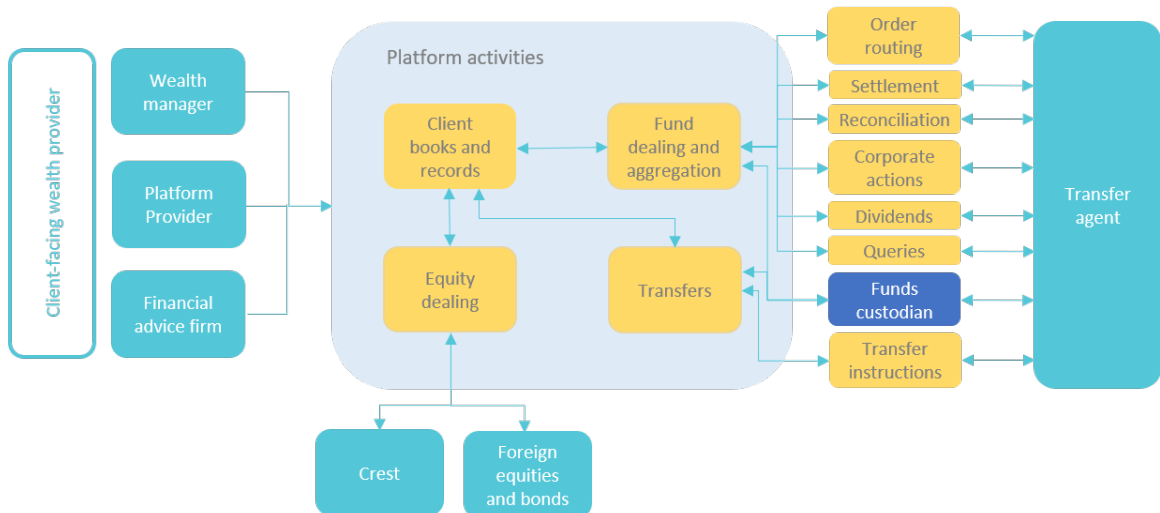
As with the full in-house model, cost is the main drawback of the hybrid model:

- FTE cost savings and process efficiencies can't be fully realised. The potential benefits of using a third-party funds custodian are reduced because some of the less automated processes continue internally.
- The cost of duplicating activities can lead to even higher operating costs than running processes internally.

*"We trialled the hybrid outsourced model and we found that using a deal-routing service for settlement worked out too expensive and with little additional benefit. Ultimately, we moved to a fully outsourced partnership arrangement, handing over interaction with transfer agencies to a global custodian. This suited both our operating model and our need to keep operating costs down." Platform provider*

We estimate that converting a complicated hybrid to the outsourced model could achieve an FTE staff cost saving of approximately 2-3bps of AUA.

Diagram 2: The hybrid outsourced model



### Example of the hybrid outsourced model

The hybrid model brings in an external fund custodian in addition to the arrangements for the full in-house model. The external custodian covers the following activities:

- Fund dealing and order management:
  - Account opening, maintenance, and operation (including AML and KYC).
  - Fund distribution agreement management.
  - Fund data provision.
  - Provision of a centralised record of consolidated fund holdings.
  - Routing of orders to transfer agents.
- Settlement – processing, monitoring and management of settlement of all orders provided, with ‘delivery versus payment’ (DvP) net settlement terms.
- Transfers – management and processing of all transfer instructions.
- Stock and cash reconciliations:
  - Time-sensitive daily cash reconciliations.
  - Daily stock reconciliation and investigation.
  - Liability for processing and safekeeping held by custodian.
- Distributions and corporate actions processing and tax voucher provision.

## 3.3 Fully outsourced third-party funds custody arrangement

The full outsourced partnership model uses a third-party funds custodian, with the technical and operational servicing capabilities to manage a comprehensive suite of processes. Technology requirements can be retained or separately outsourced to businesses like FNZ, Pershing, Platform Securities or SEI.

### Key features and benefits of fully outsourced arrangements

- Unlike the full in-house service model, fixed operational costs can be converted into variable costs. Future growth is supported by the ability to scale efficiently, with service levels maintained.
- Unlike the hybrid model, FTE cost savings and process efficiencies are fully realised through removing duplication and the benefit of the automated processes of the service provider which include:
  - Industrial processing capability and scalability.
  - Efficiency gained through automation and centralisation of consolidated fund holdings.
  - Reduced risk and exposure to processing errors.

## Rationale for the outsourced approach

The outsourcing strategy reduces the potential liability for third-party funds custody and related activities and simplifies the structure and operation of the business. In particular, the custodian is responsible for:

- Processing and safekeeping (when dealing, settlement and reconciliation are fully outsourced).
- Providing a centralised location to view all holdings and a single point of contact for reconciliation.
- Order routing services such as Calastone and EMX are often regarded as the answer. However, they only cover order routing, leaving the platform or wealth manager to operate many other services which could be managed by a third-party funds custodian.

## Example of services typically offered by a third-party funds custodian

Standard Services		Value Added Services
■ Dealing	■ Corporate actions	■ TA account opening (including AML/KYC)
■ Settlement	■ Dividend processing	■ Net cash management
■ Asset transfers	■ Tax voucher provision	■ Reporting
■ Reconciliations		■ Funds reference data checking
		■ Compliance checking for all instruments

## Advantages of the fully outsourced model

- The outsourced partnership model enables platforms and wealth managers to focus time and resources on front-end innovation, while passing the less glamorous back-end processes to a specialist.  
*"It's a matter of taking out oversight of multiple providers, the SLA meetings, KPI packs and reducing risk for the Head of Operations." Direct platform*  
*"Operational overheads are reduced [by the outsourced partnership model] and the supplier manager chain is simplified by reducing the number of providers needed to operate the business." Adviser platform*
- There is more control of the cost base.  
*"Our tech is all in-house, but it would be a fairly massive piece of work to take in the third-party funds custody arrangements and a distraction from initiatives relating to other business." Adviser and direct platform*  
*"Clearstream has allowed us to triple our FUM whilst reducing the FTE by around 40%." Adviser platform*  
*"It took us some time to fully move across to a global fund custody provider, but it was undoubtedly worth it." Adviser platform*
- Added value through the facilitation of true net settlement reduces the risk of CASS client money breaches, while enhancing the speed, accuracy and frequency of reconciliations and providing better liquidity management, especially where DvP is used for settlement. For example, the Central Facility for Funds (CFF) platform provides straight-through processing (STP) settlement with member fund groups and enables a real-time view of settlement, cash positions and next day funding requirements.  
*"The benefits of CFF are that STP settlement occurs, with funds available by 11am. There's a 99% success rate for on-time settlement using CFF. We offer contractual settlement to clients, so we have to fund unsettled trades to comply with CASS rules. At certain times of the year (like year-end), CASS funding is a major issue and we've been able to work very carefully with Clearstream to manage these times." Wealth manager*
- Outsourcing can reduce the level of capital employed by platforms or wealth managers. Running a custody business can require substantial regulatory capital and might be more profitably used in the core business.
- Third-party funds custodians will undertake annual AML/KYC checks on instruments and accounts with transfer agents, saving the time and effort of ensuring compliance with regulations.
- Customers can leverage the custodian's distribution arrangements with asset managers to benefit from the attractive commercial and operation terms.

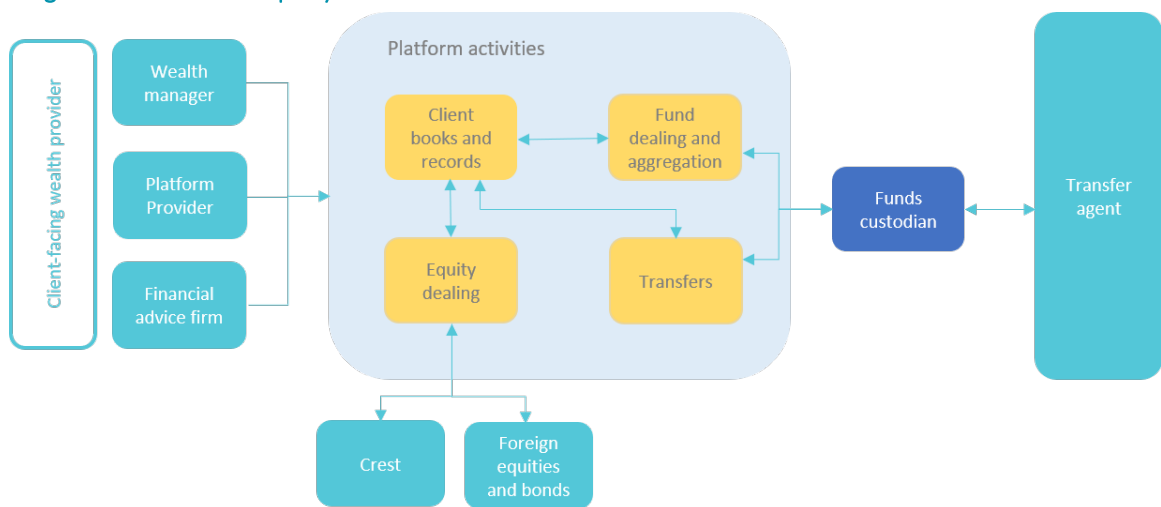
According to our research, a fully outsourced partnership arrangement can reduce FTE requirements by 2-3bps compared with full in-house or hybrid arrangements.

### Potential drawbacks of the fully outsourced model

Some of the possible drawbacks include:

- **Loss of control over service standards and quality control** – Some platforms and wealth managers have outsourced functions with poor experiences of the service provided. Sometimes the firm's feeling of loss of control is more apparent than real. The choice of provider is clearly crucial.
- **Responsibility** – There is a temptation for providers to think that they have delegated regulatory responsibility to the outsourced business. While the risks should be significantly lower with an internationally recognised funds custodian, the provider retains regulatory responsibility and must undertake proper due diligence checks and monitor standards and performance.
- **Possible higher costs** – In most situations, the charges for outsourced services are more than offset by the direct savings, but at certain points in a company's growth this may not be the case. Much depends on the outsourcing arrangements, charging structure, the shape of the firm's business development and the point it has reached on its growth curve.

Diagram 3: The full third-party outsourced model





### 3.4 Conclusion – pros and cons of outsourcing third-party funds custody

Solution	Advantages	Drawbacks
<b>Full in-house servicing model</b> Platform or wealth manager retains full responsibility for third-party funds custody.	<ul style="list-style-type: none"> <li>Teams that cover multiple functions can mitigate the risk of resource gaps in some areas, e.g. in adapting to the coronavirus pandemic.</li> <li>Companies can prioritise control of all their business functions above achieving FTE-cost efficiencies – providing an apparently premium service at a premium price.</li> </ul>	<ul style="list-style-type: none"> <li>High volumes of manual reconciliations with settlement processing, via multiple systems.</li> <li>Transfers through multiple liaison points with transfer agents – time-consuming, resource-heavy and laborious for admin functions e.g. tax vouchers</li> <li>Stock and cash reconciliations are time-consuming and time-sensitive and platforms and wealth managers keep processing/safekeeping liability.</li> <li>Lower profitability when activity drops and revenue falls, but high same operational costs. Capacity constraints affect service standards if activity rises.</li> <li>Harder to future-proof the business without scale.</li> <li>Higher cost – approx. 2bps of AUA more than outsourcing.</li> </ul>
<b>Hybrid outsourced partnership model</b> Third-party funds custody arrangements may be retained in whole or in part.	<ul style="list-style-type: none"> <li>Allows continuity with previous fully in-house approach.</li> <li>Management retains sense of control.</li> <li>Possible access to more funds than fully in-house model, especially for very niche products.</li> </ul>	Most of the above plus: <ul style="list-style-type: none"> <li>FTE cost savings and process efficiencies can't be fully realised. Some of the less automated processes continue internally.</li> <li>The costs of duplicating activities can lead to even higher operating costs than running processes internally.</li> </ul>
<b>Fully outsourced partnership model for third-party funds</b> Platform or wealth manager uses an external fund custodian with whole market distribution reach.	<ul style="list-style-type: none"> <li>Platforms and wealth managers can focus on core business and front-end innovation.</li> <li>More control of cost base.</li> <li>True net settlement reduces risks of CASS client money breaches. Enhances speed, accuracy and frequency of reconciliations. Better liquidity management, where DvP settlement used.</li> <li>Reduces regulatory capital employed for platforms and wealth managers.</li> <li>Annual AML/KYC checks with transfer agents, save time and effort of regulatory compliance.</li> <li>Better terms from asset managers through greater buying power.</li> </ul>	<ul style="list-style-type: none"> <li>Some outsourced services have disappointed. The choice of provider is crucial.</li> <li>The wealth manager or platform retains regulatory responsibility and must undertake due diligence checks and monitor standards and performance.</li> <li>Charges for outsourced services may sometimes be higher – depending on the arrangements, charging structure, how the firm is growing and where it is on its growth curve.</li> </ul>

## 4 CLEARSTREAM VESTIMA INVESTMENT FUND SERVICE

Clearstream offers a fully outsourced third-party funds custody service that enables wealth managers and platforms to focus on how they best deliver value to clients, and removes the inefficiencies of in-house or hybrid arrangements.

### Order routing, settlement and asset servicing for all fund classes

Vestima bundles Clearstream's entire suite of investment fund services providing order routing, settlement and asset servicing for mutual funds, exchange-traded funds (ETFs) and alternative funds, to achieve:

- Efficiency gains – through automation and centralisation of consolidated fund holdings. Operational efficiency is significantly increased through DvP settlement, the synchronous exchange of cash and investment fund shares.
- Asset safety – long-term AA ratings from major international rating agencies reflect Clearstream's focus on risk management and operational efficiency as well as its strict regulatory framework.
- Highest safety standards – including asset segregation and DVP settlement.
- Coverage of all fund markets and classes – holding investment fund assets for customers in over 50 jurisdictions worldwide. All types of funds are covered in Vestima, from mutual funds to alternative funds, such as private equity funds, hedge funds, real estate funds, and ETFs.

### Fund Centre – Distribution Support Services

Clearstream Fund Centre complements the Vestima one-stop for funds with services in the distribution support space. This range of services provides access to a wide range of funds, distribution agreement and distribution commission management, fund research, compliance and regulatory support, as well as enhanced data and documents exchange between fund providers and distribution partners. For 320 distribution partners, Clearstream Fund Centre provides a single point of access for fund documentation including dynamic, static and regulatory data across a wide community of asset managers.

### Connecting fund providers and distribution partners

Distribution partners gain access to more than 430 fund providers with a single distribution agreement. Clearstream Fund Centre's covered investment universe is continuously growing and currently offers over 72,000 products, including funds of the major ETF providers. The Vestima Published Fund List service offers customers daily reporting of reference data on all Vestima eligible funds.

#### Vestima – key advantages

- Reduction in manual processes and operational risk.
- Reduction of processing costs which increases margins.
- Tailored model to suit the needs of wealth managers and platforms.
- Full fund coverage.
- Low implementation costs.

#### Key wins for user businesses

- Reallocation of resources to core tasks.
- Scale and stability for wealth managers and platforms while reducing risk.
- Ability to leverage Clearstream's experience, systems and data.

#### Key facts and figures

- Over 200,000 funds available for custody and execution.
- Connectivity to 700+ transfer agents and fund administrators globally.
- Approximately 500 financial institutions in over 75 countries use Vestima.
- Client segments include universal banks, private banks, retail banks, global and local custodians, asset manager fund platforms and other institutional investors.
- Over 24 million annual STP orders placed.
- €2.6 trillion fund units deposited in Clearstream.

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