Private Bank

Is your custodian helping you protect and grow your wealth?

KEY CONSIDERATIONS FOR SELECTING THE RIGHT CUSTODIAN

INTRODUCTION

The needs of worldly and wealthy individuals are evolving as their wealth becomes increasingly complex and global.

More than ever before, individuals, families, and family offices are seeking investment, business, and real estate opportunities in many regions of the world and want access to a broader range of assets, currencies, and opportunities to help achieve their goals. In order to do so, they need the right resources to navigate various tax, regulatory, and legal requirements. This is transforming the role custodians play in centralizing access to information to help clients grow and protect their wealth.

A custodian is a financial institution – typically a bank or brokerage firm - that holds, safeguards, and services its clients' assets. Custodians are responsible for clearing and settling all trades and transactions, as well as reporting dividends and interest payments accrued from held assets.

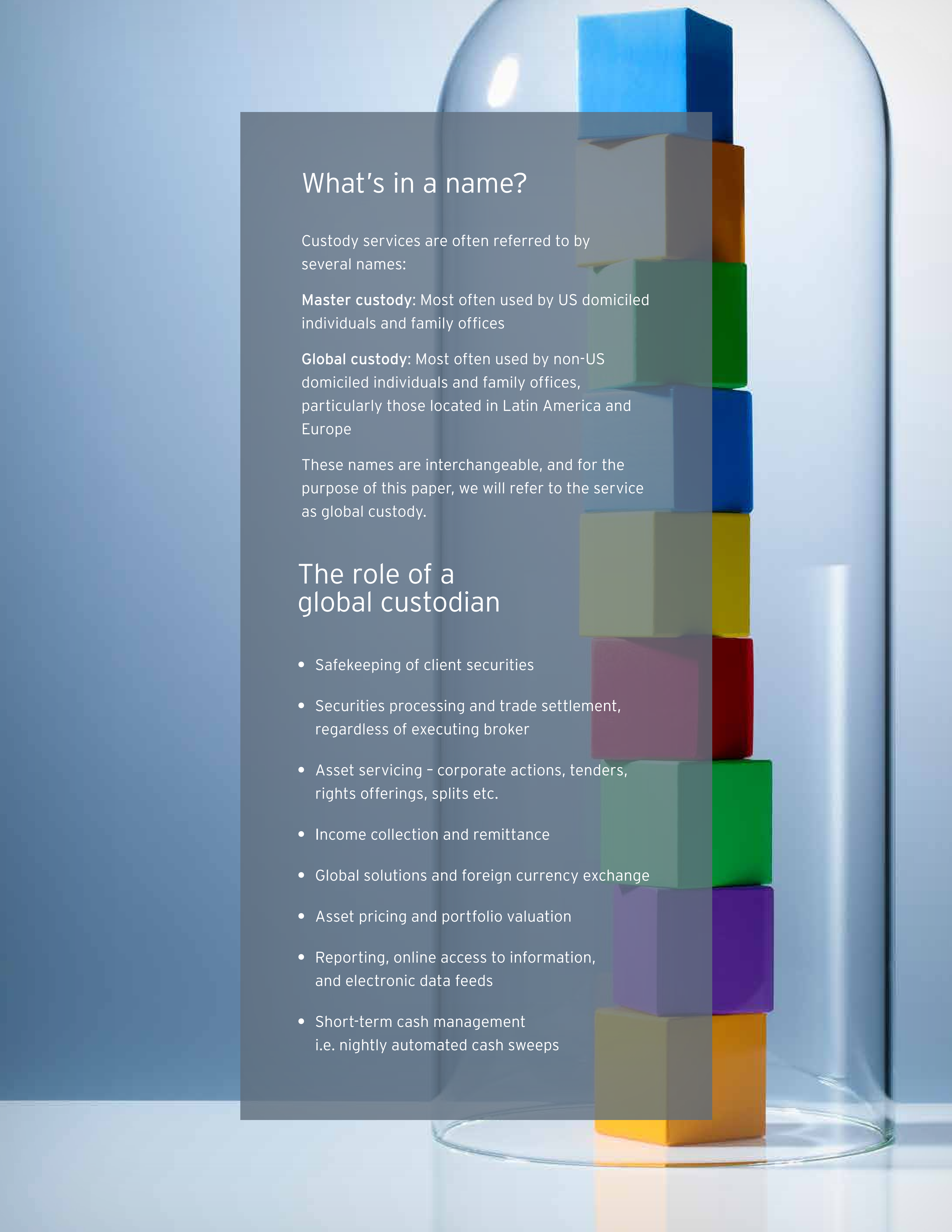
The world's four largest custody banks had more than US$114 trillion in assets under custody and administration[1] in 2018, a 10% increase from the prior year. But these are not the only providers, as there are a multitude of custodians around the world, each with their own model, proposition, and fees.

As a result, finding the right custodian can be challenging. A suitable custodian can provide asset safety benefits, effective tools to simplify viewing and accessing wealth information, and service and oversight services – freeing time to focus on other pressing issues. Selecting an unsuitable custodian, or having too many custodial relationships, may result in asset safety risks, higher costs, data quality errors, and many hours spent on administrative tasks.

Regardless of specific objectives and requirements, individuals, families, and family offices should consider four key factors when assessing custodians.

In this paper, we explore these key considerations to help you make an informed decision based on your specific circumstances.

[1] Team, Trefis. "Largest Custody Banks Overcome Industry Headwinds To See Further Growth." Forbes, Forbes Magazine, 18 May 2018, www.forbes.com/sites/greatspeculations/2018/05/18/largest-custody-banks-overcome-industry-headwinds-to-see-further-growth/#32993936363b.



What’s in a name?

Custody services are often referred to by several names:

Master custody: Most often used by US domiciled individuals and family offices

Global custody: Most often used by non-US domiciled individuals and family offices, particularly those located in Latin America and Europe

These names are interchangeable, and for the purpose of this paper, we will refer to the service as global custody.

The role of a global custodian

- Safekeeping of client securities
- Securities processing and trade settlement, regardless of executing broker
- Asset servicing – corporate actions, tenders, rights offerings, splits etc.
- Income collection and remittance
- Global solutions and foreign currency exchange
- Asset pricing and portfolio valuation
- Reporting, online access to information, and electronic data feeds
- Short-term cash management i.e. nightly automated cash sweeps

CONSIDERATION #1:

Should I centralize my assets with a single custodian?

Many individuals, families, and family offices typically use multiple banks and brokers to help them build their wealth. This is often a result of an evolution of needs as wealth spreads across many different asset classes, geographic regions, and currencies.

For example, if an individual decides to open a new investment portfolio with a particular provider or for a particular strategy, it may be easier to add another provider to the list, rather than move all assets to one single provider.

Having multiple providers may have numerous benefits. However, it may create potential issues when an individual or family wants a comprehensive overview of their financial situation across all portfolios.

For example, a family office trying to understand their exposure to a specific company (e.g. shares of Apple), or investment strategy (e.g. municipal bonds or short term cash), will need to piece together information from accounts from various sources.

Creating a consolidated overview of all assets in real-time can be extremely challenging given that each custodian may have their own reporting processes, periods, and use various data and information sources, including benchmarks, which makes meaningful comparisons difficult. Those with multiple custodians resort to manually consolidating all reports in order to report and analyze their overall position. This is a time-consuming process, which can be prone to human error.

As a result, many individuals and families make the decision to outsource this important responsibility to a third-party asset aggregator. While some may have heard of third party asset aggregation services, a large number are unaware of another option to effectively consolidate their assets - global custody.

A global custodian can safeguard and centralize clients' assets in one place. While this means moving assets from existing accounts and holding them in one place with the chosen global custodian, clients maintain the flexibility to continue working with outside portfolio managers and brokers for trade execution and advice.

This is a crucial function to effectively grow and protect wealth, as comprehensive, up-to-date information helps individuals and families act on opportunities and mitigate risks.

Determining whether to use a global custodian or keep multiple custodian relationships and use an asset aggregator depends on an individual or family's unique requirements and wealth goals. While in some respect they can achieve similar goals, including access to a full financial picture in one place, and robust transaction, holdings and performance reporting, they are very different services with unique advantages and disadvantages that require a thorough assessment.

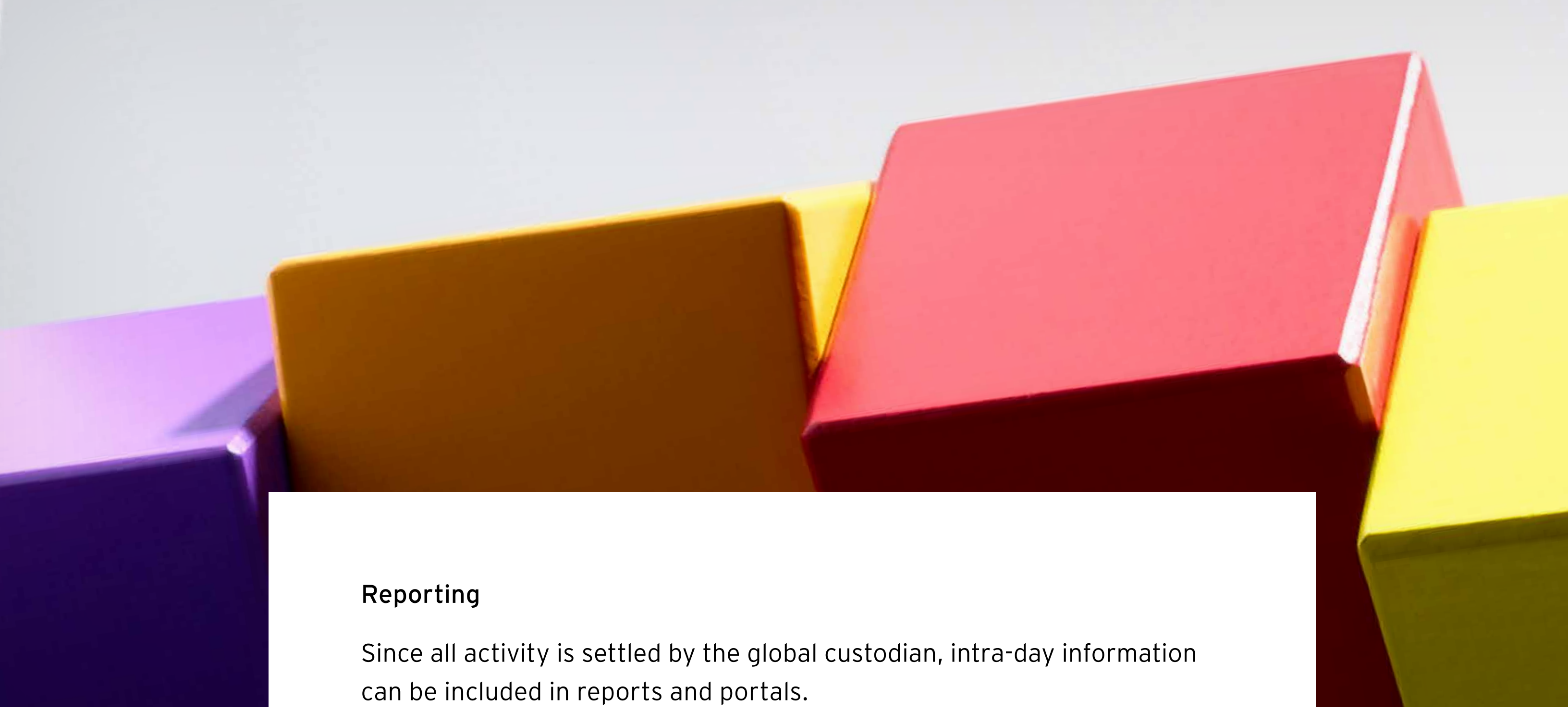
Global custodian
Factors to consider

Books and records of all investments

In this model, all trading is done by the individual or their advisors, and the collection of all income and processing of all tender offers, proxies, or rights offerings is done by the custodian. This means a global custodian becomes the official books and records for all the assets held. For example, for US assets, a global custodian provides all annual tax (1099) documents and manages the interfacing of this information directly with the Internal Revenue Service. A single global custodian avoids reconciling multiple data, information sources, and reporting capabilities – benchmarks, definitions, formats – which make comparisons challenging.

Asset safety

A bank acting as a global custodian cannot commingle client assets with its own investments, as client assets held in bank custody must be segregated. Therefore, creditors of the bank have no access to client securities held in custody in case of failure.



Reporting

Since all activity is settled by the global custodian, intra-day information can be included in reports and portals.

Dedicated client service

A global custodian can provide a dedicated service team for administrative matters, acting as an extension of the client's staff and supporting day-to-day requirements.

Lower operational cost and risk

A global custodian typically offers lower costs as there is usually no on-boarding or annual fee, and usually a smaller annualized basis point fee. There is also less operational risk as assets are not spread across multiple parties. Custodians who leverage a proprietary network may also have a leaner operational model, which reduces overall risk.

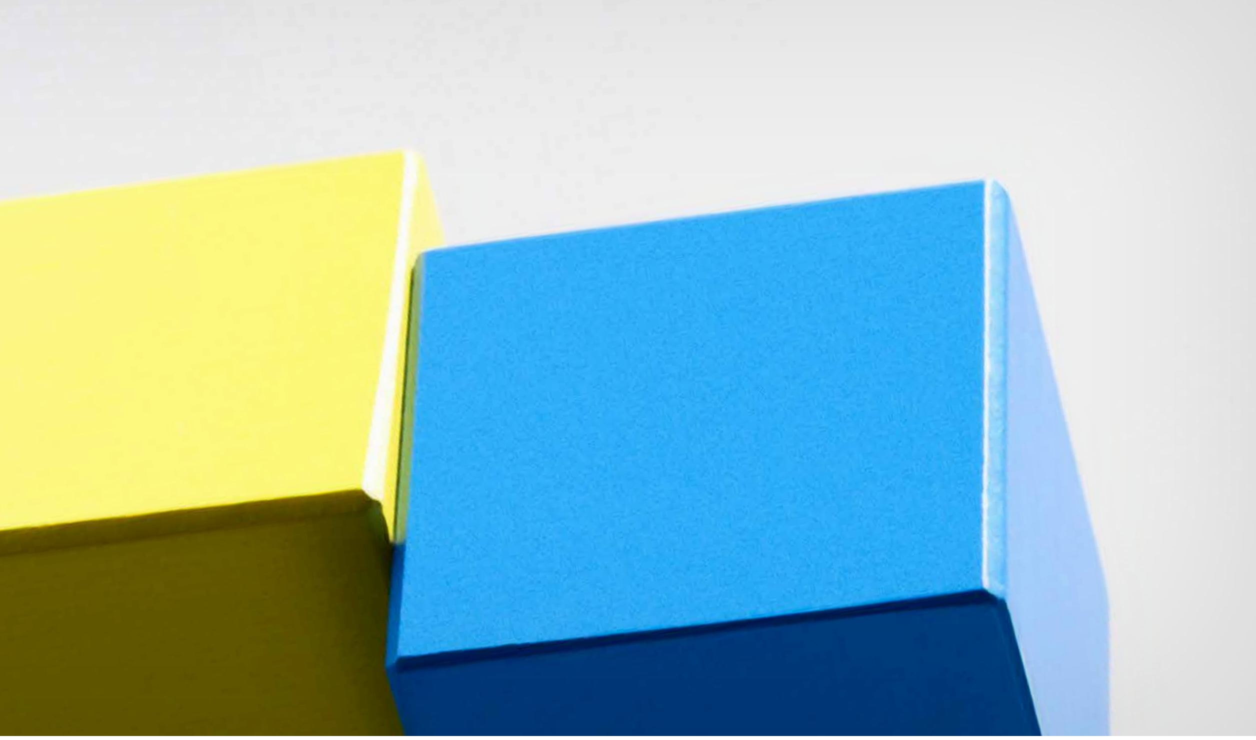
Better pricing

A large global custodian may be able to use its institutional book of business to negotiate institutional pricing for its clients, which may be cheaper than the retail pricing other providers may offer.

If a client chooses to use other services offered by the custodian, they may be also able to negotiate reduced pricing on their custody fees.

Lending opportunities

Individuals with a global custodian may find it easier to get a larger lending amount than those with multiple custodians. The larger and more diversified the asset pool, the more banks are willing to use the underlying assets as collateral. This way, individuals and families can optimize their lending needs and use economies of scale to finance their business, or even their home or yacht.



Fund manager reluctance

Some investment advisors – typically those on an open architecture investment platform – may push back when instructed to work with a global custodian since they may already have a preferable custody process in place.

New accounts

Additional paperwork will be necessary when establishing a relationship with a global custodian, which may take considerable time and effort.

Individuals or families who do not want to consolidate their assets through a global custodian may opt to use a third party asset aggregator; however this service is often costly and can present many challenges, including data quality and integrity, no asset safety benefits, and no dedicated client service.

KEY QUESTIONS TO ASK:

- How difficult is it to access information on all your portfolios when you need it?
- At the end of a reporting period, how long does it take to consolidate all your portfolio information in order to analyze it?
- How much are you paying for your current custodians' services? Do you feel this is too much?
- Have you considered adding additional resources to your family office staff due to the administrative challenges your portfolios provide?

CONSIDERATION #2:

What are the key differences between a bank and brokerage firm providing custody?

Since the financial crisis, many clients have prioritized knowing where their assets are held and understanding how this decision impacts their asset safety. While safeguarding assets is said to be a custodian's most critical function, the difference in how various custodians hold and use assets held in custody is often misunderstood. It is critical individuals, families, and family offices understand these differences in the case of a serious risk event outside their control.

A brokerage firm pools its clients' assets together. This means that client assets may not be fully segregated from the securities of other clients or the brokerage firm itself. Therefore, the brokerage firm may use client assets for its day-to-day activities, or even for other clients' needs e.g. to cover a short position. This could result in creditors seizing the assets if the firm were to become insolvent. Consequently, clients may unintentionally be exposed to safety risks when holding assets in custody with a broker dealer.

Bank custodians, on the other hand, fully segregate client assets from the bank's own assets. As a result, clients always remain beneficial owners of their assets, which cannot be lent out (hypothecated) by the bank. In the event of a bank's insolvency, custody assets are returned to clients with minimal disruption.

There are other differences between bank and brokerage custody services that may affect how individuals and families grow and protect their wealth, for example: trade execution, borrowing, and costs.

The below table highlights some of the differences between the two solutions:

	Brokerage firm custodian	Bank custodian
Trade execution	Clients are typically required to trade through their captive broker-dealer desk	Clients have the flexibility to trade with any third-party execution desk and have trades delivered vs payment to their bank custodian
Costs	Typically no separate custody fee, as revenue is earned on trade commissions and mark ups charged on trades done through the trading desk	Transparent custody fee for safekeeping client assets; client negotiates trade commissions and mark ups charged on trading through the respective trading desks they use
Borrowing	Margin lending (Reg. T)*	Reg. U* collateralized lending i.e. purpose vs non-purpose
Service	Financial advisor and sales assistant support client needs	Dedicated team of service specialists can work directly with clients or their intermediaries
Regulators and insurance (In the US)	SEC and FINRA; SIPC for investments and cash	FED and OCC; FDIC for on balance sheet deposit cash

The financial crisis demonstrated the real risk of not segregating client assets. The collapse of certain financial services companies and the ongoing challenges its investors still face in retrieving their assets, has taught many to focus on this key issue when considering custodians.

KEY QUESTIONS TO ASK:

- Where are your assets held today?
- In the case of a crisis, what might happen to your assets?
- Do you have any leverage to reduce commission costs if you hold your assets with a brokerage firm?
- Do you have the ability to trade away from your broker's desk?
- Is hypothecation truly something that you need to understand, and if so, why?

*See definition of terms

CONSIDERATION #3:

What technology and reporting solutions should I look for?

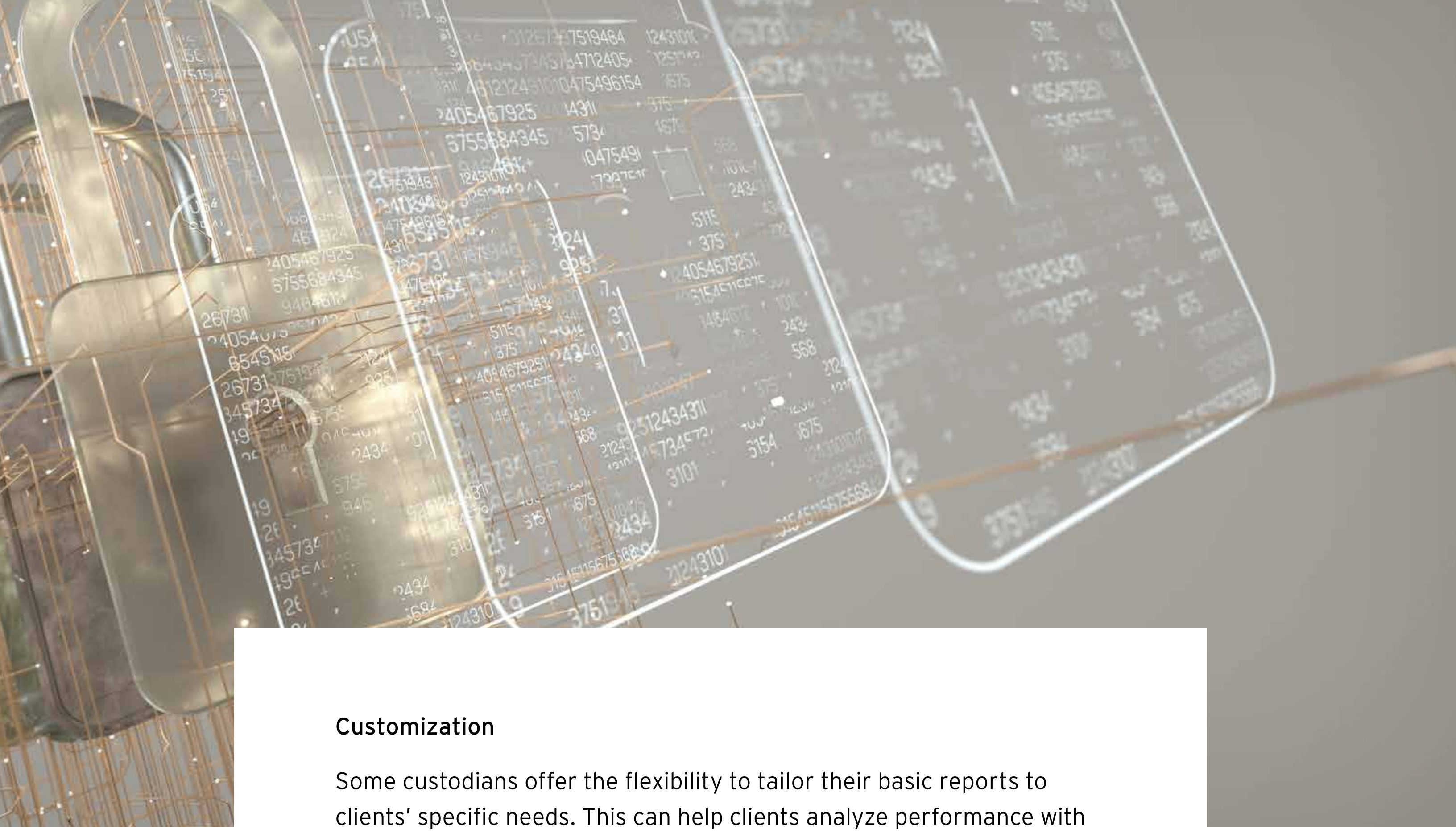
Assessing a custodian's technology and reporting capabilities is crucial to understanding whether it can deliver its functionalities. A custodian's ability to successfully provide access to information on a client's assets in real-time and deliver customized reporting is entirely dependent on the efficiency of its technology and reporting solutions.

Individuals and families should assess their reporting requirements before evaluating what a custodian can offer. For example, while some may be content with accessing basic reports at the end of reporting periods through a simple portal, those with complex portfolios spanning multiple providers, regions and currencies may require access to live information and tailored reporting capabilities. As a result, the following factors need to be considered:

Real-time reporting

Custodians with real-time reporting allow their clients to view and access detailed information on their wealth in one place wherever and whenever they need it.

This provides an overview of all holdings, recent transactions, and functionality to group accounts by currency, region, and asset class, as well as assess weightings, which enables clearer and better decisions.



Customization

Some custodians offer the flexibility to tailor their basic reports to clients' specific needs. This can help clients analyze performance with customizable data by account, asset class, holding, currency, or other customizable benchmarks.

Automated data feeds

Custodians who provide automated ways to send and receive trade data and portfolio holding information can help reduce the risk of manual intervention and help convert and process trades electronically.

Having the connectivity to portfolio management systems and data aggregators, and a flexible data structure to work with new vendors, are also key capabilities to look out for if individuals and families have more complex needs.

KEY QUESTIONS TO ASK:

- How elaborate are your reporting requirements?
- Do you want or need real-time, intraday information on your investments?
- How frequently do you want to receive consolidated performance reviews?
- How can you access information, create reports, and schedule reports to be ready at a specific day and time?
- How much are you willing to spend to enhance the reporting?

CONSIDERATION #4:

How important is a custodian's global reach?

For individuals and families whose wealth is becoming increasingly global, it's being seen as more crucial to work with a custodian who can offer the right resources, expertise, and coverage to help with any multi-jurisdictional investments.

Another benefit of a global custodian is that it has a global presence and provides access to a large number of countries around the world by using either their proprietary network or third party local custodians, allowing clients to consolidate assets globally. A custodian's global reach – or ability to hold assets around the world – should be a significant factor when finding the right custodian to work with.

Global custodians should have the breadth of capabilities to support those clients with international asset needs, as well as those with predominantly domestic requirements. However, it is critical that a global custodian has a well-placed, best in class sub-custodian network to support clients' local market needs around the world.

However, even if a custodian has the right access and coverage for an individual or family's needs – it is important that it can aggregate this information effectively so that potential cross-border or multi-regional challenges or opportunities may be identified.

KEY QUESTIONS TO ASK:

- Does your current provider offer you the capabilities needed to invest globally?
- Are you able to negotiate costs for global services only in the markets you require?
- Are the markets and currencies you wish to invest in a core offering of the custodian?
- If you are risk averse for the currency, can you auto repatriate back to your base currency?

CONCLUSION

As worldly and wealthy individuals and families become more complex and global, they will need custodians who can provide real-time information to make informed choices and reduce the administrative burden of managing their assets.

The custody landscape is evolving to meet these changing requirements, so it is important individuals and families assess the entire spectrum of considerations, including:

- Asset consolidation
- Safety of assets
- Reporting capabilities
- Globality

Assessing the above areas will help determine an individual or family's own priorities and the type of custodian that is best suited to achieve their specific goals.

Citi Private Bank's Custody team provides professional portfolio administration to clients seeking to consolidate accounts and simplify securities recordkeeping and safekeeping. With $22.8 trillion in assets under custody/administration, Citi is one of the largest institutional custodians in the world.

To safe keep client assets, we leverage our global custody network, spanning more than 100 foreign markets, 63 of which are Citi branches or affiliates. Custody assets are held off the balance sheet and fully segregated from the general assets of Citi.

Our dedicated private banking team and custody specialists provide institutional-level expertise through a highly personalized service. To find out more, please contact your Private Banker, who will be more than happy to set up a meeting with a Custody Specialist.

ABOUT THE AUTHOR

Michael Grippo is the Head of the Americas Custody business at Citi Private Bank. He manages a team of custody specialists who support private banking clients throughout North America and Latin America.

Michael's team supports many market segments including ultra-high net worth individuals and families, multi-family offices, RIAs, and institutional clients such as hedge funds and private equity firms.

Michael holds a Bachelor of Science degree from The State University of New York in Communications Media Management, with a minor in Business Administration. He also attended New York University's School of Professional Studies earning a Certificate in Financial Planning.

Definition of Terms

Regulation T was established by the Board of Governors of the Federal Reserve System and is a collection of provisions that govern investors' cash accounts and the amount of credit that brokerage firms and dealers may extend to customers for the purchase of securities.

Regulation U is a Federal Reserve Board regulation that governs loans by entities involving securities as collateral and the purchase of securities on margin. Regulation U limits the amount of leverage that can be extended for loans secured by securities for the purpose of buying more securities.

www.citiprivatebank.com

Private Banking for Global Citizens

Private Bank