

Selling in Sweden

Svante Linder talks about the importance of asset safety, collateral management, competitive and fee quotes when appointing a custodian.

AP7, one of the Swedish state pension funds, recently reappointed BNY Mellon to provide global custody and collateral services to assets valued at \$28.8 billion.

The assets are part of a defined contribution scheme into which each Swedish worker places 2.5% of their yearly income. The scheme is the default alternative for those who opt out from choosing a private fund.

As the 7th member of Sweden's largest pension scheme manager, there are four concerns that the scheme places at front of mind when appointing a custodian: asset safety, collateral management, competitive fee quotes and people.

Chief operating officer Svante Linder believes there is little distinguishing between global custodians in regards to what they can do on core custody services. But one area of differentiation is the ability to hold the custodian accountable to the furthest degree possible. "We were quite convinced that BNY Mellon and a number of others can settle transactions and inform us about corporate actions and so forth so we set out a couple of distinct areas that we felt were increasingly important and of course we gave extra weight in the evaluation stage to the safety of client assets by putting as much responsibility on the custodian as possible, for themselves and for their sub-custodian, to safeguard against a potential default."

To this effect, AP7 spent numerous months negotiating the exact wordings of the global custody contract with BNY Mellon and ensuring that it gets as much comfort on its client assets as possible.



In addition to this, the scheme also placed a lot of emphasis on regulatory change in its tender process, notably regulation for OTC derivatives. The regulation has significant implications for a scheme like AP7, which has 50% of its underlying assets under management, invested in OTC derivatives and will be impacted by the European Market Infrastructure Regulation and by Dodd Frank. "Just ensuring that we have a provider that gives us as much sup-

port as practically possible when it comes to collateral management and ensuring that we use our assets to the best degree possible is one area that we put quite a lot of effort in," says Linder.

The third area of focus in the tender process for the scheme is ensuring it gets a competitive fee quote. It is in this area that the scheme believes things have improved. "Last time we had a tender was 2006 and we recognized that prices had decreased



quite substantially since that time,” says Linder. “So we basically felt that in a nutshell we got a better product at a lower cost than was the case previously.”

The fourth area of focus for AP7 in the tender process was on relationship management. Here the fund placed a lot of emphasis in the evaluation of the people that are going to be the scheme’s main point of contact and their level of understanding of the scheme’s needs and challenges. “We are quite convinced that that will make them provide better solutions and provide better support to us,” says Linder. The daily contact was also important, in addition to the effectiveness in responding to queries and problem solving.

As a result of these four factors, the client provider engagement process, particularly the negotiating of contracts, has changed significantly since 2006. “When it comes to fees, market price has changed so for us it is about ensuring we currently get what is market price,” says Linder. When the scheme first appointed BNY Mellon in 2006 the mandate was for core custody services. Following that the scheme added securities lending and collateral management. “This time around it was important for us to tie up everything so that it together was a precise product offering meaning we negotiated everything at the same time. That was an important part in the process. As I mentioned previously just ensuring that further protection on client assets in the unlikely though not impossible event that something happens either with the custodian or with the sub-custodian was something that was a change in comparison with the previous contract.”

At a time where custodians are changing their strategies in order to add value, there are number of services, which are high up on the priority list for AP7. While extensions on core custody included value added service, it was important for the incumbent to provide core custody, ensuring assets are

in the right place and that transactions are settled and then received back and forth. Related to that, it was important for the incumbent to ensure they could provide the fund with seamless integration of services that included collateral management “because that is not traditionally the business lines of the global custodians as perhaps core custody is,” says Linder. “But just seeing that different parts of the organization, be it J.P. Morgan, BNY Mellon could work seamlessly to provide help for us in other areas such as securities lending and collateral management, was something that we felt was important. It was important that they didn’t say “well we can do this for you but not on an integrated basis. For us it was important to see something being integrated.”

While BNY Mellon previously provided AP7 with securities lending and collateral management, the fund decided to tie things up. This enabled the fund to formally benchmark those services and compare them with that of other global custodians. “To be perfectly honest that was one important part of us reappointing BNY Mellon as we felt their services in both of those key fields stood out,” says Linder.

During the benchmarking process, in the first instance, the tender questionnaire was sent to nine banks. The fund then had seven banks responding to the RFP, which included “hundreds of questions” related to cut off times in cash and services within collateral management. Based on this, the fund came up with a score on each of these questions giving it a list of preferred providers. It then had a beauty parade in its office with four of the different candidates and met three at their premises too.

In addition to BNY Mellon, the fund also signed a contract with J.P. Morgan, the first runner up. “We now have a global custody agreement in place with them as well as well – they don’t hold any assets on our behalf but it gives us the possibility to diversify and

to move assets and so forth if we would need to do so. In other words, they are a back-up provider.”

With the reappointment of BNY Mellon now in place, AP7’s expectation of the global custodian is different to a few years ago and there are a number of things it would like to see more of. The further integration with other parts of the business such as collateral is a prime example of this and is something that Linder would like to see evolve even further. “Providing additional services in other fields that we have, whether that is in alternative services such as private equity or tax, that remains to be seen but recognizing that everybody can do core custody, the question is how can they provide a somewhat wider scope in order to provide value add in the business proposal.”

AP7 has a 3% allocation to four different private equity fund-of-funds managers. In the quest for operational efficiency, the fund is looking at whether there is any scope for integrating some of the operational aspects of that portfolio with the operational work it already does with its custodian. “I assume there are some advantages of scale of having parts of that that operational work with the global custodian as well,” says Linder. “That will be on the agenda going forward.”

“The rationale for just appointing one global custodian is that you will want them to do as much of the custody and related services as possible so integrating even more, inputting even more into their general business proposal is something that will be important for us.”

Is this integrated services offering is something that AP7 would pay more for in the future? “Yes, we would definitely review it in greater detail,” says Linder. “Risk management is another key area where further integration would be beneficial for us. If a global custodian sits on all of your data why not have them do some or all of your risk management calculations as well.”

–Janet Du Chenne

