

‘WE’VE BECOME THE SEXY PART OF THE BUSINESS’

The chief executive of Clearstream Jeff Tessler talks about his firm’s acquisition of Citco’s hedge fund custody business in Cork and why the AIFMD means liabilities can multiply. George Mitton reports.

IN THE NINETIES, when Jeff Tessler was running the securities business at the Bank of New York, it was common for teams such as his to be based on the first floor. Why? Because from 5pm delivery boys would arrive to collect and deliver paper securities across town and office managers didn’t want them jamming up the elevators. “Physical securities still exist, but you don’t have messengers going round lower Manhattan with a million dollars of bonds on a bicycle,” he says. “The securities industry evolved and now we’re doing the same with the funds industry.”

Tessler joined his current employer, Deutsche Börse, in 2004 and is now chief executive of Clearstream, the clearing and settlement division. Although the funds arm is a relatively small part of Clearstream’s business – about €400 billion out of a total €11 trillion of assets – he sees it as a key area to develop because the system of transfer agents and custodians, in which order routing systems still rely on phone and fax, offers so many opportunities for improvement.

Complexity is particularly rife in the world of alternatives – hedge funds, private equity funds and the like – which continue to elude automation, creating back-office work for investors and custodians. Clearstream has a plan, however, having bought the hedge fund processing business, based in Cork, Ireland, of Citco Global Securities Services.

The deal brings 300 employees



to Clearstream and should allow the firm to process clients’ alternative fund holdings through the same platform as conventional funds, offering a one-stop shop that could lead to more efficiency savings.

“I’ve had a lot of clients come to me and tell me it’s a great idea. In their back office, they have all this

inefficiency. Now they can start to consolidate more of their back office and rely more on us.”

The acquisition is Clearstream’s second foray into Ireland, having opened and closed a small Dublin office, and will give the company its fifth major operating centre after Luxembourg, Frankfurt, Prague and Singapore.

TAKE THE LEAD:
Tessler hopes Clearstream will play a leading role in adapting to any new rules.

THE AIFMD

Perhaps more importantly, the deal is seen as a good opportunity to get into the hedge fund space – a timely move. The Alternative Investment Fund Managers Directive (AIFMD) came into force last July, with a range of reporting requirements for alternative funds and, significantly for custodians, new rules that make depositaries liable for lost assets.

As a central securities depositary (CSD), Clearstream is fairly comfortable with the rules, says Tessler. Regulators are effectively asking the industry to underwrite funds' exposures and, as a CSD, Clearstream is already positioned to do this. However, there are still areas of concern.

"What becomes unclear is about the networks," he says. "When you're using an agent bank in another country, who's going into the depositary, where's the liability? This is like a gigantic game of hot potato."

The onset of the directive has already had some interesting effects; for instance BNY Mellon declaring it would become a CSD, a decision taken largely to comply with the directive.

The question is animating executives at the highest level of banks from the around the world, and Tessler says he does not expect the scrutiny to stop, given the intention of the public and the regulators to hold the alternative funds industry to account.

TALKING AT THE TOP

The AIFMD is just one of a number of regulatory moves that have made the job of being a CSD, which is sometimes considered merely the plumbing of the financial system, into an increasingly important role. Tessler says the move to take derivatives out of the opaque, over-the-counter market and into central clearing parties is

"the number one game changer in banking". Parties must now collateralise their trades, but where do they find the collateral? How do they move it?

"In the past, I would go into an organisation and if I met with the CEO he would always bring either his COO or head of operations and say Jeff, 'I'm more than happy to meet with you, but these are the guys who you really need to speak to.' We'd have a conversation about pricing and trends in the industry, and the CEO didn't care.

"Now, I go into visit these same CEOs and they're sitting there with paper and pencil saying, 'Basel III, how can you help me? EMIR [the European Market

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Infrastructure Regulation], how can you help me? AIFMD, how are you guys going to help me? We've become the sexy part of the business."

Another regulatory change that affects Clearstream is Target-2 Securities (T2S), an initiative to harmonise the post-trade landscape in Europe.

Tessler is clear about the significance of the project, which amounts to European politicians "erasing the blackboard" after 40

years of relative stability in the post-trade environment.

Again, he hopes Clearstream will play a leading role in adapting to the new rules. The project may even be a chance for Clearstream to gain a lead over its post-trade rival, Euroclear.

"We think our status and our strong working relationship with the Bundesbank will help us," says Tessler.

COKE AND PEPSI

All these big regulatory changes have had another effect. Tessler says that as clients digest the various compliance headaches, they become more open to swapping between Clearstream and Euroclear in a way they weren't before.

"In the past, clients of our competitor [Euroclear], would say, it's Coke and Pepsi. I like Coke, I don't want to drink Pepsi, let's not even talk," says Tessler. "Now, we can have a wider conversation."

Issues such as T2S, the AIFMD and the European Market Infrastructure Regulation are, in effect, entry points which can lead to discussions and eventually to the winning of new business.

These changes come alongside a more general focus on cost savings, which makes Clearstream's project to increase automation and transaction efficiency popular among a new set of potential clients.

"The private banks and the global institutions are facing a lot of pain now. They've got to push towards more efficiency, less pain, not more inefficiency. In the funds business, there are still lots of people, faxes, paper. Their senior management are saying, 'Are you kidding me? You've got to be more efficient'."

The acquisition of Citco's hedge fund processing business in Ireland is a step forward in Clearstream's project to do away with faxes and paper. ☺