Asset Servicing

SRI trades gaining prominence in global custody

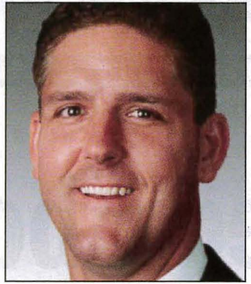
More requests for bids are seeking specific compliance procedures

By RICK BAERT

Global custodians are seeing a surge of interest, particularly among public pension plans, looking for trade-monitoring services for socially responsible investments, spurred in large part by concern over international events like the Syrian civil war.

Such services, which ensure that securities trades comply with investors' SRI and environmental, social and governance principles, have been provided for clients since the mid-2000s by large firms such as BNY Mellon Asset Servicing, Northern Trust Corp. and State Street Corp., but in the past year there have been more specialized, focused requests in RFPs specifically for SRI and ESG monitoring by custodians.

Two outstanding RFPs for global custodians — issued by the $15.5 billion San Francisco City & County Employees' Retirement System and the $9.7 billion Chicago Public School Teachers' Pension & Retirement Fund — specifically request candidates' capabilities in monitoring compliance with the U.S. Patriot Act and the Treasury Department's Office of Foreign Assets Control Specially Designated Nations list, both of which outline countries, organizations and companies in which the federal government has banned investment.



SEEKING: Paul d'Ouville said after the Newtown tragedy, clients wanted data on firearms exposure.

"We're looking to see what full slate of services a custodian can offer us," including ESG and SRI monitoring that is important to the pension fund, said Robert Shaw, interim deputy director for investments at the San Francisco system. "It's about the capability to parse the data."

Paul d'Ouville, senior vice president and global head of product management at Northern Trust Corp., Chicago, said: "After the Newtown (Conn.) shootings (in December 2012), clients wanted us to measure their firearms industry exposure. It's also been to check on compliance with (clients') prohibited countries lists to see if they have any exposures to Syria, Iran and others.

"As clients' social consciousness gets reminded of things going on in the world, boards of investors ask about it."

BNY Mellon Asset Servicing, New York, has seen a 40% growth in new client business for SRI and ESG monitoring in the past 12 months, said Samir Pandiri, CEO. The new business, which brings total clients using the monitoring service to 110, came mostly from

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pension funds, endowments and foundations. Although Mr. Pandiri wouldn't say just what sparked the increased interest, he did say current events "might be a factor."

"People are now actually asking for this," Mr. Pandiri said.

"Over the last year, there have been a lot more questions asked about this," said Ash Tahbazian, Toronto-based senior vice president, global product management group, at State Street Corp. About 20 clients use State Street's SRI monitoring service, and while Mr. Tahbazian said there haven't been many new clients added so far this year, State Street "is still going through RFPs" and he expects to see a significant increase in new business by year-end.

While such SRI and ESG monitoring services have been offered since the mid-2000s, Virgilio "Bo" Abesamis III, executive vice president at Callan Associates Inc., San Francisco, said the recent surge is the result of clients implementing "the third leg of compliance, which is performance and risk compliance monitoring. ... It's been an evolution over a 15-year period."

Mr. Abesamis added that more recently, "there's been a surge of interest. It's more of an add-on service to date, adding on top of the custody piece. It's normally charged on a per-portfolio basis."

Concerning what those charges are, Mr. Abesamis said, "Depending on the level of SRI reporting, the minimum I've seen is around $10,000 to $20,000 ... all-in per year, or $1,000 to $2,000 per portfolio per year. It's relatively de minimis — less than half a basis point. The exception would be ultra-custom compliance monitoring arrangements, but those are very rare."

Mr. Tahbazian said the heightened interest "goes hand in hand" with significant improvements in thequantity of data custodians monitor and the increased pressure on public pension funds to "balance their fiduciary responsibility of maximizing returns with the social responsibility that they have."

Clients' monitoring requests in recent months have focused more on global sanctions testing, along with earlier screens on holdings in tobacco, adult entertainment and carbon footprints. "The global monitoring is growing quickly," Mr. Tahbazian said, spanning issues from governmental bans on investments in countries like Iran to Shariah law compliance testing for sovereign wealth fund clients in predominantly Islamic countries.

He added compliance is checked in two ways: on an absolute basis to check for specific banned securities and on a flexible basis where a client has set a percentage limit on holdings in certain sectors, like tobacco or alcohol.

BNY Mellon expects interest in SRI and ESG monitoring to continue to grow, citing the company's client surveys that show one in three institutional investors consider such monitoring as "increasingly important," Mr. Pandiri said.

Mr. d'Ouville said recent RFPs for which Northern Trust has bid specifically included requests for SRI and ESG monitoring in their proposals and have asked for such compliance monitoring services as part of an overall services platform. "My gut response is that I see ESG and SRI in RFPs more frequently lately." He said that about a third — 60 — of Northern Trust's approximately 200 global clients are actively monitoring more than 600 ESG and SRI guidelines, and more clients are expected to do so.

RISING DEMAND: Virgilio Abesamis says the increased interest in monitoring services is the result of a 15-year evolution.

Among current clients who don't use Northern Trust's SRI monitoring, they "may have other ways of doing so already, like the ability to do so internally," Mr. d'Ouville noted.

Whether clients want such monitoring depends on the country where they are domiciled, their investment principles and their level of transparency.

"In the U.S., the highest concentration of clients that use our tools are public entities, religious organizations, and foundations and endowments," said Mr. d'Ouville. "For clients, such monitoring allows them to be sure their investments are in line with their views, and also provides for public scrutiny of their investments."

In Europe, SRI interest is much more consistent across all business segments. "The Australasian region is the most advanced in this area … in Australia, people who've grown up there are very attuned to SRI."

The size of the clients applying these monitoring tools "depends on who they are," he added. "Among religious organizations, all sizes of clients do this, while others will depend on the size of their actual SRI portfolio." He said among public pension funds, the "most vocal and aware" of SRI are the $260.9 billion California Public Employees' Retirement System, Norway's $712.6 billion Government Pension Fund-Global and Australia's US$82.8 billion Future Fund.

"Clients go at this different ways. It's not as dependent on asset size. It's more to do with the client's philosophy and public perspective."

Such monitoring is provided specifically to securities lending under a separate unit begun in May 2011 at Citi Transaction Services called Open Lend for Socially Responsible Investors, said Jeff Bonaldi, New York-based director, securities finance. "We wanted to provide the option of investing the cash collateral for securities lending in accordance with SRI and ESG factors," Mr. Bonaldi said. Citi and its partner, Sustainalytics, a New York-based ESG research firm, "applies multidimensional ESG screens" based on client guidelines to build a universe of eligible securities in which Citi's cash collateral management team can invest, he said.

Mr. Bonaldi said a "number of large lending clients," particularly in the U.S., use the service. He wouldn't elaborate on how many have signed on in the past year or what kind of institutional investors they were.

Overall, the growth in the monitoring business is a "natural progression" for large custodians looking to find new ways to apply the huge amounts of aggregated data they use, Callan's Mr. Abesamis said. "This is all about data," he said. ■