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New African Custody

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Into Africa

African custody is changing. Quality in technology, regulation and services is spreading across the continent reports **Craig McGlashan**.

Most people involved with the African custody market would agree that South Africa is in pole position, when it comes to both technical and regulatory infrastructure. But a number of other markets have grown strongly over recent years, and it is not inconceivable that some of these could eventually move past South Africa in terms of their ability to provide custody for investors.

Khalid Mukhtar, director of Sectech, a custodial software solutions provider with a number of African clients, believes that African custodians' back offices are far more advanced than some may think.

"In our experience, hardware has never been an issue, except for delays due to customs clearance. The only issue, and this is a problem across the continent, is telecoms - although this has changed tremendously in the last few years. 10 years ago internet connections were rare - but you go now and every organisation is connected. In terms of hardware specifically, I don't think that's an issue."

South Africa's position as a developed market may well have aided this situation, Mukhtar explains: "Any hardware that comes into South Africa gets passed around the other countries as all the banking hardware distributors are usually based in South Africa and all of Africa benefits from it."

Indeed, the fact that many African banks have the latest technology and are not running legacy systems may give them some advantages over their peers in more developed markets, Mukhtar adds.

To many, the most obvious candidate as a rival to South Africa's crown would be Nigeria. With a population of nearly 155 million it dwarfs the next largest country (Ethiopia, with 85 million) and has huge oil reserves. This has of course led to perhaps as many problems as it has provided wealth to the general population.

Corruption has been at the source of many of these problems, and the Central Bank of Nigeria has recently pledged to address this issue. Indeed, in February, a Fitch Ratings report said that corporate governance and accounting disclosure within the banking sector had begun to improve as a result of the Central Bank's initiatives, although more improvement could be possible.

Bruce Lawrence, from HBL Consultancy Services, works heavily in the Nigerian market. He says that Nigeria "still has a long

way to go in terms of transparency". He adds: "You have everything there, the structure; but the securities law still needs to be tightened up. It gives you the fundamentals, but if you go through the old version you'll have a clause which has nothing against it - it's still waiting to be drafted or pulled together."

"For example when I was working there in 2007 and 2008, there was no regulation for custodians and it's only in the last 18 months that you've had to register with the Securities and Exchange Commission (SEC) and get their approval. So we've had custodians in the marketplace for some time, without any real rules or legislation to follow."

That is not to say that the Nigerian custodian market has not been changed by new legislation over the past few years, however. Changes to capital rules in 2005 meant that a number of banks merged, while the Pension Reform Act in 2004 - which required all Nigerians to contribute toward their state pension - meant that a new branch of custodians emerged. These pension custodians - all local - are separate from general custodians, and instead of being regulated by the SEC they are governed by the National Pension Commission (NPC).

Indeed, two Nigerian banks - First Bank and UBA - operate in both the general and pension custody spheres, but the different branches must be completely separate legal entities, with different offices and separate mainframes.

According to Lawrence, this model has proved a success in terms of regulation. "They've really tried hard to make it work well," he says. "I would say the NPC is more advanced than the SEC, but then it has a smaller market to play with - they only have five custodians and 32 pension fund administrators. They also don't have the legacy of old documentation."

While Nigeria may not be fully developed in terms of regulation, custodians in the country have access to advanced technology. "They have an infrastructure and it works; there's a central securities depository called CSCS, it's electronic, and that process works."

However, he adds: "It's not a totally dematerialised market - if you want your physical share certificates it's going to take you a bit of time. That's one of the problems we have in the market - if you want to hold your share certificate you do suffer the incompetence of the registrars."

Segun Sanni, head of custody at Stanbic

IBTC bank - the Nigerian branch of the pan-African bank Stanbic - also believes that the Nigerian market has come on in leaps and bounds over the past few years, despite suffering during the credit crunch.

"We've had tremendous growth in terms of knowledge of what custody represents, of what it does and of what it can do," he says. "We've had growth in terms of asset values, and so one can say that in the last five years there has been tremendous growth in the Nigerian custody market."

This growth may well continue. Custody is still a relatively new concept in Nigeria, and many local investors choose not to use it - but the growing number of international players in the country may well be leading to a change in attitudes, although not in every industry.

"I think from the discussions we've been having that the SEC is favourably disposed to compelling mutual fund managers to use the services of custodians, just like pension fund managers have been compelled to," Sanni says.

"But to compel stock brokers to relinquish the custody of clients' assets and limit their responsibility - that has been met with fierce resistance from stock brokers and I cannot say how that will pan out."

However, Nigeria still has its problems. Corruption is still rife, and while banking infrastructure may be up to international standards, general infrastructure is not. Regulators - based in the capital, Abuja - are an hour's flight away from Lagos, the financial centre, which can also mean they are behind the game.

No one doubts Nigeria's potential - and it is quickly gathering the infrastructure and expertise to match - but how can it move ahead? Three things need to be done, according to Toyin Sanni, head of custody at UBA.

"We need to fix our electoral process; we very urgently need to have electoral reforms, with credible and tenable electrical processes. We need to have our power infrastructure challenges fixed - we need a government that will address our power problems. We also require corruption to be dealt with definitively," she explains.

"I think that if those three issues are fixed Nigeria will be very much on the way to greatness."

However, Nigeria is not the only market in Africa that is advanced in terms of custody.

Ramy Bourgi, head of emerging markets development for Société Générale Securities Services, believes that Egypt and Morocco also have a claim to be leaders on the continent - particularly when compared to Nigeria's regulatory record.

"The regulatory factor is the most important and customers, when they go into a market, would look at the risk/return and the risk today is not just market risk," he says. "It's market, insolvency, compliance, regulatory, repatriation, operational - there are a lot of risks. And I think this is why Egypt, Morocco and South Africa have been ahead of the game."

He adds: "The second factor is population. The economies matter. The Egyptian stock exchange now is at a EUR106 billion - and it was not unscathed by the financial crisis. We really are finding that clients want competition in those markets. They have grown to the size that it's very open to competition - now Egypt and Morocco are featuring more and more in people's investments and I think people are looking for competition - which will always give you a better service and a better value for the client."

However, Chris Wooldridge, head of securities services at Barclays Emerging Markets, cites some markets as being the most exciting in Africa. Barclays offers custody services in 16 African countries via a combination of proprietary subsidiaries and agent banks, and believes that people should be looking at Kenya and Mauritius.

"Kenya is a very well established market that's been running well for decades," he says. "They have a history of prudence in developing their market, so it's well regulated, it's got good infrastructure, and changes are well planned and developed. Kenya was one of the early adopters of a

central depository system; they were one of the early adopters of automated trading, so certainly in Kenya I see great potential.

"They are in the process of finishing off the last segment of immobilisation - namely corporate bonds. They are still physical but they have planned this year to immobilise those. But all other securities are automated."

Wooldridge describes Kenya as a "bright star" on the continent in terms of being a well-run market. "Efficiency is excellent, dividend payment is very good - so they don't have any of the problems investors associate with frontier markets."

Wooldridge also points to other markets that Barclays has a presence in, a total of 10 across Africa. He believes that Mauritius, one of the smallest countries in Africa in terms of population, is also one of the most advanced in terms of custody and financial services. This is partly as a result of the fact that Mauritius has one of the most stable economic and political histories among the African nations, according to Wooldridge.

Jennifer Ah Leung-Bundhun, custody business unit manager at the Mauritius Commercial Bank, agrees that "the political stability and economic prosperity of Mauritius cannot be disputed".

She adds: "The financial services sector is a contributor to that economic prosperity thanks to its regulators, modern infrastructure and know-how. I can hardly see any other African countries with such a track record." Its position as a 'key interface' between Asia and Southern and Eastern Africa - shown in its membership of a number of regional organisations - is also a benefit, she believes.

Leung-Bundhun also sees "great potential" in the Mauritian market. "Making custodians compulsory for investors appointing an investment manager, for

example, government giving tax incentives to use collective investment schemes as an alternate means to traditional saving," she says. "I also believe that Mauritius is well positioned to ease investment into the region for reasons already stated above. This would, however, require that the other members have adequate regulations, if not common ones, for investments."

Mauritius may have one of the most stable economic and political histories among the African nations, but one country which does not is Zimbabwe. However, it may be surprising to those living in the West that the recent turmoil in the country has not meant its financial institutions are in ruins.

"African custodians' back offices are far more advanced than some may think"

Sectech's Mukhtar explains: "We always forget about Zimbabwe. In terms of the market infrastructure, in terms of the attractiveness of the market, it has done well. Of course, because of the situation there, we don't really hear anything positive.

"What is interesting to note is that the stock market is still ok - it hasn't been affected as much as we think it might have been."

However, despite the power-sharing agreement now in place in the country, there are still problems - in February, president Robert Mugabe defended new regulations which would see large corporations, including banks, be required to sell 51% of shares to locals.

Many of the countries in Africa could stake a claim to being the "next South Africa", each for various reasons. Some have got things right that others have not, while others simply have too much potential to stay quiet for long. While people will have their opinions, it is probably impossible to say which of these markets will develop fastest and furthest. What is certain, however, is that the African market as a whole is far more advanced than many may think.

"We have clients in 10 countries in Africa," says Mukhtar. "All of us travel to all these countries regularly and have never faced any problems. The reality in Africa is much better than the perception. Unfortunately, it is the perception that we need to change and that might take a while."

Africa certainly has its problems, but perhaps sometimes the Western media focuses too much on the negative and not on the positive - such as the rapidly developing and maturing investment market in the continent, and the custodial services to back it up.



Khalid Mukhtar
Sectech