PHΩCION
investment services

Shhhhhhh…..the Big Secret: What the Industry Does Not Want to Divulge About Custodian, Administrator Output Accuracy

The degree of profitability for custodian and administrator service providers is predicated on keeping costs low and scaling the business with volume. Typically, many of these firms' employees are tainted by certain stigmas: insufficiently trained, underpaid, poorly incented and over-worked. This is especially true in the case of public entities obsessed with meeting or exceeding public shareholders' expectations. These firm often have hundreds of clients, each one with unique requirements which adds complexity to the business.

With this as a backdrop, market participants should awaken to the notion that it would be highly unlikely that each and every performance figure ever produced by service providers is accurate. A long list of anecdotes recounts tales of managers and investors having to devote excessive amounts of time and resources to interact with custodians and administrators in order to resolve issues emanating from the latter's production of incorrect performance figures. Indeed, our deep experience in the field is consistent with that. Factors that inhibit performance accuracy include problems arising from: mapping, stale pricing and corporate actions. As well, when it comes to input data even the most reputable are prone to mistakes – none of them are perfect.

No Incentive to go the Extra Mile Yields Client Frustration

Phocion has yet to encounter a custodian or administrator that performs ex ante analysis of their performance system as it relates to a given customer. There is no incentive for an assigned person to perform "above-the-call-of-duty" tasks. In fact, as a way to underpay the assigned professionals often possess insufficient skills to look under the hood to ensure that performance systems have no issues with mapping, stale pricing and corporate actions. Client grievances over outputs are typically handled by adjunct departments whose duty it is to investigate. In some cases resolution can take much time, which only adds to client frustration.

Lowest Common Required Denominator

Industry participants need to acknowledge the service rendered by administrators and custodians for what it is: the lowest common required denominator. Nevertheless, the industry vastly misterprets their work as doctrine. Similarly, though accounting firms are indeed competent to provide vetted NAV's the industry improperly assumes that their skillset extends to the accuracy of performance figures themselves. This is in fact not the case. Industry participants need to be mindful that these entities - especially the large ones - often present themselves as being an authority in performance in addition to accounting, when in fact they are absolutely not. The reason why they are capable of hoodwinking their clients is because they are blessed with reputable brand names - they know very well that they can charge elevated fees because of it. To make matters even more profound, they typically send junior employees to perform the client work. Usually these employees know far less than the firms' more experienced partners. Most certainly they have never been taught performance theory, peripherally at best.

Concluding Remarks

Published numbers belong to the manager, whether they were calculated by the administrator or via internal shadowing. The onus is squarely on the manager to ensure accuracy of the figures. In turn, investors must have a thorough due diligence process that makes clear light of the manager's operating practices from trade, through accounting, the performance system, right up to and including the reporting of the figures in marketing material. When forced to restate performance, investors will have bolted for the hills way before the manager considers pointing fingers at his administrator for their sub-par work on performance. In fact this would be erroneous. The only entity the manager should point a finger at is itself.

Phocion Investment Services (Head Office) | 1010 Sherbrooke Street West, Suite 1800 | Montreal, Quebec | H3A 2R7 Canada
T. 514-564-9955 | info@phocioninvestments.com | www.phocioninvestments.com