

Objective

The Investment Back-Office functions of the Kent County Council Superannuation Fund (the Fund) need to be organised in a manner so as to provide a robust and seamless flow of information with minimal duplication and /or need for manual intervention, for the production of timely and accurate management and accounting information.

In addition the quality and ease of access to data needs to be improved to assist in good decision making.

Background

The Treasury and Investments team 2014-15 business plan anticipated the procurement of custody services on behalf of the Fund using the LGPS procurement framework.

Service Providers

At the present time the Fund uses several third parties in respect of its custody, accounting and reporting services as follows:

- **JPMorgan** provides Global Custody services mainly comprising of securities contract settlements and custody, tax recovery, and voting arrangements on behalf of fund managers. JP Morgan was engaged as custodian back in 1999 and although the custody agreement has been reviewed at least twice since then, it is an open ended contract. As a matter of good commercial practice contracts should have a maximum term of 5 years. The LGPS custodian services framework was agreed in 2013 and KCC now has an opportunity to retender the contract at minimum cost.
- **KCC** Treasury and Investments undertakes the accounting for the whole Fund and specifically recordkeeping for pooled and alternative investments. The team uses the Shareholder system supported by Euraplan for recording all transactions, validating fund manager returns and providing information for upload to the Oracle accounting system. 1.5FTE's are actively involved in the KCC investments accounting function including providing an accounting service and preparation of the Fund's annual accounts.
- **Euraplan** support the Shareholder system. This has not been upgraded for a number of years and we believe there to be a more up to date version available. Euraplan also provide the independent valuation of securities, currencies and expected income.
- **The WM Company** prepares quarterly and annual performance measurement reports and League tables based on reports from all the fund managers.

Total costs for 2013-14 of the custody, accounting and reporting services provided by non KCC entities were £196,349. These do not include internal costs of the 1.5 FTE staff. A breakdown of this figure is at appendix 3.

The current arrangement has been in place for a long time while the size and complexity of the Fund has increased substantially in the last few years. Whilst the arrangement has the benefit of using inputs from several parties and thus maintains a high level of independent validation, it also involves

Custody Services Review 2014

a lot of duplication of information at several levels and hence is not the most efficient or the best use of time and resources.

The changes made to the Goldman Sachs' fixed interest segregated mandate in 2013 highlight the shortcomings of the Shareholder system as the system is not geared to record the type of transactions undertaken in that portfolio and hence involves a lot of manual intervention. Additionally, many of the Fund's recent investments have been in pooled funds eg SSgA equity funds, private equity funds and (further) investments in direct property which do not use the Fund's custody service. None of these funds require the full functionality of Shareholder, or have unique requirements not available in shareholder.

Reporting

Currently each month, on the 20th of the month following, the KCC Treasury and Investments team provide members with a brief overview of fund managers' performance for the month, and quarterly a Fund Position Statement is presented to the Committee that has been prepared by the WM Company.

Officers advised the Fund Committee at its meeting on 2 July of the need for further development of current practices primarily:

1. Improved investment management reporting to the Committee
2. Quarterly monitoring and reporting of funding levels in conjunction with Barnett Waddingham
3. Improved long term cash-flow forecasting

Fund values

As at 31 March 2014 the total value of assets under management was £4,113m of which 46.6% was invested in segregated portfolios with 4 fund managers – Schroders, Baillie Gifford, GSAM and Sarasin. The balance of the Fund was invested in pooled funds, private equity, direct property holdings and cash. A detailed breakdown of funds is at Appendix 2.

Workflow Analysis

To achieve the above objective it is important to break the current processes down to be able to identify and minimise areas of duplication and or manual intervention.

Segregated funds

- 1. Custodian**
 - a) The Custodian records all security activity and is the main repository of all transaction activity at source.
 - b) The Custodian shares this information with the fund managers who validate it against their own records, and provide electronic transactional files to KCC for recording in the in-house Shareholder system.
- 2. KCC Treasury and Investments – monthly process**
 - a) The transactional files are uploaded to the Shareholder system but the vagaries of the securities, currencies and corporate actions involved often means that the records need

Custody Services Review 2014

to be manipulated to achieve the correct result on Shareholder before the information can be used and summarised for accounting purposes.

- b) Reports are run from Shareholder and reconciled with the information from Fund Managers' reports to ensure accuracy of data on the Shareholder system.
- c) Shareholder reports are used to prepare journals for uploading on Oracle.
- d) A holdings list is then generated from Shareholder and sent to Euraplan for independent pricing.
- e) The pricing file is received from Euraplan and uploaded onto Shareholder.
- f) A valuation is run on Shareholder to reconcile the holdings and the prices per Shareholder to the Fund Manager's reports.

3. KCC Treasury and Investments – quarterly process

The stock holdings per Shareholder are reconciled to the custodian's records.

Pooled funds and private equity

1. The Fund's Custodian does not provide custody services for the Pooled Funds and alternative investments such as Infrastructure and Private Equity funds as they have their own custodians / administrators
2. KCC maintains records for these investments but they do not lend themselves to recording on Shareholder in the same way as the segregated funds.
 - a. Independent prices are not readily available for these investments
 - b. Detailed Excel Spreadsheets are needed to record the Drawdowns and Distributions of Private equity and Infrastructure funds for Private Equity and Infrastructure investments
 - c. Memorandum records are maintained on Shareholder and updated on a quarterly basis.

Direct Property Holdings

1. DTZ the Fund's property investments manager maintains detailed records of rental activity for the properties.
2. These investments do not lend themselves to recording on Shareholder in the same way as the segregated funds.
 - a. Independent prices only available annually from the property valuer. At other times estimated values are used.
 - b. Detailed Excel Spreadsheets are used to record the property purchases and sales
 - c. Memorandum records are maintained on Shareholder and updated on a quarterly basis.

Operational Cash

1. The Custodian does not handle the Fund's operational cash balances managed by KCC who use NatWest for banking services. The Investments in Money Market Funds are recorded using the SunGard portal. These and the HSBC FIBCA account are recorded using spreadsheets and Oracle and not recorded on Shareholder.

Performance measurement

1. The fund managers and KCC send quarterly information to The WM Company who calculate performance figures for their portfolios individually and for the Fund.
2. WM use the information for calculating returns at asset class level, as well as preparing LGPS league tables.
3. WM prepare performance reports that need to be validated by KCC against the fund managers' returns for accuracy and consistency.

Disadvantages of the current back office arrangements

As the custodian services, accounting and performance measurement / reporting services are provided by different organisations it necessitates separate flows of information to all or some of them and duplicates records. This is time consuming, requires several layers of validation and delays the production of accounting and management information.

Current services arrangements are not comprehensive

- The current custody arrangements with JPM do not cover the entire portfolio
- Shareholder does not cater to accounting for all asset classes and transactions and information needs to be maintained on alternative spread-sheets.

The source of custody and accounting information being fragmented, preparation of complete accounting and management information is complicated and time consuming.

Appendix 1 provides further details of current problems with the KCC managed Shareholder service and the custodian service provided by JP Morgan.

Options

1. KCC to continue to provide the accounting service and implement an upgraded Shareholder system. Look to transfer all non Shareholder based recordkeeping onto Shareholder and dispense with Excel spreadsheets. Using the LGPS Custody Framework either to continue to use the JPM custody service or engage a new custodian. Continue to use the performance measurement service provided by The WM Company.

Advantages:

- Professional services provided by providers specialising and expert in the specific activity
- Independent validation of information by different parties
- Reduced dependence on a single organisation for the provision of the majority of services
- Less chance of systemic errors going un-noticed

Disadvantages:

- Fragmented workflow.
- KCC to continue to manage separate accounting arrangements for direct property investments and KCC cash

Custody Services Review 2014

2. Call off the LGPS Custody Framework for one provider of fund custody, accounting, pricing and performance measurement services and cease the use of Shareholder and WM other than for league tables.

Advantages:

- The Fund would have one provider of custody, accounting, pricing and performance reporting services.
- The custodian would use the same data that it already holds for the segregated portfolio – reduced re-keying of data and risk of error.
- Additionally, we would expect that as the custodian is already likely to be providing those services for a number of clients with the same fund managers and /or investments they could use their expertise to deal with queries / problems that arise more efficiently and economically than KCC can.

Disadvantages:

- Duplication of recordkeeping and performance measurement for the pooled funds and private equity investments which have their own custody / administration arrangements.
- KCC to continue to manage separate accounting arrangements for direct property investments and KCC cash

On balance the advantages of having one provider of services far outweigh the disadvantages, given the nature and size of the fund and its direction of travel. Besides, the disadvantages can be countered by having a sound selection process for the provider of custodian services and robust processes to monitor their performance once the contract is set up.

Considerations

1. Potential for time saving for KCC staff so enabling them to undertake more value added activities.
2. Timeliness of services to be provided
3. Cost
4. Complexity of data migration and potential loss of historical data.

Conclusion

The increasing complexity of the Fund's investments, number of fund managers and value of the Fund's investments coupled with increasing regulatory requirements, is placing additional demands on the back office function. Also given increasing local authority budgetary pressures optimum use needs to be made of the KCC resource. We need to consider how it can be best used in supporting better governance and improving value added activities such as monitoring, evaluating and reporting on the Fund and fund manager performance.

The above options should be explored and evaluated so that by the end of the current financial year we would have decided upon and implemented changes in the back office functions to achieve the required efficiencies to free time for staff to support improved governance structures and processes for the Fund.

Custody Services Review 2014

Sangeeta Surana and Alison Mings

Treasury and Investments

August 2014

Action Plan:

Refer to LGPS Framework Guidance at

[LGPS Custodian Framework](#)

	Action	Deadline
1.	Invite Euraplan to present potential improvements through Shareholder upgrades. Assess potential efficiency improvements from new functionalities.	30 September 2014
2.	Obtain Custodian Framework information from the LGPS Framework administrators to do background reading regarding the operation of the Framework. Information to be considered: Funds using the framework, services covered, cost parameters /estimates if available, mini competition procedure, monitoring information and feedback from users.	31 July 2014
3.	Decide whether Shareholder should be upgraded or not.	30 September 2014
4.	Start the process for using the Custodian Procurement Framework	15 October 2014
5.	Obtain SF committee approval to carry out a procurement process	14 November 2014
6.	Using the LGPS framework undertake a further competition as per guideline procedure	1 December 2014
7.	Appoint custodian	31 March 2015
8.	Undertake data migration if required.	April 2015 onwards

APPENDIX 1

Issues with current in house accounting arrangements/ Shareholder

1. Outdated version of Shareholder- limits certain functions now available in the newer versions/upgrades- new functionalities to be reviewed
2. Time consuming- Typically requires 2 -3 days of staff time per month for input and review of data, especially given the complexity of the GSAM portfolio as well as the alternatives.
3. Not suitable for accounting for property, Pvt Equity, Infrastructure and FOREX transactions- This requires maintaining parallel records outside shareholder and requires a substantial amount of time.
4. Euraplan pricing not always timely- Due to the delay in reconciliations and consequent delay in requesting prices, the price file does not include new securities that month and need to be manually requested an input
5. Where securities relate to different currencies from the underlying country, pricing often needs to be manually corrected and is time consuming.
6. Corporate Actions- poorly explained by Fund Managers in reporting and tricky to implement on shareholder.
7. Tax information- reconciliation with JPM/FM- could be easier by custodian as underlying data held by them. Need to explore if the accounting services provided by custodian would include Tax recs with FM's records.
8. Cash and securities position reconciliation with custodian- Shareholder does not deal with that aspect. Needs to be done manually. Need to explore if the accounting services provided by custodian would include Cash recs with FM's records.
9. Management of Period ends and data archiving- needs to be understood and implemented

Issues with JPM

In the past-

1. Account closures - Issues with Cash transfer transactions and conflicting information regarding fax numbers - lack of joint up service provision. Now addressed by giving us direct access to senior staff who can facilitate smooth delivery of services across teams within JPM.
2. Change in staff in Market opening section and hence conflicting advice provided.
3. Transition services- timing.

APPENDIX 2

	31 March 2014	
Asset Class / Investments	£000's	%
Schroder Institutional Stlg Broadmarket 'X' Acc	111,108	
SISF Strategic Bond GBP Hedged	109,499	
MPF UK Equity Index Sub-Fund	710,903	
Impax	30,196	
BMO Investments (Ireland PLC) Global Total Return-Pyrford	183,481	
M&G Global Dividend Fund	200,749	
MPF International Equity Index Sub-Fund	173,361	
Schroder GAV Unit Trust	185,363	
Fidelity Property Fund	25,733	
DTZ property funds	86,858	
Total pooled funds	1,817,251	44.19
Chandos Fund (YFM)	3,764	
HIPEP VI- Cayman	12,254	
HarbourVest Partners IX	8,943	
Henderson Secondary PFI Fund I and II	9,984	
Partners Group Global Infrastructure 2009	31,889	
Partners Group Direct Infrastructure 2011	6,652	
Total private equity / infrastructure	73,486	1.79
DTZ direct property	282,117	6.86
Total non-segregated funds	2,172,854	52.83
Schroders UK Equities	705,026	
Baillie Gifford Global Equities	751,405	
GSAM Fixed Income	310,429	
Sarasin Global Equities	149,775	
Total segregated funds	1,916,635	46.60
KCC cash	23,184	0.56
Total assets under management	4,112,673	100.00

Custody Services Review 2014

APPENDIX 3

Back Office costs 2013-14

Cost	£
Custody	149,073.92
Shareholder service	4,760.31
Performance Measurement	42,514.75
Total	196,348.98