

By: Chairman Superannuation Fund Committee
Corporate Director of Finance and Procurement

To: Superannuation Fund Committee – 5 February 2016

Subject: **PENSION FUND CUSTODY SERVICES REVIEW**

Classification: Unrestricted

Summary: To seek the Committee's approval to expand the Fund's Securities Lending Programme

FOR DECISION

Background

1. Securities Lending is an additional source of income on assets directly held by the Fund. Tax considerations and market making are two of the key drivers for the market for securities lending.
2. LGPS regulations restrict lending to 25% of a Fund's total assets and only permit lending to EEA (European Economic Association) borrowers. When the Kent Fund's programme was agreed with JP Morgan, its then custodian, lending US stocks was excluded. In the past few years UK intermediaries have started borrowing US stocks and these arrangements are allowed within the LGPS regulations. The Kent Fund could now lend its US stocks to the intermediaries but this change requires the Committee's approval.
3. In the financial year 2014-15 the Kent Fund earned £327k from its Securities Lending programme on the basis of JP Morgan charging a fee of 30% of the revenue received.
4. In 2015 when the Fund went out to tender for custodian services the Northern Trust Securities Lending Programme was evaluated and taken into account in the award of the Custodian contract.
5. The Kent Fund contracted with Northern Trust for custodian services from 2 November 2015 and agreed with the bank that initially they would implement the programme that had previously been operated on Kent's behalf by JP Morgan.
6. Northern Trust has quoted a fee of 28% of revenue received for the current programme. Should we decide to include US stocks Northern Trust have quoted a fee of 19%.
7. All of the other 20 LGPS clients of Northern Trust engaged in securities lending already include US securities in their programmes.

Current Programme Parameters

8. The Fund's current programme parameters with Northern Trust are as follows:
 - i) Security Types Approved for Lending
 - a. UK Equity and Fixed Income
 - b. International (excluding US) Equity and Fixed Income
 - ii) Borrowers Approved for Lending
 - a. UK borrowers including European UK and UK intermediaries (UK AUKI) approved
 - iii) Approved Collateral
 - a. US and UK Government Securities
 - b. Eurozone Government Securities
 - c. No cash

Proposal

9. The proposal is to expand the current lending programme to include US stocks, taking advantage of Northern Trust's lower fees, and enhance the income from the programme.

Benefits - Income enhancement

10. Based on the Fund's current asset profile the gross revenue for non-US stocks is estimated to be £559k. Given the current fee split of 72:28 estimated net income is £402k.
11. If US stocks are included in the lending programme Northern Trust propose a fee split of 81:19. Gross revenue for US equities is estimated to be £762k, net £453k. Total estimated net revenue is £1,070k.
12. Inclusion of US stocks could therefore increase the Fund's revenue by £453k, i.e. more than 100%.

Risk

13. Northern Trust has an extensive indemnity in place covering operational, counterparty and collateral risk which applies to our current as well as to the proposed expanded programme.
14. There are no plans to change any other parameters and therefore the risk profile of the lending programme is not affected.

Recommendation

15. The Committee is recommended to agree to an expansion of the Fund's securities lending programme to include lending US stocks.

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