Summary
• No longer just safeguarding assets, custodians are finding new areas to help streamline pension operations.
• Regulatory requirements are piling pressure on pension reporting – custodians are creating ways to help.
• ESG – no longer just an investment manager issue. Custodians are measuring and monitoring who is doing what they say.

New ground

Custodians are gaining new ground within the pensions space, forming stronger partnerships with pension funds. Elizabeth Pfeuti reports

In the past 15 years, the generic UK pension fund has shifted massively.

Not only has its asset allocation changed from a simple balanced portfolio containing two types of listed securities to a spectrum of off-market products, but its requirements for reporting to regulators and stakeholders have increased remarkably, too.

Alongside shifts to assets that promise to diversify and bring income, regulators are demanding to see the inner workings of trading and reporting to ensure these pension funds are getting the best possible outcomes for members. All the while, a range of stakeholders want to make sure these retirement savings are not harming the planet or its people, but not at the expense of benefits paid in old age.

While fund managers have been first in line to promote the investment products these investors need to meet their new requirements, one sector has not often been in the limelight, despite its importance.

Custody and asset servicing underpins everything a pension fund, its asset management and other investment partners do and as the sector's needs are shifting quickly, the large banks operating in the space have had to scramble for solutions, too.

The first major change these institutions have had to tackle is the holdings in portfolios.

In 2003, the average UK pension held 68 per cent in equities, 31 per cent bonds and just 1 per cent in what was classed as 'other' by investment consultant Mercer in its annual *European Asset Allocation Survey*.

By 2018, this had changed markedly. Equity holdings had fallen to 25 per cent – split 7 per cent to UK equities and the rest held internationally – investors had 3 per cent in property, 1 per cent in cash and 50 per cent in bonds.

The explosion came in the shift to alternatives – now 21 per cent – which can span private markets, timber or even agriculture investments – quite a challenge for the institutions tasked with keeping it safe and accounted for.

J.P. Morgan global pensions executive, Benjie Fraser, says continued low interest rates had pushed pensions to look outside their traditional asset allocations.

"They have been searching for something that will give them decent returns without significant volatility – and the hunt goes on," Fraser says. "Investors are moving considerable parts of their portfolios into alternatives, including private equity, and implementing derivative strategies too."

A broadening remit

Rather than just keep the assets safe, as might have been the requirement back in 2003, custodians need to make sense of what is in the portfolios and report back, often in real time, too.

With publicly-listed equities and bonds, this can be as simple as plugging into a generic market reporting system – not so with private assets.

With many of them valued as infrequently as quarterly, being able to access relevant information is the challenge for pension investors, according to Northern Trust, chief strategy officer for corporate and institutional services, Penny Biggs.

"Our asset owner clients want to be able to make better decisions," Biggs says. "To do this, they need information on

assets that is up to date, accurate and plugs into the rest of their dashboard, which holds data from the rest of their portfolio."

Not only does collating and standardising these data make pension investors' lives easier, it lowers operational risk – or the likelihood of getting key decisions wrong. To this end, Northern Trust has launched a product that gathers, verifies and stacks all investors' data in a format that is accessible and tailored just for them.

They are not alone. Custodians, once seen as safe keepers of assets, have moved up the food chain to become investors' strategic partners, according to MJ Hudson Amaces managing director, Tom Robertson.

"Custodians used to look after pension fund assets in segregated funds and charge a fee," Robertson says. "These assets have mostly moved to pooled funds, the custody of which is the responsibility of the fund manager, and custodians have changed their relationship – and revenue models – with pension funds."

Meaningful reporting

Recent regulations, such as the update to the Markets in Financial Instruments Directive, require much more granular data on trading and other middle and back office functions than was expected even five years ago.

"Regulatory requirements need to be delivered and expectations are becoming more complex," Robertson notes. "Custodians need to support pension clients with reporting, very robust investment accounting and performance measurement – clients would struggle to do that on their own."

The span of data that needs to be collated, cleansed and analysed purely for regulatory requirements is no mean feat – pension funds typically have multiple fund managers, advisers, indexes and other service providers all feeding in their own flavour of data.

Kas Bank managing director, Pat Sharman says: "It is not about providing spreadsheets of data – it is about providing meaningful reporting and insights that can be actioned by clients." Kas Bank has developed an app that draws together the key information for pension funds, so they can make actionable and more informed decisions. And these decisions can have significant consequences.

"Ten years ago, pension funds used their consultants to challenge fund managers over their performance. Now the larger funds are doing it themselves and they need good, reliable data to do it – it is their custodian that supplies it," says Fraser.

Increasingly, it is not only regulators that are demanding reporting data or trustees questioning managers' actions – it is their members mobilising, too. Once on the fringes, environmental, social and governance (ESG) issues are concerning the general population like never before and pension funds are under pressure to respond.

A recent study from Create Research found that 61 per cent of 161 pension funds said their ESG allocation would increase over the next three years.

Sharman adds: "Trustees will need ESG data in order to monitor their managers. The challenge from a custodian's perspective will be trying to measure this development, as there are a wide range of tools currently available, but no one universal standard."

Fraser states that the first task for a custodian is to gather the various streams of data that a pension fund might use, a selection that is likely to be different for each, and pipe them into something manageable.

"For example, company filings provide information on what a company has done regarding its responsibilities towards sustainability," Fraser says. "An investor can also buy data feeds that are piped into one central repository. It is up to the custodian to sort through all this data and present it to the pension fund investor."

Then the custodian needs to take all this data and use it to calculate what it means to an investor and their investment principles.

Biggs says pension funds wanted close monitoring and tracking of ESG performance against their own set of requirements, both on their commitment to protecting the planet and society and their performance.

"Increasingly, investors want more sophistication in what is available and how it is put together and applied, so custodians are continuously working on improving these systems," Fraser notes.

J.P. Morgan is working on improving the front end of its system, making it easier for clients to use and ensuring what they need is where they want it and in the correct format. The way all this will be achieved is through technological advances and as some of the largest financial institutions in the world, these banks are not short on budget to develop them.

Apps, revolutionary front-end systems and blockchain solutions are all in development at these large banks as they look to lead the charge into a new age where they operate front and centre of the investor challenge.

All this, and asset security too, is piling the pressure on an industry known for its relatively low fees, compared with many in the investment sector.

However, Robertson says custodians and their clients were realising the value of long-term, strategic partnerships and few were letting the grass grow.

Written by Elizabeth Pfeuti, a freelance journalist