

Pensions Audit Sub Committee

10.00 a.m., Tuesday, 15 December 2015

Global Custody Services Performance

Item number	5.6
Report number	
Executive/routine	
Wards	All

Executive summary

This report presents the Key Performance Indicator Report for the 12 months ended 30 September 2015 provided by the Funds' custodian, Northern Trust. The purpose of this report is to demonstrate that the performance of the custodian is regularly monitored to ensure that the services provided meet the needs of the three Pension Funds.

The conclusion is that Northern Trust's services are currently meeting the needs of the three Pension Funds and are of a sufficient standard. As discussed in the report, there have been a few examples of deterioration in the timeliness of some services. This has not impacted the effectiveness of the Pension Funds and the issues have been discussed with Northern Trust.

Links

Coalition pledges

Council outcomes

[CO26](#)

Single Outcome Agreement

Global Custody Services Performance

Recommendations

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider; and
- 1.2 Note the report and highlight any points it would like to raise at the Pensions Committee on 16 December 2015.

Background

- 2.1 Following a competitive tender process, Northern Trust has provided investment custody services since early in 2011 for the three Pension Funds. Provision of these services is vital to the management of the Funds' investments. The range of services includes:
 - Reconciling investment valuations and accounts.
 - Ensuring that investment transactions are processed within market requirements.
 - Collecting investment income.
 - Providing notification of all corporate actions and passing responses to the companies concerned.
- 2.2 In order to assess the services provided a number of key performance indicators have been agreed with Northern Trust. These indicators are subject of a report from Northern Trust, the latest of which is for the 12 months ended 30 September 2015. The indicators cover the services listed above.
- 2.3 In addition, Northern Trust provides foreign exchange conversion and investment income tax services. The performance of these services is assessed in separate reports that are presented to Committee on an annual basis. The only other significant service provided is securities lending, this revenue item being included in the budget and outturn figures which are also presented to Committee.

Main report

3.1 Information about all of the performance indicators is summarised below:

Month End Valuation Reporting

Description of Indicator	Month end valuation reports of investments completed and reviewed by Northern Trust and available to client within the target number of business days of end of the previous month.
Performance Traffic Lights	Green – Completed by business day 14 Amber – Completed by business day 15 Red – Completed by business day 16 or later
Service Rating Over 12 Months to 30/9/15	Amber (Previous Report: Green)
Comments	<p>Unreviewed valuations are available on business day one; these are accurate for quoted investments. Portfolios that contain unquoted investments take longer for valuation information to be obtained.</p> <p>Month end valuations provided by Northern Trust are reconciled with records maintained by the external or internal investment manager. In addition, checks are made on the prices used by Northern Trust and the prices used by the external or internal investment manager.</p> <p>For the year end up to 30 September 2015, on three occasions the sign off period was after the 14 day target. On each occasion queries had been submitted by the Funds' staff which resulted in the delay of the final sign off. The queries were raised to improve the accuracy of the monthly valuations and are an essential part of quality assurance role played by the Funds' staff. Working proactively with Northern Trust helps to minimise future problems.</p>

Financial Reporting

Description of Indicator	Since April 2012, Northern Trust has been responsible for providing investment accounts for all three Pension Funds. This includes a month end trial balance and summary accounts and at the year end additional information for inclusion in the annual accounts.
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	Month end investment accounting packs should be completed and sent to client within the target number of business days of end of the previous month.
Performance Traffic Lights	Green – Completed by business day 18 Amber – Completed by business day 19 Red – Completed by business day 20 or later
Service Rating Over 12 Months to 30/9/15	Amber (Previous Report: Green)
Comments	More time is allowed at the year end for the preparation of the additional information required for the annual accounts. The month end accounts are checked by the Fund for accuracy. The delays mentioned above, in the comments on the month end valuation performance indicator have had a knock on effect in completion of the monthly financial reporting on three occasions. Fortunately, there were no delays at the year end.

Trade Settlement Statistics

Description of Indicator	Each investment market around the world has a set of requirements that must be followed regarding the settlement of trades (purchases and sales). These requirements include a fixed number of business days for a trade to be settled. For example, shares trade in the UK must be settled in a three day period. Within that period each side must “deliver” either the shares or the cash as appropriate. The indicator is the percentage of trades that have settled on time.
Performance Traffic Lights	Green – 94% or higher Amber – 92% to 94% Red – 91% or lower
Service Rating Over 12 Months to 30/9/14	Green (Previous Report: Green 97.19%) 96.40%
Comments	During the period there were a total of 6,446 trades of which 6,214 (96.40%) were settled on time. Of the 232

	<p>trades settled late, 205 were purchases and 27 were sales. This reflects the main reason for late settlement that Lothian Pension fund experiences – that the selling broker does not initially have sufficient shares to settle the purchase trade.</p> <p>Northern Trust provides a range of reports on settlement statistics; this includes one that provides information by broker. This is particularly useful for identifying the source of settlement problems.</p> <p>Northern Trust provides contractual settlement on all trades. So in the case of sale trades, Northern Trust will credit the Fund with the cash proceeds on the contractual settlement date of the underlying trade regardless of whether it settles on time in the market. Northern Trust would then seek compensation by issuing a market claim against the purchasing broker.</p>
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Income Collection Statistics

Description of Indicator	<p>It is the responsibility of the custodian to account for all dividend income when it becomes due and to receive the money into the bank when the dividend is actually paid.</p> <p>The indicator is the percentage of the number of income payments received on pay day.</p>
Performance Traffic Lights	<p>Green – 95% to 100%</p> <p>Amber – 90% to 95%</p> <p>Red – 90% or lower</p>
Service Rating Over 12 Months to 30/9/14	<p>Green (Previous Report: Green 98.35%) 98.65%</p>
Comments	<p>The performance indicator is based on the number of income collections rather than their value. During the period there were a total of 2,821 income collections, 2,783 (98.65%) of which were received on the correct pay day.</p> <p>Northern Trust provides a range of reports on income receipts this includes one that provides information by country. This report would be useful to identify any problems at the market rather than individual company level.</p> <p>Northern Trust provides contractual income in around 46</p>

	countries. This means that Northern Trust endeavours to credit the Fund's bank account with the income on its pay date irrespective of the actual date of receipt.
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Corporate Actions

Description of Indicator	<p>Corporate actions are events announced by companies that give shareholders the opportunity to make a decision on two or more potential choices. For example:</p> <ul style="list-style-type: none"> • Rights issue to buy additional shares • Dividend reinvestment in additional shares • Receive dividend in GBP, USD or EUR <p>It is the responsibility of the custodian to collate responses from its clients to corporate actions and communicate the results to the company. The Fund has the responsibility of responding to corporate actions on a timely basis.</p> <p>The indicator is the percentage of responses made by the client with the deadline date set by the company for a response.</p> <p>The Fund has the responsibility of responding to corporate actions on a timely basis. Responses are made by external and internal investment managers for the portfolios that they are responsible for.</p>
Performance Traffic Lights	<p>Green – 100%</p> <p>Amber – 95% to 99%</p> <p>Red – 94% or lower</p>
Service Rating Over 12 Months to 30/9/14	<p>Amber</p> <p>96.24% (Previous Report: Amber 95.50%)</p>
Comments	<p>During the period there were 559 corporate actions, 538 (96.24%) of which are recorded as having been responded to within the time limit.</p> <p>Northern Trust provide an online system to advise clients of all upcoming corporate actions for the investments that are held. The same system is used by the client to record decisions. As the deadline for an action approaches and no response has yet been recorded, Northern Trust staff will attempt to contact the client for a response. Contact is initially made by e-mail and on the day prior to the deadline contact by phone is attempted. In the event that a client</p>

	<p>response cannot be obtained Northern Trust will elect the default option for the action.</p> <p>The twenty one late items have been reviewed to assess the potential consequences. Virtually, all relate to the option to elect to take additional shares instead of a cash dividend. The assessment is that these and the other late items do not represent the potential for financial loss.</p>
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Measures of success

- 4.1 Performance is measured against the indicators that have been set for the main services provided by Northern Trust.

Financial impact

- 5.1 The budget set for the provision of custody services for 2015/16 is £352k. This report has no impact on the cost of custody provision.
- 5.2 Poor performance of the custodian could have a financial impact on the three Pension Funds. For example: from delays in or failure to collect investment income or failure in the system to notify companies of decisions made in response to corporate actions. However, staff monitor service provision and corrective action would be taken if any issues were ever to arise.
- 5.3 The cost and quality of custody services are assessed as part of a rigorous competitive procurement exercise. Northern Trust was the clear winner of the last procurement. The contact is for five years ending in February 2017, with the option to extend for a further three years. Northern Trust currently provides custody services to 36% of the LGPS market in the UK and has been named Pension Fund Custodian of the Year in the Custody Risk European Awards for 2015. In addition, Northern Trust has retained a high credit rating (AA-) for many years and has not been involved in high profile litigation cases with clients (in contrast to other global custodians).

Risk, policy, compliance and governance impact

- 6.1 There are no risk, policy, compliance and governance impacts arising from this report.

Equalities impact

- 7.1 There are no equalities impacts arising from this report.

Sustainability impact

8.1 There are no sustainability impacts arising from this report.

Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading/external references

None

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Links

Coalition pledges

Council outcomes CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed

Single Outcome Agreement

Appendices None