The role of Custodians in "good governance" for pension funds

Custodians are concentrating more and more on supporting pension fund boards in completing and carrying out their governance tasks; for example, by independently evaluating the investment portfolio in the areas of performance, risk and compliance.

We know that pension fund assets must be separate from the capital of the sponsor through the trust structure of the pension fund. The trustees of the pension fund must then ensure that this capital is kept safe. Day-to-day trustees must be able to rest assured that the pension fund's assets are in safe hands. There is also increasing demand for independent reporting on and monitoring of these assets. This is why pension funds are choosing to outsource their pension administration and investment tasks to independent custodians.

Investment administration

The separation of functions between managers and monitoring of investments is traditionally applied slightly less strictly when it comes to maintaining the investment administration. This is often still left to the asset manager and a comprehensive financial fund administration is carried out within the fund based on these managers' investment administrations. There is however a clear trend to also implement a sharper separation of functions on this point. The custodian will then have a greater role in the administration and the fleshing out of a control and monitoring system for the benefit of the trustee board and their advisors, preferably without conflicted interests.

The pension fund trustee board remains ultimately responsible whatever model is chosen. The board should therefore outsource tasks in such a way that it is and remains de facto "in control". This places demands on the board members' knowledge level, the style of the mandate and the arrangement of the monitoring and control process. Basically, being "in control" requires a full governing role by the board.

The changing role of the Custodian

This governing role of the pension board trustee also means major changes in the traditional work of a custodian. It progresses from being simply a custody company to a business that concentrates on supporting the pension fund as regards governance and independent evaluation of the investment portfolio in the areas of performance, risk and compliance. The trustee board and their advisors should namely have such information at their disposal at all times so that they can check whether the asset manager is remaining within its mandate and the pension fund's investment policy.

Another principle that an independent investment administration can guarantee is the timeliness of information. The board and their advisors should be able to access daily information as to the current state of affairs with their pension fund. Details should be collected on time and from an independent source. This also strengthens the manager's position in the information process. It also enables independent monitoring of all decisions, guidelines and other parameters. Reliable data from a neutral source gives trustees a solid basis in order to take well-founded decisions and exercise control, in other words, putting them fully in the driving seat.

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Independent performance management, risk management and costs transparency
Pension funds do not always have a critical and independent risk monitoring function. Functions are not sufficiently separated between the pension fund and the implementing body as many pension funds opt for large-scale outsourcing of risk monitoring to an investment consultant, asset manager or fiduciary manager, sometimes even the same.

The more tasks are outsourced to one party, the more important it is to have sufficient countervailing power to suggest the unilateral submission of ideas and opinions.

It is also important to have a full insight into both the direct and indirect pension fund costs. The custodian can contribute via investment administration and performance management to the independent accounting regarding the economic positions in the securities portfolio. This contributes to the organisation of sufficient counterforces and an independent vision of the valuation of the position.

Control of the investment mandates
Implementation of the strategic investment policy can often be accompanied by unintended or unforeseen additional risks. Mandates towards asset managers and implementing bodies for some investment categories may involve too much freedom to deviate from the strategic benchmarks via active management. The demarcation of the permitted investment categories and instruments is also often not specified sufficiently. This can lead to unforeseen positions and additional losses. Various custodians in response to this offer so-called compliance monitoring which can support both the pension fund and the investment consultant or implementing body by providing a real time independent and neutral oversight function. They compare daily the asset manager's investment policy with the agreed mandate, or with other investment beliefs such as your ESG policy. Such control also renders the mandate correct and quantifiable to the benefit of trustee, member, consultant and manager.

Investment Management Services
The above changes are important to you as a pension fund manager but also for us at KAS BANK as a custodian. As an independent custodian in the UK, Germany and the Netherlands, we are in a good position to help you in interpreting your governance issues.
For a discussion on the many possibilities for Investment Management Services, please contact Steven Polese or Matthijs Verweij in our London office.

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"We are all custodians, dependent on each other." Willie Smits
Indonesian forestry engineer, microbiologist and conservationist