

DAILY DATA: A GROWING REQUIREMENT FOR PENSION FUNDS

A pension fund need not perhaps take investment decisions every day, but it does have to have figures that are as up to date as possible. Not only due to the unsettled nature of the financial markets, but also to satisfy regulatory requirements. Consequently there is both a clear trend and a growing demand for data on a daily basis, compiled for example in a book of record. A conclusion reached at Northern Trust's recent annual Dutch Conference with an overwhelming 88% of delegates considering it essential to have access to daily investment data in their role, and only 40% indicating they currently have access to the data they need*.

Prior to this, it was common practice for pension funds to value their assets using the custody platform, based on end-of-month results. In financially settled times, this was usually enough. But it did mean that at some point, the figures could be almost two months old. As Wim van Ooijen, Managing Director of Northern Trust Netherlands said, with a nod to the conference venue – the EYE Film Museum: "We're freeze-framing film and cutting it up into loose images. But now that the number of frames per second has speeded up so much, we have to do it far more often, and the images have to be pin-sharp. Everyone wants their pension fund to be in control at all times, and to convincingly demonstrate that this is the case."

Partly for this reason, a leading Dutch pension fund switched from the custody platform to a book of record supplied by Northern Trust, and as a result now has an immediate daily overview of the value of all its assets. The book of record also gives it a more accurate insight into the risk profile so that it can hedge interest rate fluctuations. This is useful because the pension fund has a long derivative position, and needs to make swift ad hoc responses.

BALANCING ACT

The Chief Operating Officer of the pension fund explained how his organisation had arrived at the decision to switch to a book of record, which was previously only really used by asset managers. "Our real ambition is to optimise and maximise the opportunity to grant indexations in the future, which is quite a balancing act. And of course we want to do this as efficiently as possible. That's why we started to think about moving from the custody platform to a book of record, to ensure that we have information on a daily basis. All our asset data will then be automatically reconciled."

Penelope Biggs, Head of Institutional Investor Group, EMEA at Northern Trust, confirmed that the financial landscape has changed radically. "Pension funds need data to fulfil their regulatory and disclosure obligations. And they need it with far greater frequency and flexibility than before." In the Netherlands maybe more than anywhere else: "Nowhere else in the world, as far as I am aware, does the regulator walk into your office and ask for evidence of why you made a particular decision. So we are giving asset owners the tools to ensure oversight and compliance and evidence this as well."

GROWING CONVERGENCE

A financial consultant agreed that there is a growing convergence between asset owners, such as pension funds, and asset managers: "Asset owners are becoming asset managers. Under the new regulations, asset owners have to be much more aware of the risk

profile of their entire portfolio, and also have to be accountable for it to the regulatory authorities. This means more work for pension funds, but that's offset by the fact that there are fewer risks, lower costs and greater transparency. Not to mention a satisfied regulator. So it's very important to have good quality data at your fingertips." He reminded the audience that in 2002, legendary financier Warren Buffet had already claimed that derivatives were weapons of financial mass destruction. "But it wasn't until after the financial crisis that governments began to say they wanted a specific central clearer. And the CCP now demands cash collateral on deposit on a daily basis. Everyone who works with derivatives will have to meet that requirement."

DATA: FUEL FOR ALL SOLUTIONS

Les Beale, Global Product & Strategy, Northern Trust, indicated that more and more asset owners are looking for data solutions: "Pension funds want to know whether the data they have is sufficient for their business use. Whatever the role you may have in an organisation, fuelling your solution is the underlying data. Solvency II, EMIR and other regulations are all data hungry. The key facets to this data are timeliness, accuracy, accessibility and flexibility, and you can guarantee effective reporting, especially on a daily basis, by utilising a robust book of record to underpin the reporting infrastructure." Penelope Biggs added: "Asset owners need to be able to achieve certain outputs relating to risk, performance, compliance, exposure, regulatory disclosure, liquidity analysis and optimisation. By the time you are in a central clearing environment and EMIR is what you live and breathe, that will be really important. So now is the time to act."

LEHMAN NEXT WEEK?

The financial consultant concluded that it was all about the quality of the information and the capacity to respond when a situation changes. "We've had a stable financial environment for a number of years now. But if there were to be another Lehman situation again next week, how many of you would be confident in looking at your end of month statement from maybe six weeks ago? You may be quite comfortable with an environment in which you have access to that book of record the second you need it. The ability to produce more accurate key risk indicators has become crucial for running a successful business. Transparency is now the biggest issue. Investors are increasingly demanding a breakdown of costs so they can see where their money is being spent."

THE NEXT STEP: ALGORITHM TRADING

Once again, rapid data is the foundation for the next challenging step: the partial automation of investment decisions using algorithms. Asset managers are

already working hard on it right now: high frequency trading, often mentioned in the same breath as algorithm trading. According to the financial consultant "Ten years ago, an IT manager was asked to send orders to the market within six milliseconds. In those days, that was seen as ridiculous. Yet now we're making the transition to nanoseconds. But even then it's primarily about the transparent availability of data to enable important investment decisions to be taken. It's also about decision management, with which you can use algorithms, for example to filter out emotional arguments. You can also build in some of the regulatory requirements so that they are automatically taken into account in the decision-making process."

"There is consequently a fundamental shift towards automated trading, and automated execution on the decision-making and execution side. This has led (and will continue to lead) to greater transparency, more robust order trails, a controlled environment and reduced costs. Although I won't see a market managed solely by computers and artificial intelligence in my lifetime, it is about enhancing traditional methods of investment management using the tools available, and every asset manager should therefore have a good tool kit. Having people who understand the needs of their stakeholders, the needs of their staff - these are also important aspects which aren't always factored into the algorithm."

LOOKING FOR CO-CREATION

In the long term, we were also interested in this next step to promote good decision making, explained the COO of the Dutch pension fund, "Suppose my CIO hears that unemployment in the US had gone up or interest rates were rising. He could turn on his computer and have a set of three, maybe four, alternative decisions he could make. We have an advanced system and advanced data, but can't yet convert them into decision-supporting advice. I'd like to be able to do that one day. But until then, I have a practical approach. To begin with, I'm working on my current information environment, finding ways to order it neatly, correctly, unambiguously, available and safely. Next, I'd like to develop an attribution analysis: a calculation engine which we could use at any time. We haven't figured it all out yet; we're currently looking at all our partners: Other pension funds, custodians, consultants and providers of technical solutions. What I'm looking for is co-creation."

* Dutch institutional investors were surveyed at Northern Trust's Dutch conference, 24 September 2015

