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Research Update

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Seeing through the risks of DC fund Investment Administration

This article shines bright lights into dark corners on how new technology is poised to revolutionise the administration of DC pension fund solutions in the UK pension landscape - and how this can fuel both opportunity and risk reduction for those operating here.

This update is for:
CEO's, CIO's Trustee Directors, Client Directors and CROs

Seeing through the risks of Investment Administration

At the end of 2015 Rory Mclroy, one of the world's leading professional golfers, announced that he had undergone laser eye surgery in an attempt to improve his short game as he felt that he was struggling reading the putting greens due to his poor eyesight and the wearing of contact lenses.

For somebody whose whole career could have been jeopardised if the procedure had gone wrong, you would have thought that this would have been a major decision, but evidently this was not the case. Maybe 15 years ago the decision may have been more difficult to make as the technology was not as advanced as it is today and the risk of the procedure going wrong would have been much higher. It is amazing to see how over time technology advancements can change the perceived levels of risk associated with something as radical as using a laser on your eyes. The huge reduction in risk from enhanced medical technology has resulted in a massive increase in the demand for laser eye surgery and a growth in the number of providers - so much so that this surgery can now be purchased from a provider on most main high streets.

You may be asking, "What has this got to do with investment administration...?" Let me explain.



There has always been a view that there are major risks attached to the calculation of unit prices for collective investment vehicles. These risks emanate from the manual nature of the processes utilised to administer assets through their trading lifecycle and also due to the 'tick and bash' approach surrounding the calculation and verification of unit prices. Traditional investment accounting platforms cannot handle Fund of Funds structures easily, which has resulted in the generation of spreadsheets and databases to deal with the fund dependencies, the management of cash flow, and rebalancing processes. End user computing solutions also play a major role in the control environment. Due to the scale of assets under management and the potential costs for rectification if unit prices are calculated incorrectly, many companies choose to outsource their investment administration to third party administrators and pass the risks on to them. We are therefore in the same position as laser eye surgery was 15 years ago, with very few providers, higher risks due to the manual nature of the process and severe ramifications in the event that it goes wrong.

However, similar to laser eye surgery technology, we have seen a major investment by certain software providers in technology innovation over the last 15 years. These enhancements deliver straight through processing across all investment functions, including Fund of Funds structures, whilst incorporating an integrated control framework, which reports breaches on an exception basis. This has transformed the structure of investment operations by dramatically reducing headcounts and operational risk. These operations departments now only require a small team of specialists to analyse exceptions rather than an ever-increasing army of data processors as the volume of funds grow.



Perfect Fit for the new Pensions landscape:

The new technology is a perfect fit for the administration of the fund solutions required to meet the new UK pension landscape.

There is a growing demand for Fund of Funds solutions, either to support white labelling of funds for schemes or to deliver target date funds and lifetime funds to deliver the most appropriate outcomes for the members.

The scalability of new technology enables administrators to rethink their pricing structures and remove the shackles on fund solution providers who have been constrained due to the 75 basis charging cap. For competition reasons third party administrators need to charge a basis point fee as opposed to a flat fee for their services – this would be uneconomic for them with low AUM in the early years of the fund unless top-notch systems are used.

This can be achieved and can be economic by using dedicated technology where the hard work is automated and humans review breaches, exceptions and irregular oddities.

Unlocking the Industry:

Despite new opportunities and these innovative streamlined technologies being more readily available, the DC investment administration industry has yet to embrace them. As we have seen in the world of eye laser surgery, proven technology delivers opportunities for new providers to join the market place. The same thing can happen in the investment administration arena too – it just requires the industry to acknowledge that opportunity and take the right steps forward.

In the US we see third party administrators delivering an end-to-end solution for pension administration and investment administration in the outsourced chief investment officer (OCIO) space. In the UK the life companies, fund managers, master trust providers and employment benefit consultants are perfectly placed to offer the same. With the scale of assets on offer and technology now minimising administration risks, the financial rewards must be far greater than the much reduced potential risks of a unit pricing error. Before I forget Rory does not rely on a 15 year old driver either!

Who will be the next company to seize this growing opportunity?

Frank Carr is the Chief Marketing Officer at Financial Risk Solutions (www.frsLtd.com).

FRS supply its Invest | Pro™ investment administration software into 30 life and pensions companies and 5 outsourcers.

Dublin based FRS was founded by a group of actuaries and IT specialists in 1999.



About Financial Risk Solutions (FRS)

Financial Risk Solutions Ltd (FRS) is a leading provider of unit pricing and fund administration software to the life assurance and pensions industries. Its Invest|Pro™ product family is a recognised leading benchmark in the investment fund administration area and customers in life assurance and third party administration include MetLife, Zurich, Aegon, SEB, Charles Taylor, IFDS, and Accenture Managed Services.

Invest|GRC™ (Governance, Risk & Compliance).

This is an asset reporting product that can consume data from the company's investment and financial systems, from outsourcers and from other external data sources. It empowers senior finance, risk, audit, ops and admin staff to monitor risks and mandates, do rules management, manage breach occurrences, assist corrections and crucially produce asset reports (both regulatory reports and also risk management function reports). There are three main strands: 1. Solvency II asset QRTs, 2. Risk management metrics, rules monitoring, breach management and compliance and 3. Analytics

Invest|Pro™ manages unit pricing and portfolio valuations, asset/liability unit matching, box management, trade order management, investment accounting, tax, financial reporting and compliance with investment mandates in a single application. Product types covered include unit linked funds, portfolio bonds, self-invested/directed pensions, shareholder funds and with-profit funds. Invest|Pro™ was specifically designed to securely automate complex fund administration processes.

Invest|OPS™ (Outsourcing Partner Supervision) automates the validation of operational activity performed by outsourcing partners. It provides methods for assessing the standard of performance of the service provider; enables the investment firm to supervise the outsourced functions and to manage the risks associated with outsourcing. It also provides the firm with effective access to the data associated with the outsourced activities.



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