



INVESTMENT SERVICES



CASESTUDY

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PLAN SPONSORS:
FINDING VALUE TO RIGHT THE SHIP

Many pension plan sponsors, particularly state-run retirement systems, struggle with growing unfunded liabilities. In recent years, low returns and high actuarial assumptions resulted in lower than required gains on assets and insufficient state contributions to the plans. An aging workforce nearing retirement coupled with fewer resources entering the workforce make funding gaps difficult to overcome. To combat this urgent problem, plan sponsors must maximize their use of technology to monitor and track their investments, and must keep expenses under control.

Background

One state sponsored pension plan was using STP to monitor and reconcile their investments monthly, but wanted to switch to a daily process that included matching trades from their external investment managers against the custodian bank trades. The goal was to gain the following capabilities: daily reconciliation (with custodians and more than 30 separate asset managers), transaction processing, cash and positions, corporate actions processing, month-end reconciliation of cash, accrued income and positions, and custom reporting. The plan sponsor also wanted to gain independence from their custodian bank by acquiring a system that used available market data, such as mortgage factors, inflation rates and other data to calculate mortgage paydowns, inflation adjustments on Treasury Inflation Protected Securities and income separately from the custodian. The goal was to create an independent accounting book of record that could be verified daily. The plan sponsor recognized that addressing and resolving operational inefficiencies represented a significant opportunity to not simply cut costs, but also optimize its cost structure. Doing so would allow the plan sponsor to focus on higher value activities like increasing performance and funding.

STP's long-standing expertise with building stringent controls and implementing rigorous data management processes provided the plan sponsor with the operational air cover it needed to focus on adding value. The organization understood the limitations of its back and middle office processes, namely the financial risk inherent when reconciliation processing is lacking. Failed and mismatched trades, positions and cash threatened to impose a lingering constraint over the sponsor's ability to manage portfolios and fulfill their fiduciary responsibilities. Finding the right partner to bring control and consistency to complex processes was critical to the sponsor's longevity and success.

Analysis & Teamwork

STP's team and the plan sponsor worked together to develop and enhance the plan sponsor's ability to maintain accounting control over its portfolio, minimize problems caused by unknown discrepancies and improve their reporting and reconciliation capabilities. Establishing scalable, repeatable controls over a firm's end-to-end operations processes is challenging and typically requires an ongoing commitment from all parties involved. It's one thing to admit that controls are lacking; it's another thing entirely to take steps to resolve the gaps. To tackle the overarching task, and its various components, STP developed processes and workflows to control and manage the numerous operational functions contributing to the sponsor's operating limitations. STP applied a combination of investment operations expertise, process/workflows knowledge and technical skill to regain control over the sponsor's operating environment, while also building a data warehouse that provided much-needed data integrity.

Cost basis calculations were a mission critical process rife with inaccuracies before STP partnered with the plan sponsor. STP implemented new processes that allowed the plan sponsor to accurately track and identify cost basis discrepancies timely. At the same time, STP delivered much-needed reconciliation control with daily earned and accrued income verification that provided real-time custodian discrepancies. To improve the plan sponsor's ability to reduce losses from unrecovered income, STP developed and implemented a new process for tracking and monitoring tax reclaim receivables.

Failed trades and other trade discrepancies, such as those arising from corporate actions, pose potentially significant risk. To reduce this risk, STP devised a set of best practices for the sponsor's reconciliation processes, including four key components:

1. Build/maintain/reconcile positions, transactions and cash balances daily
2. Capture accurate market pricing
3. Properly calculate accrued income
4. Update/maintain all security master file data, with a focus on bond characteristics

An important part of the workflow was implementing rigorous custodian reconciliation processes. By capturing investment data and inflows/outflows from both the sponsor and the custodian, STP built and implemented a complete reconciliation process that enabled the plan sponsor to verify the book of record each day.

With an extensive collection of managers who represented multiple asset classes, including tough-to-value classes like venture capital, private equity and other alternatives, the plan sponsors' portfolio posed many challenges. Notably, though multiple external data sources could deliver data to STP, there was no standardized format. STP's deep expertise with data management was vital in solving for, and simplifying, the plan sponsor's ability to seamlessly integrate and use multiple data sources.



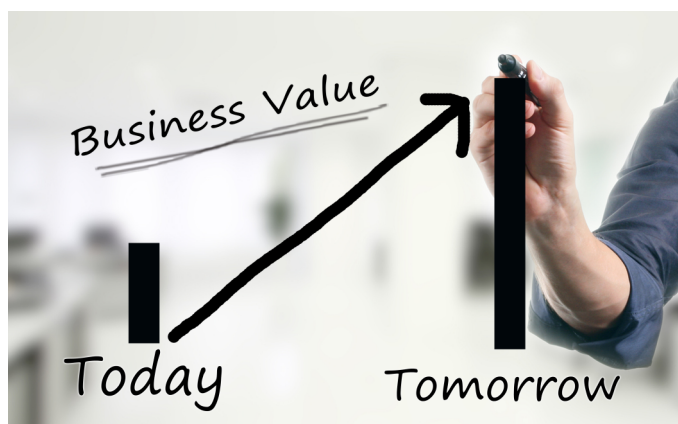
Knowing that a process is only as good as the people supporting it, STP leveraged its breadth of operational and client service expertise to deliver a true team-based approach. This focused on not only building a scalable and repeatable process, but also on implementing strict SLA standards that established proof of concept. This proved prescient during corporate

actions processing, which is often choppy when it comes to retiring old securities and posting new securities, especially when the corporate action involves multiple pieces or is voluntary in nature. In one such instance, legal action was filed necessitating an expedited, accurate and detailed response. STP's robust data management policies, which provided a clear and accurate security history, paved the way to a larger-than-average settlement for the plan sponsor.

Collaboration is an often-underestimated aspect of ongoing SLA commitments. Liaising with the sponsor's accounting team provided a path to building the appropriate controls and processes. Too often, firms look to their investment teams for guidance, when it's the middle or back office that is most affected by securities, data or other quality issues. Moving from an inconsistent, manual process to one offering daily reconciliation and a far more automated workflow required significant interaction between STP and the sponsor's team. The SLA governed STP's role, along with key stakeholders and communication, all of which provided the sponsor with sorely needed structure.

For the plan sponsor, having the ability to access data, and extract key pieces of information to answer questions from multiple stakeholders was mission critical. Slicing and dicing of data had to be user-friendly and intuitive. STP developed a graphical user interface (GUI) that offered robust standard and ad hoc reporting functionality. To further extend its operational capabilities, the plan sponsor accessed the STP Portal. With an easy-to-use graphical interface and an ability to seamlessly integrate with any system, the STP Portal gives plan sponsors added controls, including operational compliance and oversight, along with dashboards that deliver unmatched top-down analytics.

Value



Some values are easy to visualize, others less so. For plan sponsors fighting for every basis point of cost and performance as funding gaps continue to widen, finding value isn't optional, it's required for survival. Setting aside performance,

plan sponsors can look to improve their cost effectiveness in many ways, primarily by implementing effective operational processes and workflows. Daily reconciliations, and transaction and corporate actions processing represent two value-added tasks that sponsors should look to outsource as a means of controlling what is controllable, while allowing internal resources to focus on higher value-added activities like investment performance, manager selection and managing costs.

The search for value doesn't have to be as elusive as the proverbial needle-in-a-haystack. An investment operations service and software firm like STP Investment Services, with significant subject matter and leadership expertise, provides the credibility a plan sponsor needs to outsource operations functionality. Any plan sponsor in dire need of improving its operational cost effectiveness should look at STP and benefit from the following value drivers:

- ▶ Daily Processing
 - ✓ Minimize risk with daily reconciliations
- ▶ Proper Valuation of Holdings
 - ✓ Accurate pricing reduces reporting errors and improves client confidence
- ▶ Performance Measurement
 - ✓ GIPS standards for added veracity of performance data
 - ✓ Create and maintain accurate composites to calculate performance data
- ▶ A Consolidated Book of Record
 - ✓ One source for both the Investment and Accounting Book of Record eliminates reconciliation time and effort, thereby cutting costs
- ▶ Trade Settlement
 - ✓ Automated processes drive scalability to bring on more processes
- ▶ Powerful Data Warehouse
 - ✓ Robust data management rules enhance data integrity, which improves downstream processes and applications (reporting)
- ▶ Pricing
 - ✓ Obtain AND reconcile daily pricing from custodians
 - Produce daily performance data
- ▶ Audit Clarity
 - ✓ STP's documented investment operations workflows and procedures evidences processes and controls auditors expect to see
 - ✓ Minimizes risk of audit issues
- ▶ Implementation of new accounting rules and regulations
 - ✓ STP quickly interprets and implements new GAAP, GASB and FASB pronouncements affecting pension fund reporting

In an environment where every dime of cost and basis point of performance is scrutinized and evaluated, plan sponsors must uncover value wherever possible. For many, that means outsourcing non-core competencies like operations functions in favor of focusing on investment choice and performance. Choosing a partner is simple: look to STP Investment Services to provide the proven talent and expertise to deliver each of the above value drivers.