

PENSION INVESTMENT SUB COMMITTEE 18 SEPTEMBER 2019

TRANSITION OF EMERGING MARKETS AND CORPORATE BONDS TO LGPS CENTRAL - UPDATE

Recommendation

1. **The Chief Financial Officer recommends that:**
 - a) **The outcome and costs of transition of the active Emerging Market investments to the LGPS Central Global Emerging Markets Fund be noted; and**
 - b) **The transition progress relating to the Active Corporate Bonds mandate be noted.**

Background

Active Global Emerging Markets (AGEM)

2. The Pensions Committee and Investment Sub Committee have been kept up to date with the transition across of our active Emerging Markets equities to the LGPS Central Active Global Emerging markets mandate (AGEM). Worcestershire Pension Fund (WPF) currently has active emerging market mandate with JP Morgan and Schroder's totalling £373.1m as at the end of June 2019.

3. The Pensions Committee in March agreed to the transition the existing active emerging market equities to the LGPS Central AGEM subject to this due diligence taking place. If there were no issues from the due diligence, then we would work closely with LGPS Central to ensure a smooth a transition as possible and regular updates will be provided to Committee.

Due Diligence undertaken

4. There was an initial interview with LGPS Central on the 5 April 2019 to understand the investment objectives and processes that had taken place and further individual meetings with the 3 appointed managers on the 25 April 2019 and the 8 May 2019. An invite from WPF was made to all partner funds. Derbyshire had conducted their own due diligence via conference call and West Midlands Pension Fund joined us for this process.

5. A detailed update from these due diligence meetings was provided to the Pension Investment Sub-Committee in June and appended to the report to the June Pensions Committee.

Transition of asset to LGPS Central

6. LGPS Central appointed Analytics to provide transition oversight to look to provide as smooth a transition as possible within the target implementation shortfall. In trading

terms, an implementation shortfall is the difference between the prevailing price or value when a buy or sell decision is made with regard to a security and the final execution price or value after taking into consideration all commissions, fees and taxes. LGPS Central then asked Inalytics to procure a transition manager and on 7 May appointed Macquarie Capital (Europe) Limited as Transition Manager. It was felt that Worcestershire should have independent transition advice to ensure that the funds interests were protected, and we called on advice from our existing investment consultant contract with MJ Hudson.

7. The preparation period for the transition covered a two-month period during which Macquarie coordinated with all parties including the legacy (Schroders and JP Morgan) and target managers, Northern Trust (LGPS Custodian), BNY Melon (our custodian) the Partner Funds (Worcestershire and Leicestershire), Worcestershire transition advisor and LGPS Central. Project milestones included confirmation of the key dates for the movement of assets and initial contributions to the Authorised Contractual Scheme (ACS), the completion of all documentation, the presentation of expected costs to LGPS Central and the Partner Funds, and the opening of all required accounts. This process was completed efficiently with all parties being responsive and flexible which was a considerable factor in achieving what was a very tight timeframe.

8. The transition involved the restructuring of two mandates being Worcestershire and Leicestershire to three active global emerging markets equity mandates (BMO, UBS and Vontobel). Originally, further Partner Funds were identified as wanting to contribute to the funding however, it was agreed that due to the make-up of the legacy mandates only Worcestershire and Leicestershire would fund this launch. The driving factor behind this was the difference in liquidity profile and expected trading costs of the respective legacy portfolios

9. Transition trading commenced on 8 July 2019 and completed on 16 July 2019. After the first day 72% of all trading was complete rising to 93% by day three. Trading was accelerated by Macquarie thanks to some successful block trades meaning the target managers were able to be funded earlier than anticipated. The portfolios were funded to the new managers on 19th July 2019.

10. The transition overall was successful and close to the targeted implementation shortfall. There was good communication and project management provided by Macquarie. Several issues arose during the transition (see the Macquarie post trade report for more details at Exempt Appendix 1) all of which were addressed in a timely manner with positive outcomes.

11. Attached also is a post transition review report (see Exempt Appendix 2) provided by our independent advisor MJ Hudson which highlights a number of areas that can be considered for future improvements in the transition process. This has been provided to LGPS Central and partner funds for consideration at a future meeting.

12. The overall Assets under management (AUM) that have been transferred including Leicestershire is just over £536million. It is anticipated that Derbyshire and Nottinghamshire will also invest into this fund increasing the AUM to an estimated £736million.

13. Performance Reports will be available from LGPS Central monthly with a more detailed performance report every quarter. Representatives from LGPS Central will be

asked to attend the Pensions Investment Sub Committee in line with how we deal with our existing active equity managers. We may also seek one or more of the three appointed fund managers attend directly or with LGPS Central.

Overall costs of Transition

14. The overall cost or Implementation Shortfall (IS) is shown as a monetary value and expressed as a percentage cost (basis points) in terms of the fund value (total legacy asset value). The cost table below provides a summary of the realised implementation shortfall totalling £2.495million or 71.4 basis points. This includes the costs that had to be borne outside the transition and capital gains tax relating to our previous India investments. The value of the Mandate that was provided to a three-active global emerging markets equity mandates (BMO, UBS and Vontobel) was £349.461m on the 19th July 2019 and has been allocated equally to each fund manager.

15. Note also that the opportunity was taken to rebalance this mandate by £30million in line with our overall strategic investment targets and to fund future capital requirements relating to our Property and Infrastructure investments.

Table: Overall cost of the Emerging Market transition to LGPS Central

	Worcestershire £'000	
Initial Mandate overview pre-transition	374,300	June 19
Less asset allocation rebalancing	-30,000	
Total Initial Mandate overview pre-transition	344,300	
Total Portable Value after Transition	349,461	
Overall Costs of Transition		
Estimated costs borne individually, pre-transition outside ACS	268	
Costs incurred within ACS Sub Fund		
Taxes	212	
Commissions	160	
Transfer Taxes	103	
Implicit	1,369	
Total Costs incurred within ACS Sub Fund	1,844	0.528%
Target Costs incurred within ACS Sub Fund	1,779	0.509%
Variance	65	
Capital Gain Tax	383	
Overall cost of Transition	2,495	0.714%

Overall Management Fees

16. The Management fees are in the region of 37bps compared to the 65 to 69bps we pay at the moment so an estimated saving based on the existing Assets under management of approximately £1.1m per annum. However the transitions costs will need to be taken into account before any real ongoing savings are achieved.

Corporate Bonds

17. The Pensions Committee were informed in March that the next potential transition will be the existing active corporate bonds mandate currently with JP Morgan with an existing value as at June 2019 of £151.1m. The mandate proposed by LGPS Central is a 'Global active Investment Grade Corporate Bond Fund. A rigorous process similar to that of the AGEMS above was detailed in a report to the Pensions Investment Sub Committee on the 11 June 2019 to appoint 2 fund managers being Fidelity IL Pension Management and Neuberger Berman (Europe) Limited.

Due Diligence

18. As part of the necessary due diligence all partner funds had the opportunity to meet and interview the 2 fund managers at a Partner Fund Investment Working Group on the 16 May 2019. Our Independent Investment Advisor also attended.

19. It was agreed by the Pension Committee on the 21 June to transition the existing Active Bonds mandate with JP Morgan to LGPSC Active Bond mandate.

Transition of asset to LGPS Central

20. LGPS Central have again appointed Analytics to provide transition oversight to look to provide as smooth a transition as possible within the target implementation shortfall. LGPS Central then asked Analytics to procure a transition manager and on 22 August appointed Blackrock as Transition Manager. A transition kick off meeting is planned for the 10 September 2019. The Investment Sub Committee will be kept informed as to progress.

Overall Management Fees

21. The Management fees are in the region of 8.3bps compared to the 17bps we pay at the moment so an estimated saving based on the existing Assets under management of approximately £0.1m per annum. However the transitions costs will need to be taken into account before any real ongoing savings are achieved.

22. Please note that Appendices 1 and 2 contain exempt information (on salmon pages) and should members wish to discuss the information included in these Appendices they would need to consider passing the appropriate resolution and moving into exempt session.

Contact Points

County Council Contact Points

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Supporting Information

- Macquarie summary post trade report (Appendix 1) (**Exempt Information – Salmon pages**)
- MJ Hudson post transition review report (Appendix 2) (**Exempt Information – Salmon pages**)

Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) the following are the background papers relating to the subject matter of this report:

- Agenda papers and Minute of the Pensions Committee meeting held on 21 June 2019 and Investment Sub Committee on the 11 June 2019