

LGPS INTELLIGENCE

Successfully navigating the journey to pooling



Effective transition management requires forward planning and careful consideration. Transition partners can provide LGPS funds with expert support in the journey to pooling.



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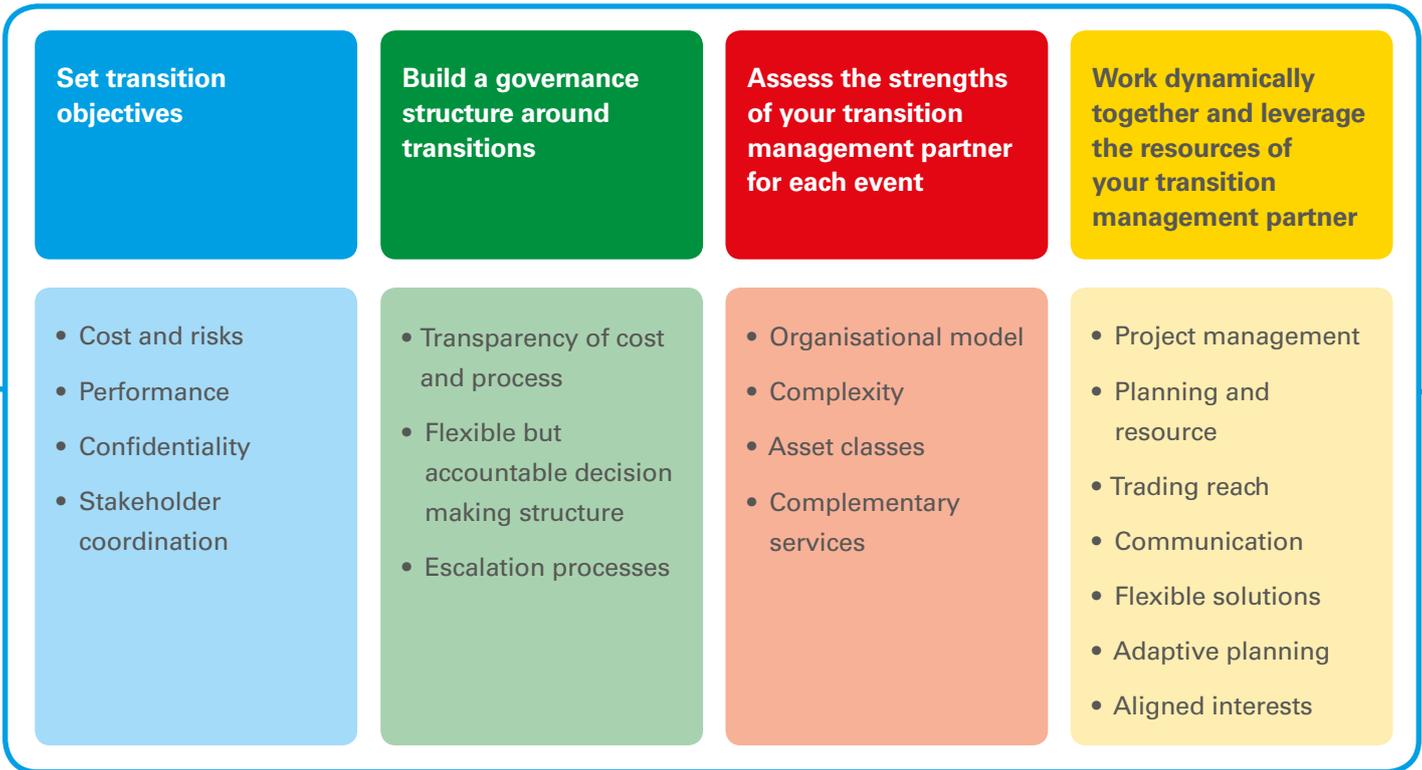
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ENSURING SUCCESSFUL TRANSITIONS

It's been a busy time for the Local Government Pension Scheme (LGPS). Each of the pools has been collaborating across its member funds to build the solution which best meets their collective objectives. As each pool formalises its appointments and the structure is finalised, attention is now turning to how assets will move into the new structures. Some have already begun the process, while others are working hard on planning.

Pools and their member funds are increasingly engaging with transition managers on both an exploratory and implementation basis, and the National LGPS Framework for Transition Management is now in place. Each pool and its member funds are likely to use transition management through a series of engagements as the pooling implementation progresses. However, we recognise that the circumstances for each pool will be unique depending on its individual requirements.

To help ensure that transition management enhances the value delivered into the target structures users may wish to give consideration to four key areas:



SET TRANSITION OBJECTIVES

The collective objective of realising savings and enhancing the value of assets delivered to the pools can be translated into some key collective transition objectives:

- Implementing change in a measured fashion
- Protecting value for the member funds whilst retaining some elements of flexibility
- Seeking to reduce the risks and costs that the pool and its member funds are exposed to when implementing these changes
- Ensuring that the process is transparent and auditable without compromising the commercially sensitive nature of the transactions

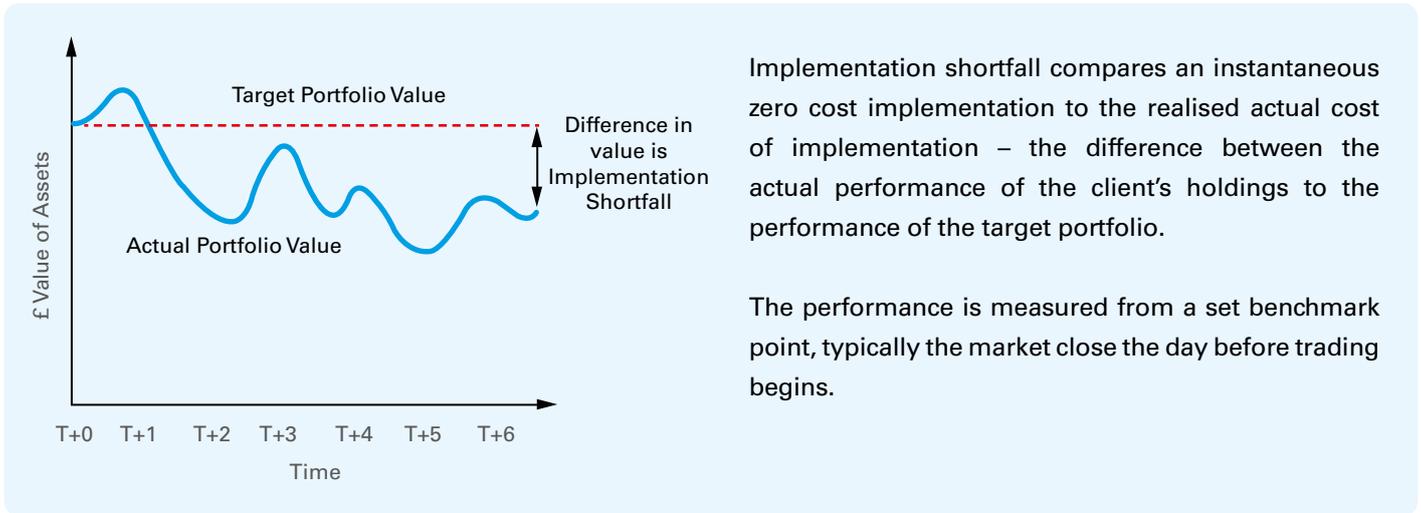
- Aiming to reduce market distortion and protecting confidentiality

Objectives for given events will additionally need to consider the coordination of various stakeholders, including other LGPS pools/funds.

Furthermore, appropriate performance metrics will need to be defined and agreed. Typically transition management uses implementation shortfall (see figure 1) but in some instances, for example selling down a run-off portfolio, other alternatives may be more appropriate (such as a trading VWAP* benchmark). It is critical that your transition manager provides clear, transparent and auditable performance reporting.

* VWAP is the Volume Weighted Average Price. It is the ratio of the value traded to total volume traded over a particular time horizon

Figure 1: Performance metrics: understanding implementation shortfall



Implementation shortfall compares an instantaneous zero cost implementation to the realised actual cost of implementation – the difference between the actual performance of the client’s holdings to the performance of the target portfolio.

The performance is measured from a set benchmark point, typically the market close the day before trading begins.



BUILDING A GOVERNANCE STRUCTURE AROUND TRANSITIONS

As with all aspects of pooling, having a strong governance framework in place will be an important part of the transition journey.

Clear, accountable decision and communication channels are important. It would also be prudent to have agreed escalation triggers and processes in place. This could involve a working group, identified points of reference and oversight with escalation processes that will enable transition managers to be responsive to evolving information or changing environments.

Transparency and auditability of process and cost will be an essential governance consideration. Working with your transition partners, advisors and stakeholders to establish a robust framework as you begin this journey will help reinforce the achievement of the collective objectives.

ASSESS STRENGTHS OF YOUR TRANSITION MANAGEMENT PARTNERS FOR EACH EVENT

Often when a panel is in place, such as the National LGPS Framework, clients will seek more than one transition bid for a given event, analysing the costs and fees in conjunction with the strategy proposal and project plan. This process tends to be most effective when you are aware of the strengths of each of the providers on the panel. Larger panels may have all-rounders, complex event specialists, equity specialists or fixed income

specialists. This level of knowledge and understanding can be used to inform the choice of who is included in mini tenders.

If possible, given the public nature of the pooling process, it would be advisable not to announce which manager will be managing a given event. It would also be prudent not to have multiple transition managers operating in the same asset class at the same time, to avoid creating competition for liquidity.

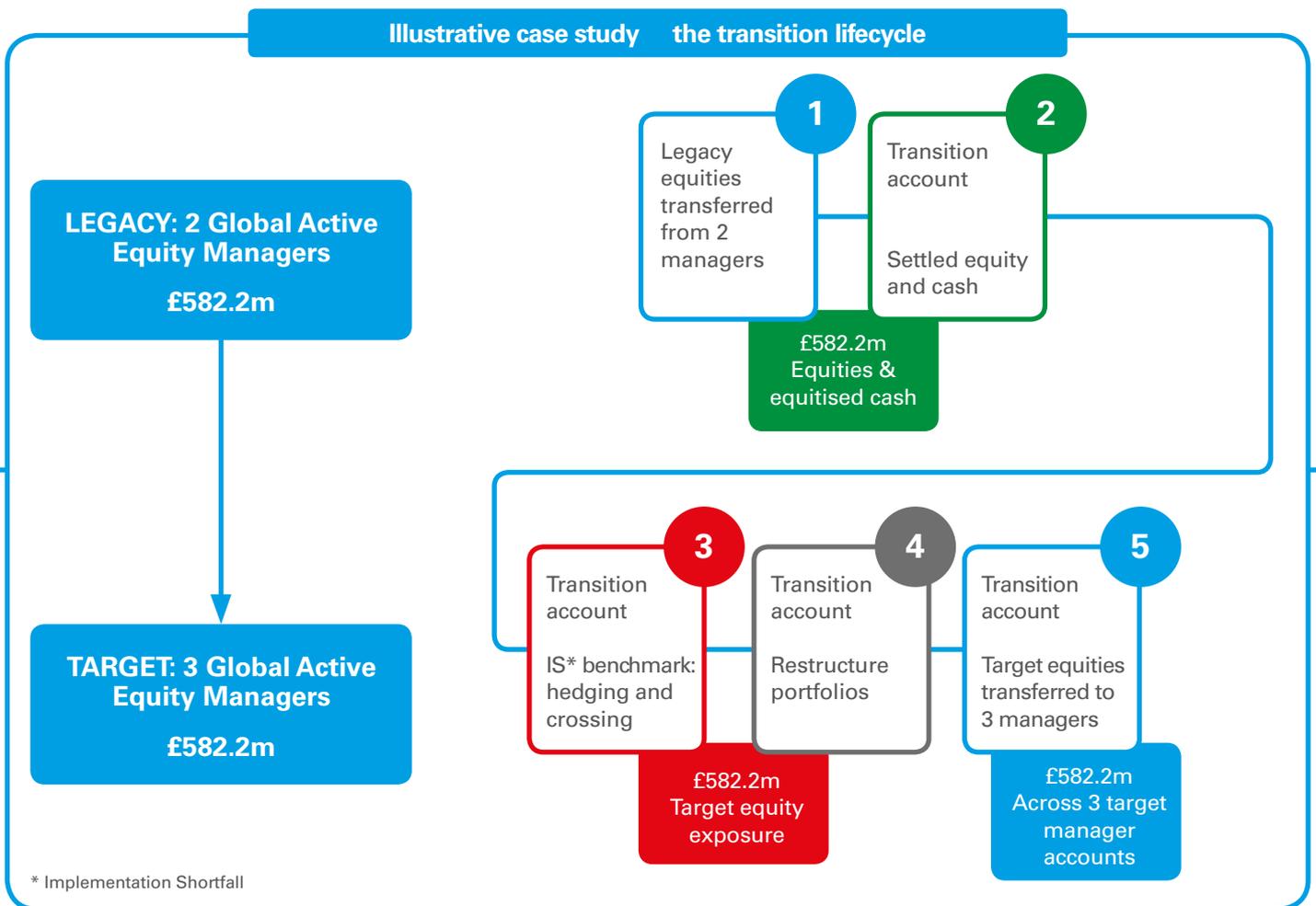
WORK DYNAMICALLY AND LEVERAGE THE RESOURCES OF YOUR TRANSITION MANAGEMENT PARTNER

At its core, this activity is a significant asset management exercise, and cannot be simply defined as a large trade. There is a lot of project management involved: coordinating the volume of information and maintaining clear and effective communication.

The pools are working together to consider the manager decisions and in what order they will transition assets into the new structures. Fostering a dynamic interaction with transition managers, even at this early juncture, could

benefit the process. For instance, a transition manager could run scenario analysis to highlight things such as overlap between mandates and estimated transaction costs. Additionally, the manager could share their experience working across different structures to help work through the key project considerations for each phase of pooling.

Working with a transition manager with a depth of project management expertise can not only help in the planning and implementation but also lift the operational burden from the pool – which have a wealth of demands on their resources.



Illustrative case study the transition lifecycle continued

Objective
A transparent cost and risk effective implementation

Investment result within estimated range, detailed transparent performance reporting and cost attribution
 20% internal crossing – saving in overall transaction costs
 Equity and FX hedging achieved over 60% reduction in overall risk, optimisation used to manage stock specific risk

Governance structure

Regular project team calls with client, their adviser and dedicated transition team; involving other stakeholders as required
 Established escalation channels with the client and their adviser
 Key project milestones and dependencies identified in planning to facilitate timely progression

Assessing the strengths of your TM partner vs. each event

Appointment via a competitive tender in conjunction with adviser
 Complex, active equity event – required project management resource, deep liquidity access and currency overlay capabilities

Working dynamically together & leveraging the resources of your TM partner

Dedicated project manager coordinated stakeholders, dynamically planning the event and managing operational risk, including complex legal requirements for the project
 Deep access to liquidity, including internal crossing

IN SUMMARY

Transition management can help the pools and member funds’ collective objective of realising savings and enhancing the value of assets delivered to the pools. This will be most effective if consideration is given to the objectives and governance structure around each transition event within the process, ensuring a transparency of cost and process for the pools and member funds.

Working dynamically with skilled transition partners, especially in the context of actively managed portfolios, could provide LGPS funds with additional resources, risk management and audit tools in a period of seismic change.

LGIM provides a range of transition management services to help you on this journey and we will continue to be a supportive partner of the LGPS.

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