Hackney

REPORT OF THE GROUP DIRECTOR, CORPORATE FINANCE AND RESOURCES		
Equity Restructure – Post-Completion Report **Pensions Committee** **23rd July 2018**	**Classification** **PUBLIC** **Ward(s) affected** **ALL**	**Enclosures** **One (Exempt)**

1. INTRODUCTION

1.1 This report provides an update following the completion of the Pension Fund's equity portfolio transition exercise.

2. RECOMMENDATIONS

2.1 **The Committee is recommended to:**

- **Note the report**

3. RELATED DECISIONS

3.1 Pensions Committee 21st March 2018 – Transition Update

3.2 Pensions Committee 4th December 2017 – Active and Passive Equity – Transition Approach

3.3 Pensions Committee 27th June 2017 – Passive Equity – Transition Approach

3.4 Pensions Committee 29th March 2017 – Investment Strategy Review – Detailed Recommendations

4. COMMENTS OF THE GROUP DIRECTOR, CORPORATE FINANCE AND RESOURCES

4.1 This report sets out an update on the implementation of planned changes to the Fund's investment strategy with regards to active and passive equity. Moving the Fund's UK equity assets to BlackRock, using the London CIV's rates, offers a potential saving on asset management costs of 3.5 basis points. The other proposals represent a cost-effective method of achieving the required changes to the Fund's investment strategy whilst at the same time offering mitigation against the risk of poor fund manager performance from the current active managers during the transition.

4.2 Whilst moving the Fund's UK passive equity mandate offers potential long term savings, the transition has generated additional costs for the Fund, both as a result of trading and through adverse market movements over the transition period. The Fund sought to minimise transition costs wherever possible through the use of an experienced transition manager. Further details of the transition costs incurred are provided both in the body of the report and in Appendix 1.

5. COMMENTS OF THE DIRECTOR OF LEGAL AND GOVERNANCE

5.1 The Committee has legal responsibilities for the prudent and effective stewardship of the Pension Fund and a clear fiduciary duty in the performance of its functions. One of its responsibilities is ensuring compliance with the Local Government Pension Scheme (Management and Investment of Funds Regulations 2016)

5.2 This transition exercise has been carried out line with the Regulations above. In transitioning to pooled funds with BlackRock and the London CIV, the Fund is acting in accordance with the Government's Criteria and Guidance for Investment Reform

5.3 There are no immediate legal implications arising from this report.

6. APPROVAL FOR EXERCISE

6.1 At its meeting on 29th March 2017, the Pensions Committee agreed a range of recommendations with regards to the Fund's investment strategy, including a recommendation to transfer of the Fund's passive equity mandate to take advantage of lower fees offered following work by the London CIV. A revised allocation of 10% to a FTSE Allshare index tracker was approved, with a further 10% allocated to a tilted low carbon global index mandate.

6.2 Phase 1 of the transition plan was approved at the 27th June 2017 Committee meeting. Approval was granted for:

- In specie transfer of the UBS UK equity assets to an equivalent UK equity mandate, managed via a fund manager charging the reduced fees negotiated by the London CIV.
- In specie transfer of a portion of the Lazard and Wellington global equity mandates into regional/global equity passive mandates. The remaining mandates with Wellington and Lazard would each be 13% of the Fund's assets, in line with the revised target allocation for actively managed global equities.

6.3 At the 4th December 2017 meeting, approval was granted for:

- The establishment of a 10% allocation in a suitable low carbon titled global index mandate, funded from the current UK passive equity allocation. as set out in phase 2 of the approach to transition considered at the June 2017 meeting, outlined in Appendix 1
- The transfer of the full Wellington mandate (16% of the Fund's assets) into a regional/global passive equity mandate.
- A single manager (BlackRock) to manage both the passive mandates described above and the UK FTSE Allshare tracker approved as part of Phase 1.
- The Fund's selected passive manager to act as transition manager for the previously approved transition from the Lazard mandate to LCIV's sustainable global equity sub-fund.

7. TRANSITION SUMMARY

7.1 The total value of assets in scope of the transition was £857m, with the breakdown of assets at each stage as follows:

PREVIOUS MANDATE	TRANSITION	TARGET MANDATE

	ACCOUNT	
Wellington Global Equity Segregated Mandate (£247.4m)	BlackRock Transition Management (£857m)	LCIV Sustainable Global Active Equity Pooled Fund (203.5m)
Lazard Global Equity Segregated Mandate (£247.7m)-		BlackRock Global Passive Low Carbon Pooled Fund (£152.5m)
UBS FTSE AllShare Index Tracker Pooled Fund (£361.9m)		BlackRock Hedged MSCI World Passive Pooled Fund (£347.7m)
		BlackRock FTSE AllShare Passive Pooled Fund (£153.3m)

7.2 As shown in the table above, the transition involved the restructure of a UK equity pooled fund and two global equity segregated portfolios to fund investments in to four new pooled funds (UK equity, currency hedged global equity, global equity with a low carbon screen and active global sustainable equity. The assets were transferred into a new transition account at the Fund's custodian, HSBC, where the transition was managed by the BlackRock Transition Management Team. Trading then took place over a 6-day period, before the assets were transferred into the target structures shown above.

8. TRANSITION TIMETABLE

8.1 The transition was initially scheduled to take place prior to the scheme year ahead. However, to gain certainty over the initial outcome of the London CIV's governance review and eliminate any impact on the Fund's year end accounting, it was decided to move the transition to Q1 2018/19. Trading was planned for April; however, challenges in putting the legal arrangements in place for some of the new funds delayed trading activity to June.

8.2 An outline timetable of the transition itself is shown in the table below. A more detailed timetable is presented in BlackRock's Post-Transition Analysis report at Appendix 1

EVENT	DATE
In-specie redemption from UBS UK equity index fund	23/05/2018
Segregated assets transferred from Wellington and Lazard to BlackRock transition account	31/05/2018
Trading commenced	07/06/2018
Trading finalised	14/06/2018
Constructed portfolios transferred to new fund structures	19-20/06/2018

9. RISK MANAGEMENT

9.1 In-specie redemptions and investments were used to maximise asset retention, reduce costs and help maintain exposure throughout the transition period. The change in allocation resulted in a regional rebalance, out of EMEA (Europe, Middle

East & Africa) (-£174.5m, -20%) and into APAC (Asia Pacific) (+£35.5m, 4%) and the Americas (+£134.6m, 16%). An index equity futures overlay was used to adjust the exposure of the fund to that of the target.

9.2 FX forwards were used to hedge the currency shifts associated with the transition. The positions were put in place on 6th June 2018 and unwound as the equity trades were settled. The target BlackRock MSCI World fund was currency hedged to GBP, so. this exposure was maintained throughout the transition period and a coordinated handover of the hedges took place at the point of in-specie into the target fund.

10. COSTS

10.1 The total cost of the transition was £2,585,493 representing 0.30% of total assets in transition. This figure can be broken down as follows:

- Dealing Costs comprising commissions, fees and taxes, spread and market impact.
- Opportunity Costs resulting from market movements during the trading period.
- Transition Fee for BlackRock, including external commissions.

10.2 Pre-transition, BlackRock estimated a mean implementation shortfall of 0.22% with a potential opportunity cost (to one standard deviation) around that mean of +/- 0.07%. The final costs of the restructure at 0.30% are therefore above the one standard deviation estimated range. Much of the additional cost resulted from increased opportunity costs as stock-specific news during the transition period affected individual stock prices

10.3 A full breakdown of costs can be found at Appendix 1 to this report

11. IMPACT ON WIDER INVESTMENT STRATEGY

11.1 The completion of the equity transition exercise represents a major first step towards fulfilling the Fund’s asset pooling commitments, as well as towards implementing its strategy to reduce its exposure to fossil fuel risk as agreed at its meeting in January 2016. Reducing the allocation to the FTSE Allshare from 23.6% to 10% should have a significant downward impact on the Fund’s exposure to reserves, which will be further reduced through a 10% allocation to a dedicated low carbon index.

6.4 This transition does not impact on the ability of the Fund to continue to explore the possibility of a 0-5% allocation to local or other housing/infrastructure projects. The mandates recommended are all liquid assets, and are generally realisable at short notice.

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Appendices

Appendix 1 – EXEMPT – BlackRock Post Transition Analysis Report