MJ HUDSON

LCIV & Hackney Pension Fund

EM, Global Equities & DGF Transitions Post-Trade

MJ Hudson

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Introduction

London CIV (LCIV) have appointed MJ Hudson (MJH) to provide strategy advice, oversight and pre- and post-event analysis of the transitions undertaken by Hackney Pension Fund (Hackney) of legacy assets into three target LCIV Funds. Over two weeks, Hackney completed three transitions totalling £489m. This report summarises the planning and execution of the events along with a breakdown of the costs.

Transition Planning and Timeline

The timeline, Table 1, summarises the transition activity undertaken by Hackney. This was divided into three transition events and although the three involved some “cross funding”, each was executed broadly independently of one another.

TABLE 1: TRANSITION TIMELINE

Fund		Trade Value £m	24-Sep-21	27-Sep-21	28-Sep-21	29-Sep-21	30-Sep-21	01-Oct-21	04-Oct-21	05-Oct-21	06-Oct-21	07-Oct-21	08-Oct-21
Transition 1	LCIV - EM JPM	85.5		Buy Inst.		Buy Trade		Buy Settle					
	RBC EME	-95.8		Sell Inst.	Sell Trade			Sell Settle					
Transition 2	LCIV - GAGPA BG	247.0	Buy Inst.		Buy Trade		Buy Settle						
	BR Global	-85.0	Sell Inst.	Sell Trade			Sell Settle						
	BR UK	-165.3	Sell Inst.	Sell Trade			Sell Settle						
Transition 3	LCIV - DGF BG	143.0				Buy Inst.					Buy Trade		Buy Settle
	GMO DGF	-102.7							Sell Inst.	Sell Trade		Sell Settle	
	BR Short Bond	-40.3								Sell Inst.	Sell Trade	Sell Settle	
Infra Call	LCIV - Infra Fund	13.9											

Source: BG, BR, GMO, Hackney, Hymans, JPM, LCIV, MJH, RBC

- **Transition 1** was a full redemption from Hackney’s existing emerging market equity mandate with RBC (3 funds) and a reinvestment into the LCIV EM fund managed by J.P. Morgan (JPM).
- **Transition 2** was a full redemption from UK passive equities (with a top-up redemption from global passive equities) both managed by BlackRock (BR) to subscribe to LCIV’s Global Alpha Growth Paris Aligned fund (GAGPA) managed by Baillie Gifford (BG).
- **Transition 3** was a full redemption from Hackney’s GMO Diversified Growth Fund (DGF) which, alongside funding from their BR Bond Fund, was subscribed into LCIV’s DGF also managed by BG.
- **Infra Call** – Separately, during the transition, Hackney received a capital call for £13.9m from LCIV for their renewable infrastructure fund which was paid from the RBC and BR global equities net raise (initially planned to fund Transition 3), alongside a £300k cash balance

During the planning process we worked with Hackney, LCIV, Hymans and the managers to evaluate the pros and cons of an in-specie vs cash transition for each event however it was ultimately decided to proceed via a cash transition for all three events, for the following reasons:

- RBC, GMO and BG (Transitions 1 and 3) were unable to accommodate in-specie redemptions/subscriptions due to their funds emerging markets and diversified growth asset classes respectively.
- The need to procure a transition manager and set-up a transition account would have delayed the process which Hackney wished to avoid.
- Transition 2 had limited crossing opportunities due to the much more concentrated target portfolio, as in common with passive to active transitions. Additionally, a large UK in-specie redemption would have resulted in a large UK SDRT bill (where utilising a transition account).

Transition 1: Emerging Market Equities – RBC to JPM

This transition involved three RBC emerging market equity funds being redeemed to fund the purchase of the LCIV EM fund. The target subscription of £85.5m was a fixed value based on Hackney's desired SAA exposure to EM equities, so the additional raised proceeds (c. £10m) were used to fund the infra drawdown.

Emerging market equities are generally not freely transferable, so this transition could only be a cash redemption and subscription. Using the indemnity allowed for a "pre-investment" into the target LCIV EM fund resulting in one day's out-of-market risk between legacy and target funds. This single day's out of market risk was the result of needing to match RBC's T+3 settlement with the LCIV EM funds T+2 settlement requirement.

TABLE 2: EM TRANSITION SUMMARY

	LEGACY	TARGET
Portfolios/Funds	3 x RBC – EM	LCIV EM - EM
Traded (£ size)	£95.8m	£85.5 + £10.3m Cash
Turnover (of Legacy)	100%	

Source: JPM, LCIV, MJH, RBC

LCIV charged an ADL on the target EM fund of 11 bps resulting in a net investment of £85.4m. RBC have been unwilling to provide exact details on their swing pricing, citing "best practice guidance from the CSSF". Hence, we have estimated 0.15% (based on their indicative range of 0.05-0.25% and our experience of other EM fund redemptions).

TABLE 3: EM TRANSITION ADL/SWING SUMMARY

FUND	ADL/SWING	TOTAL (£K)	TOTAL (BPS LEGACY)
RBC – EME	*0.15%**	*144*	*15*
LCIV/JPM - EME	0.11%	94	11

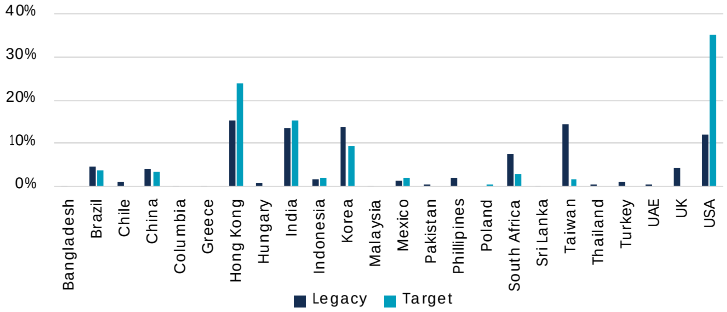
Source: JPM, LCIV, MJH, RBC

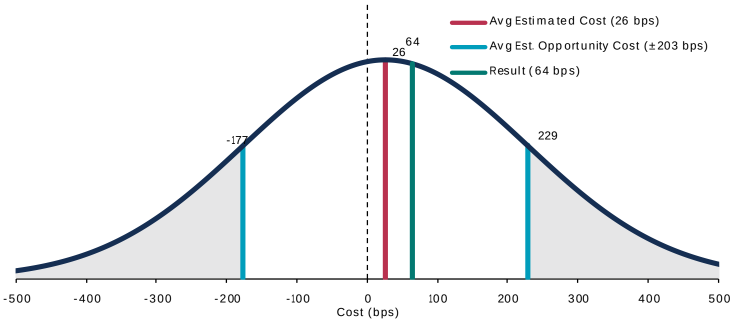
* Estimated

The result is summarised on the transition dashboard, Table 4, shows the fixed and opportunity cost (slippage) of the one day disinvested. This caused a slippage of 40 bps but is within our initial risk estimate. The slippage was calculated by revaluing the purchased EM units on the 29th at the 28th's valuation point, in line with the RBC redemptions.

TABLE 4: EM TRANSITION DASHBOARD

Transition Summary	Estimate		Result	
	£m	%	£m	%
Legacy Value	86	100%	96	100%
Trade (B&S)	171	100%	181	89%
Pre-Estimate	**Cost**		**Cost**	
	£k	bps	£k	bps
Trading Commission				
Transfer Taxes				
Trading Taxes				
Market Impact/Spread				
FX Spreads				
Legacy ADL*	43-213	5-25	144	15
Target ADL	94	11	94	10
Explicit Cost	222	26	238	25
Op Cost (±)	1,735	203	380	40
Total Cost			617	64
Low (-1 std)	-1,513	-177		
High (+1 std)	1,956	229		
Legacy Value £85.5m			*£95.8m*	





Source: JPM, LCIV, MJH, RBC

*Estimated

Transition 2: UK & Global Equities – BR to BG

Transition 2 involved a full redemption of the BR UK passive equity holdings and partial sale of the BR global passive equity holding (as a filler) to fund a subscription into the LCIV GAGPA Fund.

Again, through using the indemnity, we were able to "pre-invest" into the LCIV GAGPA. The requirement to align settlement again resulted in one day's out-of-market risk, between the legacy and target funds, where BR settled T+2 and LCIV GAGPA requires settlement on T+2.

TABLE 5: GLOBAL EQUITY TRANSITION SUMMARY

	LEGACY	TARGET
Portfolios/Funds	2 x BlackRock – UK and Global Passive Equities	LCIV GAGPA – Global Active Equities
Names (£ Size) ex. Cash	£250.3m	£247m+ £3.3m Cash
Turnover (of Legacy)	100%	

Source: BG, BR, LCIV, MJH

BR charged a spread of 2 bps and 6 bps on the UK and Global equity funds respectively. LCIV charged an ADL of 8 bps on the GAGPA subscription.

TABLE 6: GLOBAL EQUITY TRANSITION ADL/SWING SUMMARY

FUND	ADL/SWING	TOTAL (£K)	TOTAL (BPS LEGACY)
BlackRock – UK	0.02%	£41k	1.6
BlackRock – Global	0.06%	£48k	1.9
LCIV/Baillie Gifford - GAGPA	0.08%	£197k	7.9

Source: BG, BR, LCIV, MJH

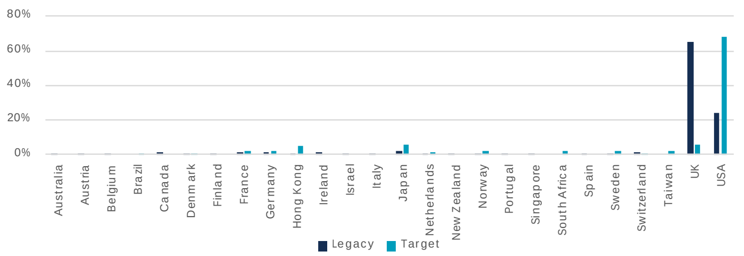
The result is summarised on the transition dashboard, Table 7 below. The transition was subject to one day's slippage between the dealing days of 27th and 28th respectively.

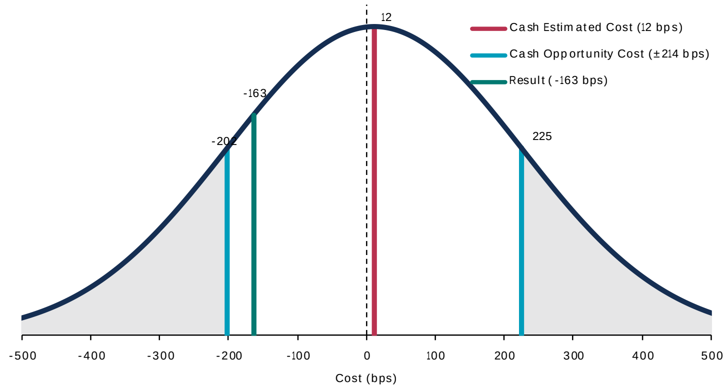
The slippage was calculated by revaluing the purchased GAGPA units on the 28th at the 27th's valuation point, in line with the BR redemptions.

TABLE 7: GLOBAL EQUITY TRANSITION DASHBOARD

Transition Summary	Estimate		Result	
	£m	%	£m	%
Legacy Value	247	100%	250	100%
Trade (B&S)	494	100%	497	99%

Pre-Estimate	Cost		Cost	
	£k	bps	£k	bps
Trading Commission				
Transfer Taxes				
Trading Taxes				
Market Impact/Spread				
FX Spreads				
Legacy ADL	91	4	89	4
Target ADL	198	8	197	8
Explicit Cost	289	12	286	11
Op Cost (±)	5,346	214	-4,368	-175
Total Cost			-4,082	-163
Low (-1 std)	-5,057	-202		
High (+1 std)	5,635	225		
Legacy Value £247m			*£250m*	





Source: BG, BR, LCIV, MJH

We note that this transition exhibits a relatively large negative cost result ("profit"), falling within the lower limit of our risk estimate. This was due to a -1.7% fall in the unit price of GAGPA between the 27th and 28th. While in this case, it was a benefit to Hackney, reflecting them "selling higher and buying lower" over the two days, it serves as a reminder of the out-of- market risk present when transitioning and the need to control/limit it through measures such as the indemnity.

Transition 3: Diversified Growth Funds – GMO/BR to BG

Transition 3 was a full redemption of the GMO DGF (plus additional funding) to fund a fixed purchase (£143m) in the LCIV DGF managed by BG. Additional funding was planned to be from RBC in Transition 1 plus any difference using a further BR global equities redemption. However, because of the infrastructure drawdown requiring the RBC cash, Hackney instead decided to use their BR short-term bond fund as an interim funding measure due to possible settlement delays from global equities once the final redemption value from GMO was known.

TABLE 8: DGF TRANSITION SUMMARY

	LEGACY	TARGET
Portfolios/Funds	GMO – DGF BlackRock – Short-Term Bonds	LCIV – DGF
£ Size	£143m	£143m
Turnover (of Legacy)	100%	

Source: BR, BG, GMO, LCIV, MJH

Baillie Gifford charged a subscription spread of 30 bps however because the LCIV DGF is a pooled fund it is not reflected on the contract note. We note this is less than BG's estimated ADL of 36 bps Additionally, GMO charged a spread of 10 bps on the redemption. The short-term bond fund did not charge an ADL. Total explicit costs were less than estimated because of the substitution of global equities for short-term bonds.

TABLE 9: DGF TRANSITION ADL/SWING SUMMARY

FUND	ADL/SWING	TOTAL (£K)	TOTAL (BPS LEGACY)
GMO – DGF	0.10%	£103k	7
LCIV/Baillie Gifford - DGF	0.30%	£423k	30

Source: BG, GMO, LCIV, MJH

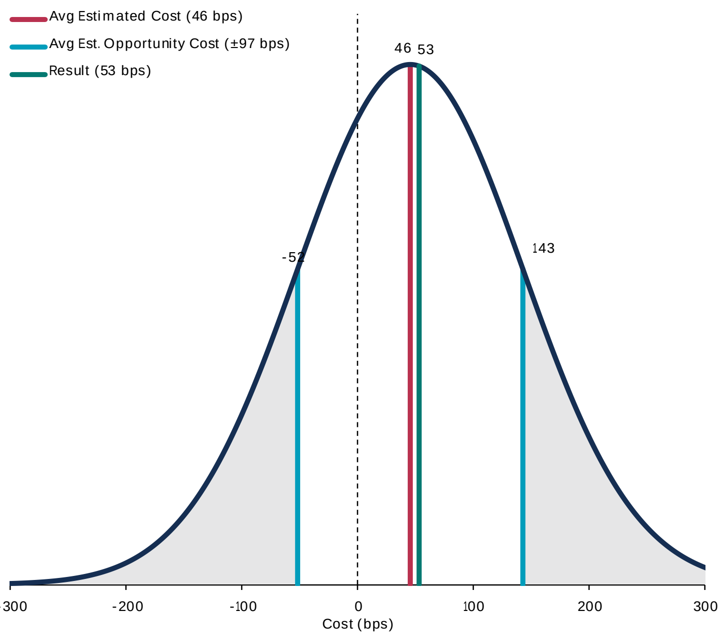
The result is summarised on the transition dashboard, Table 7. The transition was subject to one day's slippage between the dealing days of 5th and 6th respectively.

The slippage was calculated by revaluing the purchased DGF units on the 5th at the 6th's valuation point, in line with the GMO redemption.

TABLE 10: DGF TRANSITION DASHBOARD

Transition Summary	Estimate		Result	
	£m	%	£m	%
Legacy Value	143	100%	143	100%
Trade (B&S)	285	100%	286	100%

Pre-Estimate	Cost		Cost	
	£k	bps	£k	bps
Trading Commission				
Transfer Taxes				
Trading Taxes				
Market Impact & Spread				
FX Spreads				
Legacy ADL	122-153	9-11	103	7
Target ADL	513	36	428	30
Mean Cost Estimate	650	46	531	37
Op Cost (±)	1,388	97	232	16
Total Cost			762	53
Low (-1 std)	-737	-1,342		
High (+1 std)	2,038	1,433		
Legacy Value £142.5m			*£143m*	



Source: BR, BG, GMO, LCIV, MJH

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Key MJH Recommendations & Interventions

Over the course of the transition event, MJH made the following recommendations which benefited Hackney:

INDEMNITY

Using the indemnity to allow purchase of target assets, prior to receiving cleared funds was crucial in minimising risk in these transitions. MJH worked with LCIV and Hackney to get the indemnity in place and adjusted the timeline to allow sufficient time for settlement of the funds.

INVESTMENT RISK

The absolute slippage over the event from benchmark was -77bps (-£3.8m). Based on our ex-post calculations using T+4 LCIV prices, had the transition been subject to the usual four days' out-of-the-market, the total slippage incurred would have been -1.4% (-£6.9m). Whilst the slippage in this event results in a profit, the total risk reduction delivered by the transition is 64bps.

STRATAGY AND APPROACH

MJH created a redemption and subscription schedule for LCIV and Hackney showing the dealing instruction dates, trade dates and settlement dates for all funds in the transitions. Following this meant that risk was minimised as Hackney stayed invested as much as possible over the transition.

Conclusions

Hackney Pension Fund successfully transitioned £489m of assets onto the LCIV platform in new target mandates in EM equities, Paris-Aligned global equities and diversified growth. Additionally, they funded a £14m drawdown for the LCIV infrastructure fund. The total cost paid in spreads and ADLs was £1.1m (0.22% of the legacy), versus our estimate of £1.16m. The total slippage was -£3.8m, primarily from Transition 2, but within our total risk estimate of ±£8.4m.

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