Legal & General INVESTMENT MANAGEMENT

Transition Management

Agenda Item 14

Suffolk County Council Pension Fund

Transition Post-trade Report

November 2012

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Executive summary

- Legal & General Investment Management (LGIM) was appointed to implement a change to the manager structure of the Suffolk County Council Pension Fund ("the Fund").

- The assets to be transitioned were sourced from two terminated managers; Aberdeen (fixed income) and JP Morgan (global equities), and from a reduction to a further manager, Alliance Bernstein (UK equities).

- The Fund appointed three new absolute return managers (Pyrford, Winton and BlueCrest) and increased their allocation to passive funds managed by Legal & General Assurance (Pensions Management) Limited ("L&G"). In addition, the benchmark for the L&G mandate was changed as part of the transition.

- LGIM were instructed to implement a phased approach to the funding of the three new absolute return managers. The funding took place in three tranches over a period of three months. In order to maintain market exposure LGIM built a synthetic equity portfolio ("the SEP"), comprising of a long position in equity index futures and currencies, which was held in the intervening period.

- The legacy assets were transferred into and traded within a segregated transition account which was set up for this purpose at the Fund's custodian, State Street.

- Assets totalling £376.1m[1] were transferred into the transition account during the transition period. The majority of assets were transferred on 23 August 2012.

- The changes to the investment structure were effected in two discrete stages:

  - Stage 1 involved:
    - The termination of Aberdeen and JP Morgan
    - The reduction of Alliance Bernstein's mandate
    - The increase to L&G's mandate together with a change in benchmark
    - An initial tranche of funding to Pyrford
    - The implementation of the SEP

  - Stage 2 involved:
    - The funding of both Winton and BlueCrest
    - The completion of the funding of Pyrford
    - The liquidation of the SEP to coincide with the funding above

[1] Using prevailing market values and exchange rates.

- This report treats the two stages as independent activity. Stage 1 has been reported on an Implementation Shortfall basis and Stage 2 is reported on a performance basis.
- Assets valued at £142.1m[2] (38% of the total legacy assets) were retained for the L&G mandate. This amounted to 66% of the total increase required for L&G. The balance of the mandate was funded in a combination of stocks purchased in the transition account and cash.
- The remaining assets (£212.7m[2]) were sold and the proceeds were used to purchase stocks for L&G's mandate, the purchase of L&G units and the initial funding of Pyrford's mandate. The remaining sale proceeds were retained in cash, within LGIM's Sterling Liquidity Fund, and equitised with the SEP.
- Trading commenced on 29 August and was completed on 3 September. The majority of the trading (64%) was effected on 31 August 2012 in order to coincide with the weekly dealing point of L&G's pooled funds.
- Total market trade turnover amounted to £217.9m[3]. A large proportion (36%) was crossed with other LGIM clients at minimal cost. The remaining trades were effected on an agency basis. Futures were purchased against the trades effected in order to maintain exposure and establish the SEP.
- Pyrford were partially funded on the 31 August 2012, in accordance with the transition objectives.
- BlueCrest and Winton were funded in full on 1 October 2012 and the futures and currency forward positions adjusted accordingly.
- The final tranche of the transition involved the completion of the funding of Pyrford on 31 October 2012. At this point remaining futures and currency forward positions were closed. A balancing investment was made with Pyrford on 5 November 2012.
- The overall cost for Stage 1 amounted to £0.634m or 0.17% of the initial assets, inclusive of the transition fee. This is £0.237m lower than forecast.
- Savings were made through crossing with other LGIM clients at both the unit level and stock level.
- The SEP generated a net total gain of £0.676m over the period.

[2] Using values based at 31 August 2012.
[3] Actual gross traded values.

Transition assets - legacy

- The information shown is based on the initial and target portfolio re-valued to close of business on 31 August 2012 and therefore the values shown below do not reflect the actual trading values achieved throughout the trading period as shown in the subsequent sections of this report.

- The legacy assets consisted of

  - A pro-rata of the UK equity segregated portfolio managed by Alliance Bernstein, valued at £51.0m[4].
  - The entire global equity segregated portfolio managed by JP Morgan, valued at £204.3m. JP Morgan retained three emerging markets securities as the custodian was not able to open a local account in the LGIM transition account in time for the stocks to be transferred. These holdings were sold by JP Morgan on LGIM's instruction and the proceeds transferred to the transition account.
  - The entire Aberdeen portfolio which included:
    - A holding in the Aberdeen Global II Sterling Credit Bond Fund valued at £78.4m which was redeemed by way of an in-specie transfer
    - Gilts and cash held in a segregated account, valued at £34.3m. This portfolio included fixed income futures and currency forwards which were closed out by Aberdeen on LGIM's instruction
    - A holding the Aberdeen Global II Emerging Markets Opportunities Bond Fund valued at £5.9m, which was redeemed for cash

Table 1: Legacy assets split by asset class and manager, re-valued at 31 August 2012

Asset Class	Alliance Bernstein (£m)	JP Morgan (£m)	Aberdeen (£m)	Total (£m)	Total (%)
Equities	44.772	201.945	-	246.718	66.0%
UK	42.758	27.044	-	69.802	18.7%
North America	1.784	98.426	-	100.210	26.8%
Europe (ex UK)	0.231	31.540	-	31.771	8.5%
Japan	-	10.413	-	10.413	2.8%
Asia Pacific	-	11.602	-	11.602	3.1%
Middle East	-	0.820	-	0.820	0.2%
Emerging	-	22.101	-	22.101	5.9%
Bonds	-	-	113.480	113.480	28.8%
Corporate Bonds	-	-	77.282	77.282	20.7%
Gilts	-	-	30.275	30.275	8.1%
Money Market [5]	6.260	2.384	11.016	19.660	5.2%
Total	**51.032**	**204.330**	**118.574**	**373.935**	
	13.7%	**54.6%**	**31.7%**	**100.0%**	

[4] The assets of the managers within the scope of the transition were valued as at COB 20 August 2012 to determine the proportion of assets that Alliance Bernstein needed to transfer to the transition a/c.
[5] The money market above reflects the portfolio cash, the cash balance from the in-specie transfer from the Aberdeen Global II Sterling Credit Bond Fund and proceeds from the sale of the holding in the Aberdeen Global II Emerging Markets Opportunities Bond Fund (£5.9m) which was sold for cash.

- The assets were transferred to the transition account on the 23 August 2012 with the exception of:

  - The Aberdeen Emerging Market Debt pooled fund
  - A short futures position held by Aberdeen
  - Currency forwards positions held by Aberdeen
  - Physical cash held in a segregated account managed by Aberdeen
  - Local Taiwan and India securities held at JP Morgan

  These holdings were liquidated/closed out by the respective manager on LGIM's instruction and the proceeds transferred to the transition account once available.

Transition assets - target

- The transition assets were used to fund the increase in the L&G mandate, as well as to fund new mandates for Pyrford, Winton and BlueCrest. L&G's increase in mandate was funded in a combination of stock and cash. Pyrford[6], Winton and BlueCrest were all funded in cash.

Table 2: Target assets split by asset class and manager, valued at 31 August 2012

Asset Class	L&G (£m)	BlueCrest (£m)	Pyrford (£m)	Winton (£m)	Total [7] (£m)	Total (%)
Equities	72.065	-	-	-	72.065	19.3%
UK	-	-	-	-	-	0.0%
North America	18.401	-	-	-	18.401	4.9%
Europe (ex UK)	27.765	-	-	-	27.765	7.4%
Japan	9.828	-	-	-	9.828	2.6%
Asia Pacific	12.014	-	-	-	12.014	3.2%
Middle East	-	-	-	-	-	0.0%
Emerging	4.058	-	-	-	4.058	1.1%
Bonds	74.764	-	-	-	74.764	20.0%
Corporate Bonds	72.408	-	-	-	72.408	19.4%
Gilts	2.356	-	-	-	2.356	0.6%
Money Market	69.000	31.461	94.384	31.461	226.306	60.6%
Total	**215.829**	**31.461**	**94.384**	**31.461**	**373.135**	**100.0%**
Total (%)	**57.9%**	**8.4%**	**25.3%**	**8.4%**	**100.0%**	

[6] See comment re Pyrford funding overleaf.
[7] The target assets are marginally less than the legacy assets due to variations between the predicted settlement proceeds and the actual settlement proceeds of items transferred after 31 August 2012.

- L&G's mandate increased by c£215.8m. The additional assets were combined with the existing assets and invested to bring the Fund's distribution into line with the revised benchmark set out below.

Table 3: L&G pooled fund transactions, valued at 31 August 2012

Asset Class	Initial Value (£m)	Stock from Trans A/C (£m)	Units Switched (£m)	Cash Invested (£m)	Final Value (£m)	Final %	Benchmark %
Equities	250.754	72.529		12.525	335.809	50.5%	50.5%
North America Hgd	88.532	18.401	-	-	106.933	16.0%	16.0%
Europe (ex UK) Hgd	78.891	27.750	-	-	106.641	16.0%	16.0%
Japan	-	6.437	-	-	6.437	1.0%	1.0%
Japan Hgd	18.688	3.391	-	1.000	23.078	3.5%	3.5%
Asia Pacific	-	* 12.399	0.800	-	13.199	2.0%	2.0%
Asia Pacific Hgd	30.623	-	(0.800)	-	29.823	4.5%	4.5%
Emerging Markets	34.020	4.152	-	11.525	49.697	7.5%	7.5%
Bonds	199.872	74.778		56.475	331.125	49.5%	49.5%
Over 15 Year Gilts	31.049	2.357	-	-	33.406	5.0%	5.0%
Invt Grade Corp Bds	102.435	72.421	-	22.475	197.332	29.5%	29.5%
Over 5 Yr I-LGilts	66.387	-	-	0.625	67.012	10.0%	10.0%
EM Gov Debt	-	-	-	33.375	33.375	5.0%	5.0%
Total	**450.626**	**147.307**	**-**	**69.000**	**666.933**	**100.0%**	**100.0%**

* This is comprised of retention of £7.2m and purchases of £5.2m. All other values for stocks transferred were retained from the legacy portfolio.

- As far as possible assets from the legacy portfolios were retained and transferred in-specie into the L&G pooled funds. The total retention amounted to £142.6m or 38% of the legacy assets (66% of the total increase in L&G's mandate). The balance of L&G's mandate was funded in a combination of cash and a complimentary basket of Asia Pacific stocks which were purchased within the transition account and synchronously transferred to the pooled funds. In addition a small switch was effected between pooled funds to complete the move to the revised benchmark. Full details of the L&G transactions are included within a separate report which accompanies this document.

- Pyrford's allocation of c£94.4m was to be invested in their Global Total Return Sterling Fund. Pyrford indicated that a cash investment would purchase units at NAV without incurring any charges or spreads. As a result cash funding was selected. The investment was funded in two broadly equal tranches. The first investment was made on their 31 August 2012 dealing date. The second investment was made on their 31 October 2012 dealing date, with a final balancing trade being made on their 5 November dealing date (all investments priced at close of business on the dealing date).

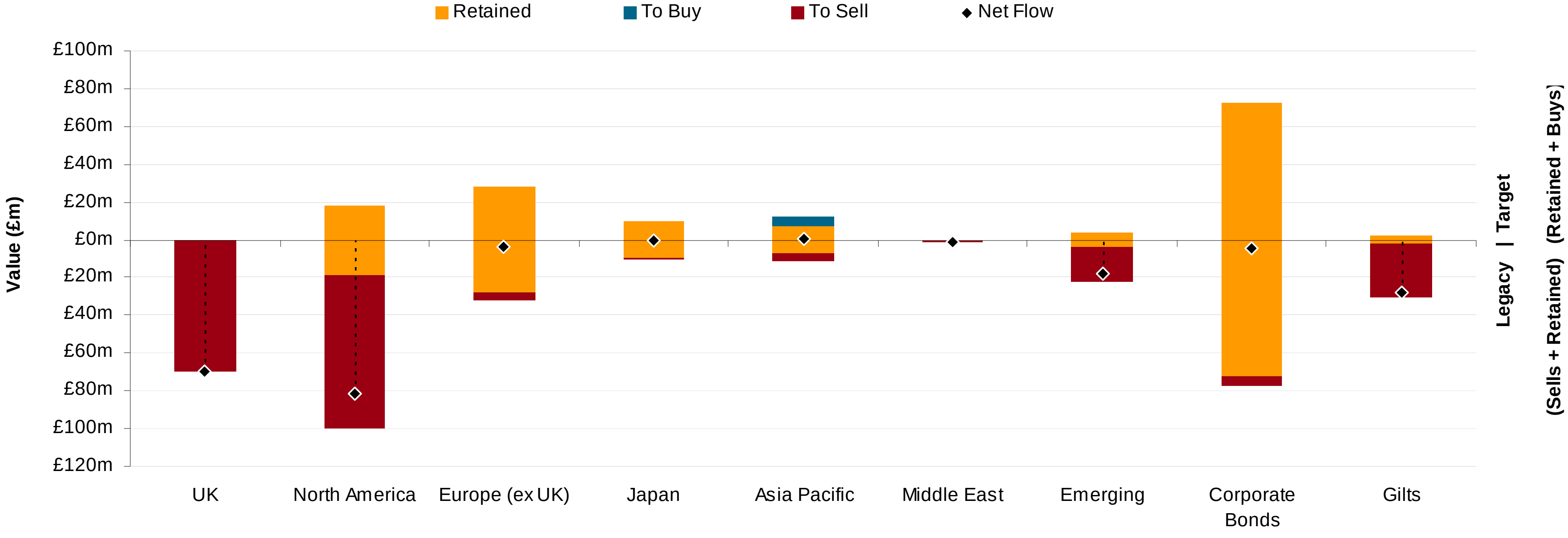
- The mandates for Winton and BlueCrest consist of holdings in the Winton Futures Fund Ltd and the Allblue Fund Ltd respectively. Both managers advised that they could only be funded in cash. The funding took place on 1 October 2012 and 28 September 2012 respectively (both priced at 28 September 2012).

- The cash raised to fund these mandates, together with the second allocation for Pyrford, was invested in the LGIM Sterling Liquidity Fund in the interim.

Table 4: Legacy, target, retained assets (excluding cash) and required trades split by asset class, valued at 31 August 2012

Asset Class	Legacy (£m)	Target (£m)	Retained (£m)	To Buy (£m)	To Sell (£m)	Net Flow (£m)
Equities	246.718	72.065	67.365	4.700	(179.353)	(174.653)
UK	69.802	-	-	-	(69.802)	(69.802)
North America	100.210	18.401	18.401	-	(81.810)	(81.810)
Europe (ex UK)	31.771	27.765	27.765	-	(4.006)	(4.006)
Japan	10.413	9.828	9.828	-	(0.585)	(0.585)
Asia Pacific	11.602	12.014	7.314	4.700	(4.288)	0.412
Middle East	0.820	-	-	-	(0.820)	(0.820)
Emerging	22.101	4.058	4.058	-	(18.042)	(18.042)
Bonds	107.557	74.764	74.764	-	(32.794)	(32.794)
Corporate Bonds	77.282	72.408	72.408	-	(4.875)	(4.875)
Gilts	30.275	2.356	2.356	-	(27.919)	(27.919)
Total	**354.275**	**146.829**	**142.129**	**4.700**	**(212.147)**	**(207.446)**

Figure 1: Legacy, target, retained assets and required trades split by asset class, valued at 31 August 2012



- As set out in the pre-trade report the cash that was retained for the funding of the absolute return managers in Stage 2 was equitised with equity index futures forming the SEP. The UK exposure was replicated using FTSE 100 futures and the overseas exposure was replicated using S&P 500 futures. The proceeds from all non US sales were FX'd to GBP and the USD from the US sales was swapped into GBP to make GBP available and maintain the USD currency exposure.

- The actual cash available during the transition was £227.9m, which is comprised of the net proceeds from the physical sales in the transition account, legacy cash, the proceeds from the sale of the Aberdeen Emerging Market Debt Fund and net cash generated from the SEP. This was utilised as below[8]:

  - £69.0m was paid to L&G to purchase units in the pooled funds on 3 September
  - £47.2m was paid to Pyrford on 6 September 2012
  - £31.9m was paid to Winton on 27 September 2012
  - £31.9m was paid to BlueCrest on 26 September 2012
  - A total of £47.9m was paid to Pyrford in November with £47.0m, being paid on 6 November and £0.9m being paid on 9 November

[8] Date of payment rather than date of investment.

Trading – physical assets

- Trading commenced on 29 August 2012 with the sale of those assets which could not be retained for the existing mandate and where no internal crossing opportunity was available. This facilitated the purchase of units without the need for pre-funding. This amounted to 36% of the total trading and included:

  - £70.3m of UK equities which did not form part of the target L&G assets and where crossing opportunities were not available
  - £7.2m of non-index securities which could not be retained by L&G's pooled funds

- The remaining 64% of trading was effected on 31 August 2012 and included the transactions below. The scheduling of the sales was designed to coincide with the L&G pooled funds' weekly dealing date in order to maximise crossing opportunities thus reducing transaction costs. This approach generated significant crossing opportunities with 36% of the trading being crossed with the L&G pooled funds. Trading activity included:

  - Sales of £107.6m of equities, mainly North America and emerging markets
  - Purchases of a basket of Asia Pacific equities of £5.2m[9] to compliment the portfolio of securities retained in this region
  - Sales of all the corporate bonds (£4.7m) which could not be retained
  - Sales of the surplus gilts (£27.8m)

Figure 2: Trading by asset class/region

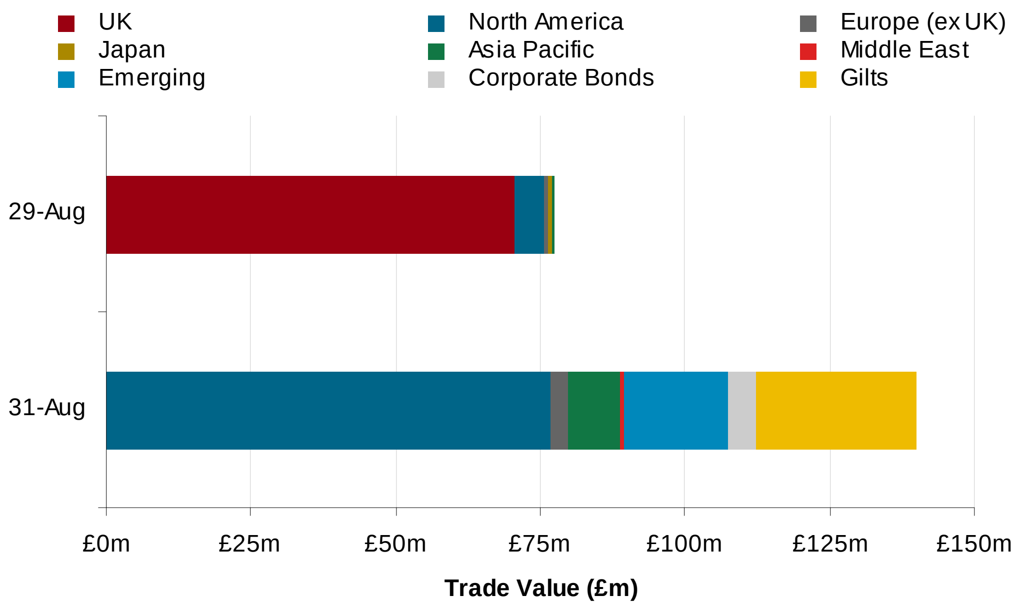
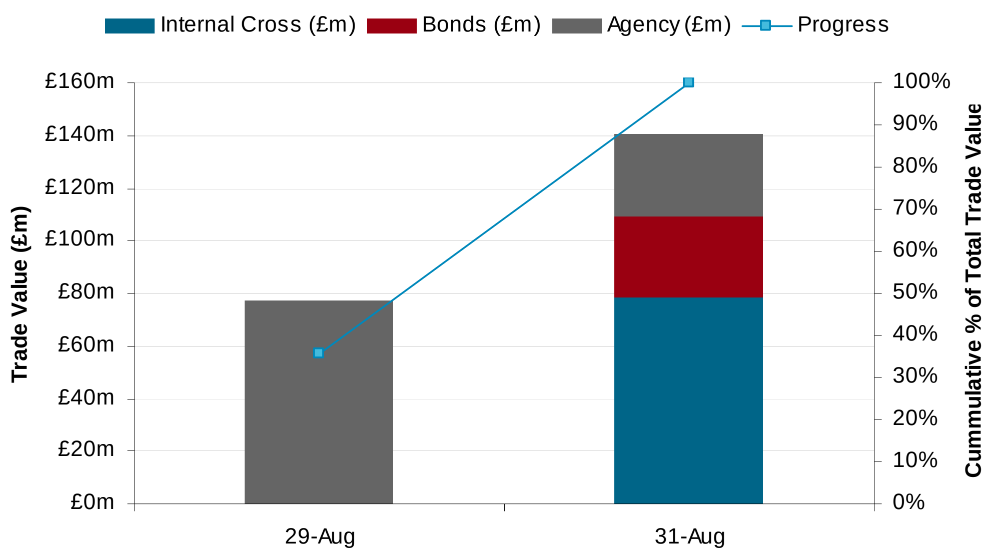


Figure 3: Trading progress by trade type



[9] The value of the basket of securities purchased was increased marginally from the original forecast in order to utilise additional cash that was made available

- Total gross trading turnover (excluding futures) in the transition account amounted to £217.9m.

- It was possible to cross 36% of the trading undertaken with the L&G pooled funds, in particular there was a significant crossing opportunities in North America and emerging markets. The remaining trades were effected on an agency basis.

Figure 4: Trading breakdown by trading technique including retention

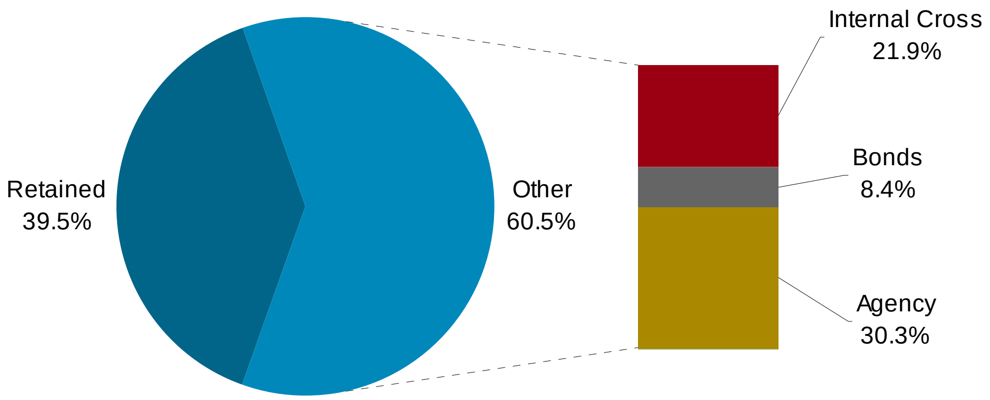
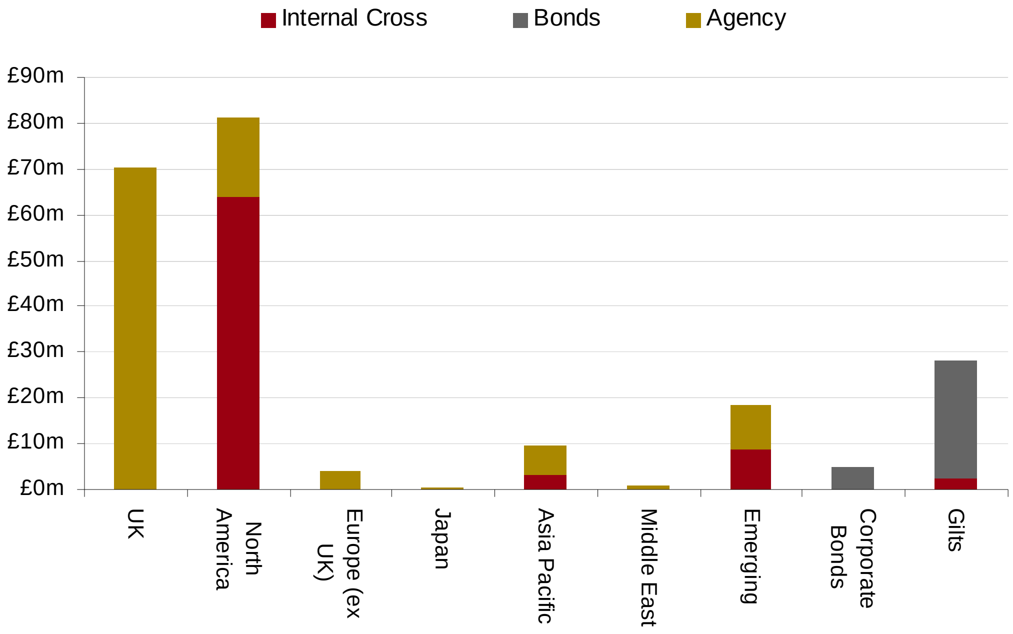


Figure 5: Trading breakdown by asset class by trading technique



Cost and implementation shortfall analysis – Stage 1

- The Implementation Shortfall measures the performance of the all transactions relative to global closing prices on 31 August 2012.
- Trading progressed in accordance with the plan and the realised costs for stage 1 of the activity of £0.634m are below the forecast cost.

Table 5: Costs breakdown for stage 1 of the transition activity

	Actual Cost		Forecast Cost		Difference	
Details	(£)	(%)	(£)	(%)	(£)	(%)
L&G pooled funds activity[10]	**(487,628)**	**(0.13%)**	**(533,050)**	**(0.15%)**	**45,422**	**0.02%**
Unit dealing	(449,359)	(0.12%)	(504,500)	(0.14%)	55,141	0.02%
Market levies and stamp duties on stock transfers	(25,109)	(0.01%)	(13,650)	(0.00%)	(11,459)	(0.00%)
Cost of placing/unwinding the pooled hedge	(13,160)	(0.00%)	(14,900)	(0.00%)	1,740	0.00%
Physical Trading	**(46,305)**	**(0.01%)**	**(238,000)**	**(0.07%)**	**191,695**	**0.05%**
Commissions	(15,745)	(0.00%)	(35,000)	(0.01%)	19,255	0.01%
Taxes and levies	(19,960)	(0.01%)	(20,000)	(0.01%)	40	0.00%
Implicit and opportunity costs (equities/futures hedge)	41,735	0.01%	(138,000)	(0.04%)	179,735	0.05%
Spread (fixed income)	(42,872)	(0.01%)	(45,000)	(0.01%)	2,128	0.00%
Currency	(9,463)	(0.00%)	0	-	(9,463)	(0.00%)
Total Trading Costs	**(533,933)**	**(0.14%)**	**(771,050)**	**(0.21%)**	**237,117**	**0.07%**
Fee	**(100,000)**	**(0.03%)**	**(100,000)**	**(0.03%)**	**-**	**0.00%**
Transition Fee	(100,000)	(0.03%)	(100,000)	(0.03%)	-	0.00%
Total Cost	**(633,933)**	**(0.17%)**	**(871,050)**	**(0.24%)**	**237,117**	**0.07%**

% costs are in percentage of the value of the initial assets at 31 August 2012 close for the actual costs and for the forecast cost as at the value of the transition assets from the original pre-trade estimate

- The transition activity incurred minimal opportunity cost.
- Commissions were lower than forecast due to the high level of crossing at the stock level with other LGIM clients. We were able to effect a significant proportion (36%) of trading on this basis, incurring minimal costs.
- L&G unit transaction costs were lower than forecast due to a greater level of crossing at the unit level. In particular, the Fund benefited from high crossing levels (over 50%) in emerging markets.

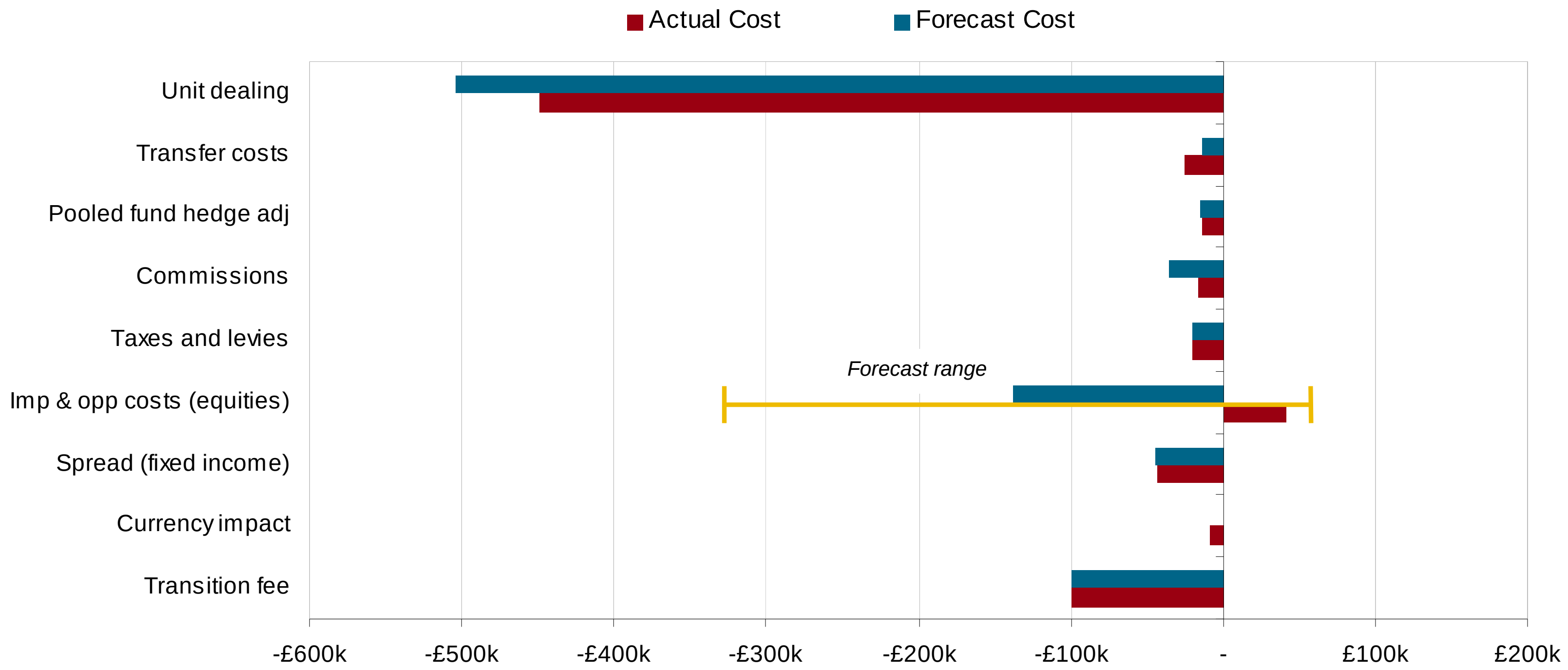
[10] The details of the unit activity including a breakdown of the costs incurred are included within a separate report which accompanies this document.

- Market levies on the transfers to the pooled funds were higher than expected due to the introduction of a French transaction tax in the period between the pre-trade and the execution of the transition.

- The currency impact primarily relates the FX of the USD proceeds that were received into the transition account from the sale the Taiwanese and Indian stocks that was effected by JP Morgan. The timing of this transaction was outside of the control of LGIM as it could only be effected on physical receipt of the cash from JP Morgan.

- The chart below provides a graphical representation of the outcome of the transition.

Figure 5: Costs breakdown

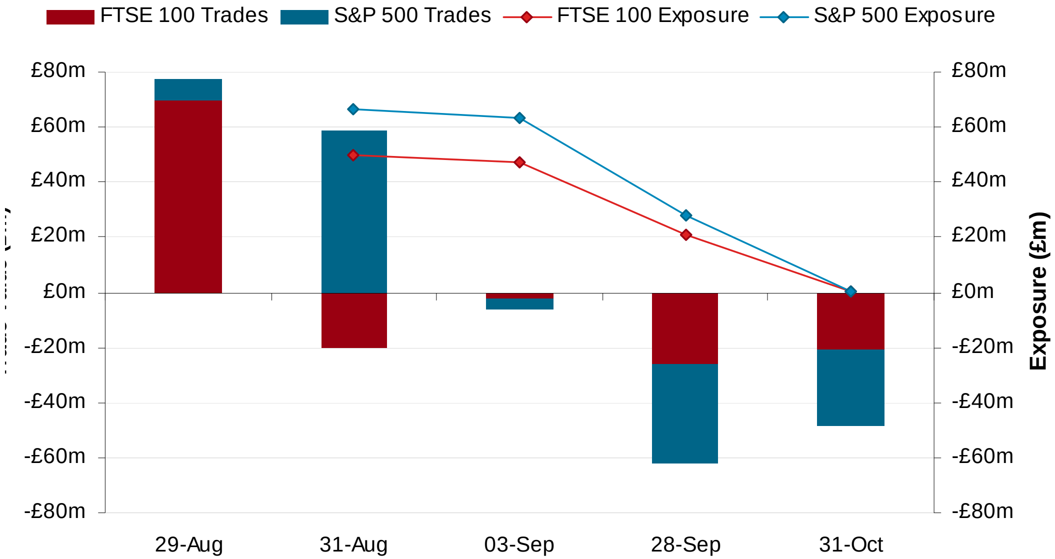


SEP overlay – stage 2

- As trading was effected the equity market exposure was maintained through the use of futures. As set out in the plan the futures overlay represented a practical proxy for those stocks which were liquidated with FTSE 100 futures and S&P 500 futures being used to mirror the UK and overseas exposure respectively.

- The futures positions were unwound as the subsequent funding of the absolute return managers was completed.

Figure 4: Futures trades and exposure



- With regards to currency exposure, the USD exposure of the US assets that were liquidated was maintained. All other non-GBP currencies were FX'd into GBP. The settled cash was held in GBP and placed within our Sterling Liquidity Fund and exposure to USD was maintained using currency forwards. The currency position was adjusted in line with the futures closure as the subsequent funding of the absolute return managers was effected.

- The SEP generated a net gain of £0.676m during the period.

Contributor	Performance (£)
Futures (from 31 August)	1,598,141
Currency (from 31 August)	(989,696)
Interest on Sterling Liquidity Fund	76,865
Sterling Liquidity Fund Fee	(9,406)
Total SEP Performance	**675,904**

Conclusion

- We are pleased to report that this transition exercise has been successfully completed in accordance with the pre-trade transition plan and in line with the forecast cost estimate.
- We believe that the result demonstrates the advantage of making use of LGIM's transition services where L&G units form part of the transitioned assets, and reflects the effective implementation of an appropriate, controlled, low risk transition strategy.
- A data report, giving line by line details of all transactions, forms an appendix to this report.

Residual items and cash balances

- As at 28 November 2012, the Transition Account holds cash balance of c£16,000 which will be transferred to the L&G pooled fund account and used to purchase additional units on the 3 December 2012 dealing date.
- To the best of our knowledge there are no outstanding accruals or corporate actions due to the transition account.
- The custodian has advised that there are accruals due to be paid to the legacy JP Morgan account of c£30,000. We have requested that the weekly sweep from the JP Morgan account to the transition account is stopped with effect from the end of November.