

# Managing transition costs when consolidating pension funds



Client case study

On 26 February 2020, Russell Investments successfully completed a multi-asset transition on behalf of Pensioenfonds Meubel (“Meubel”) and Stichting Bedrijfstak Pensioenfonds voor de Houthandel, with combined assets of over €4 billion. The two pension funds decided to merge for several reasons, including cost efficiencies. For governance reasons, the two boards wanted to use an external transition manager to merge the liquid part of the return portfolio in order to provide a transparent view on the costs of the portfolio merger, as well as minimise the risks inherent in such an exercise. Due to the longstanding history and strategic focus on transition management, Russell Investments was selected to manage the portfolio merger as the transition manager.

## Executive summary

Russell Investments implemented a robust framework and project management structure, with a clear timeline for all parties involved. Furthermore, as part of the transition process, Russell Investments provided a detailed cost estimate and managed the operational risks of trading and settlement and designed and implemented a transition strategy focused on minimising implementation shortfall<sup>1</sup> and managing risk.

The assets being transitioned consisted of nine separate mandates (€1.6 billion in value) across developed and emerging market equities, real estate equity, emerging market debt (hard and local currency), global credit, high yield, and multi asset portfolios - with just three of the managers being retained. Key to the transition was conducting a cost and benefit analysis of potential in-specie transfers and assessing the most appropriate transition strategy, where cash redemption of legacy pooled funds was necessary.

## Robust project management and collaboration

A merger of this complexity requires the transition manager to coordinate multiple parties, in this case 17 parties were involved, across multiple platforms. An effective communication structure was maintained between Russell Investments, stakeholders and all parties involved in the transition – resulting in over 1000 emails exchanged and weekly project calls with all stakeholders. The final post transition report, as well as comparing the actual results with those initially estimated, provided clarity to the board members involved and comfort that the merger was executed with a focus on; **cost savings, maximum transparency and minimising trading risk.**



*We had a positive experience working with Russell Investments previously and due to the complex nature of this restructuring, we knew the team would deliver a seamless and meticulous transition. - Montae & Partners (adviser of the pensionfunds)*

<sup>1</sup> “Implementation shortfall” is defined as the arithmetic difference between the return on the actual portfolio and the return on the target portfolio wherein the target portfolio is attained at no cost.

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## The challenge

There were two main challenges faced when managing this event:

- The first was strategic in nature – developing the optimal strategy to minimise the risks associated with merging the two funds, as well as the costs.
- The second challenge was operational – the project management of all of the diverse stakeholders associated with the event.

**Strategic considerations:** In order to provide the most cost-effective and risk-managed transition, we carried out detailed pre-transition analysis. As mentioned, there were multiple portfolios involved in different assets classes, held in both segregated accounts and pooled vehicles. Central to this analysis was a detailed cost comparison between liquidating assets to cash in their legacy structures and transferring assets in-kind, via in-specie transfers. Transferring assets in-specie, rather than liquidating them, can materially reduce costs, as well as enable the transition manager to effectively manage the portfolio risk. There can be operational risks involved in this process and some asset managers do not favour this approach. However, with an external transition manager to coordinate this and with the client's support, most asset managers can be persuaded, resulting in a potentially significant saving.

**Stakeholder management:** The key to the success of the event was robust and efficient project management. With complex transitions involving multiple stakeholders, the event was regularly evaluated not only in cost terms, but on the ability of the transition manager to co-ordinate all activity whilst also ensuring all parties were kept well-informed during all stages. This avoided any surprises once the outcome was reviewed.



*The team at Russell Investments demonstrated exceptional project management skills, with continual communication throughout the process. - Pensioenfonds Meubel*

## Trading execution

On the 14 February, Russell Investments was provided with a list of legacy assets and on the 19 February, the transition trading commenced, following the confirmation of the final target structure of the assets. Full completion of all trading was achieved during the first six days of implementation; which was in line with pre-trade expectations.

Russell Investments actively managed the transition process to obtain best execution and stay MiFID-compliant. Maximising the retention of legacy assets that could be transferred into the target structure helped to minimise the amount of trading involved and thus reduced the overall transition costs. Furthermore, extensive use of external crossing networks helped minimise market impact and, as this could have been a significant driver of costs, in turn reduced the overall transition costs. If the market has the impression that large amounts of assets were sold or bought, that may have impacted the price of that asset and therefore had a negative effect on the cost of the transition for the asset owner. The Russell investments operational diligence team worked to prevent this from happening due to a strict control on information leakage, as well as trading on numerous venues.

## Fixed Income

- Through utilising our multi-dealer approach to fixed income trading, the execution prices achieved were on average 23.7 basis points better than the average of the quotes received. Russell Investments executed 923 fixed income trades in total for this event, with 55 unique dealers approached and, on average, eight quotes received per trade.
- A matrix of all quotes received for every individual security traded was also made available on the completion of the transition in order to provide complete transparency.
- Access to such a wide variety and number of dealers not only helped keep the costs down, but also masked the size of the trades in the market.

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## Equities

- Equity trading was completed across two days of implementation and Russell Investments used the full breadth of market access of our agency-trading desk to source the best venue for executions.
- Over 1,900 equity trades were completed for this event, across 72 execution venues, with 24% of all of trading executed off exchange via crossing networks, dark pools.
- Systematic internalisers, thus not only helping to minimise our footprint in the market, but also spread and market impact costs.

## Foreign Exchange (FX)

- Trade execution for the FX component was coordinated with the legacy managers and the FX overlay manager, with 57 FX spot and forward trades being executed and settled during the event.
- There was a shift of exposure from emerging markets to European assets and impact was significant, due to currency movements. Therefore, having a clear view and thorough understanding of the FX markets was crucial to stay in control when making the shift. Russell Investments also acts as FX overlay manager for many clients globally, another competence which is very advantageous when coordinating legacy hedges and ensuring a portfolio maintains the correct hedging ratio throughout a transition.

 *We could not have managed this asset merger internally; we were pleased with the expertise Russell Investments provided as this was a very significant project. - Pensioenfonds Meubel*

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### The result – demonstrating clear cost-saving

After detailed analysis, a hybrid approach was adopted, with a strategy involving a mixture of in-specie transfers, cash redemptions and subscriptions and unit re-registrations. The risk was minimised with a vigilant management of all the transfers and subscription/redemptions, close coordination of currency hedging and a trading strategy that lessened sector and out-of-market risk.

We estimated that, based on prevailing spreads in the underlying funds, the total cost of a 100% cash transition could have been in excess of €2.54m. The final actual costs were materially lower than previously estimated. Factors which contributed to these savings included: staged cash redemptions to avoid redemption costs, maximising retentions by working with the target managers to retain as many of the legacy securities as possible and multi-venue trading to minimise spread and impact costs.

This result was measured by calculating the deviation from the estimate using the implementation-shortfall method. This transition, despite the complexity and the volume of trading, was successful and within six basis points of the final estimate.

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## About Russell Investments

Russell Investments is a leading global investment solutions partner, dedicated to improving people's financial security. At Russell Investments, we stand with you, whether you're an institutional investor, a financial adviser, or an individual guided by an adviser's personalised advice. Our approach brings some of the world's leading managers and strategies together - in a diversified, adaptive and efficient portfolio - aimed at achieving investors' goals.

## For more information

Call Russell Investments at **+44 (0) 20 7024 6000** or visit [russellinvestments.com](https://www.russellinvestments.com)

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