Northern Ireland Electricity Pension Scheme

Providing and Implementing a new Investment Strategy
Company background

The Northern Ireland Electricity Pension Scheme is a top 300 UK pension fund with a capital value of approximately £900 million. The pension scheme employs a number of fund managers that manage the pension fund’s assets in line with an investment strategy that meets the long term liabilities of its members.

The corporate sponsor, Northern Ireland Electricity (NIE), owns the regulated electricity transmission and distribution network in Northern Ireland. It is responsible for planning, development, construction and maintenance of the entire network, as well as the operation of the distribution network.
Business challenge

Following a review of fund performance and the long term liability structure of their pension scheme, the trustees of the scheme, on advice from the scheme’s investment consultant, decided to alter the investment strategy as well as change fund managers. The scope of the transition project involved:

- Transfer and rebalancing of the scheme’s existing UK corporate bonds and global bond holdings and associated derivatives from the exiting fund manager to another current manager, precipitating a mandate change for the remaining fund manager.
- Transfer and rebalancing of the scheme’s existing gilt and index-linked gilt holdings and associated derivatives to a newly appointed manager to implement a Liability Driven Investment (LDI) strategy.
- Funding for two Diversified Growth mandates.
- Ensuring the scheme would meet its cash disinvestment requirements.

The restructuring was complex, involving the rebalancing of equities, bonds, FX forward contracts and derivatives across six different fund managers. Additionally, the characteristics of the scheme’s bond holdings were complicated, including not only UK and international government and corporate securities, but also complex instruments such as asset-backed and mortgage-backed securities.

The challenge was to meet the trustees’ revised investment objectives cost effectively and with a minimum amount of market and operational risk. The scale and scope of the project meant that all procedures had to be carefully coordinated across a number of participants without compromising confidentiality. By appointing J.P. Morgan, the Global Custodian, as the transition manager and independent intermediary, each fund manager could be assured that their portfolio holdings would not be disclosed to their competitors nor would there be leakage of market sensitive information.
Solution

It was evident that with so many moving parts, rigorous transition planning would play a critical role in the efficient implementation of the project. A detailed project plan and clear communication was essential to ensuring that each step of the process was executed on time.

J.P. Morgan first analysed the holdings of the current portfolio and compared them with the assets required for the new mandates - the fund managers’ “wish lists.” This allowed J.P. Morgan to identify assets that could be directly transferred to the new accounts without trading in the market, thus avoiding transaction costs. However, as the universe of fixed income securities is very large and diverse, J.P. Morgan worked with the fund managers and discussed their portfolio construction to determine acceptable substitutes - bonds that were not an exact match to what they required, but had similar characteristics, i.e. issuer, yield and maturity. In this way J.P. Morgan could maximise the commonality between the current structure and the new structure, improve liquidity and minimise the number and impact of market transactions. The remainder of the stocks and bonds would need to be bought or sold.

Once the trade list was determined, J.P. Morgan applied the quantitative analytics of its transition management platform to identify the inherent risks from a regional, sector and stock specific perspective. The next challenge was to devise a trading approach that ensured risks were minimised early in the trade process, thus limiting the effect of any negative market or economic events. For the fixed income assets, this meant focusing on portfolio duration and, where appropriate, prioritising the sale of the longer duration bonds to limit the impact of market movement. Given the overweight position in equities, J.P. Morgan sold a liquid slice of equities immediately upon the market open on the first day the transition was executed to reduce unwanted sector exposure. The derivative and FX forwards were unwound to coincide with the underlying trades.

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Results

Post-transition results showed the actual cost of the restructuring was 26% less than the estimate - avoiding unnecessary trading saved £2 million. The successful implementation was due to the detailed pre-trade planning and the execution strategy, which ensured J.P. Morgan was in a position to take advantage of favourable bond market movements and liquidity during the execution period.

J.P. Morgan’s trading desk actively managed the government bond orders to achieve competitive pricing despite market volatility, which ensured performance remained strong. Trading was completed in four days in a risk-controlled and structured manner.

Removing the administration and operational burden of managing the project was a significant benefit to the pension fund. Transition Management is a highly detailed process that is both time consuming and resource intensive. Employing a transition team to manage and coordinate the entire event meant the trustees could remain focused on their day to day business.

“We were impressed with how well J.P. Morgan managed this complex transition, completing the event within expectations and providing transparency of both anticipated and actual costs in fixed income, which is historically an opaque market.”

Peter Turkington, Pensions Manager
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