

# WHY TRANSITION MANAGEMENT IS NOT LOST IN TRANSLATION



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## Attendees

*(From left to right)*

JOHN MOORE, managing director for Russell Investments, Asia Pacific

NICK McDONALD, principal, Mercer Sentinel

JIM KARELAS, managing director and head of Asia-Pacific transition management, Convergex Group

HEMAN WONG, executive director, Hospital Authority Provident Fund, Hong Kong

DUNCAN KLEIN, head of transition management, Asia, JP Morgan

ADRIAN TENG, group treasurer, Jardine Matheson

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## A VOLATILE MIX OF MARKET GROWTH AND CHANGE

**DUNCAN KLEIN, HEAD OF TRANSITION MANAGEMENT, ASIA, JP MORGAN:** When we talk about transition management in Asia, what gets a lot of attention are the twofold trends of increasing demand for the product and the growing complexity of many deals, particularly around fixed income and emerging markets, during these volatile times. These two asset classes by nature carry greater trading and operational complexity compared to developed market equity transitions, and therefore clients are starting to differentiate solutions and outcomes across the various transition managers in the region.

**HEMAN WONG, EXECUTIVE DIRECTOR, HOSPITAL AUTHORITY PROVIDENT FUND, HONG KONG:** At a time like this my focus is trying to preserve capital and performance in the portfolio. As a pension fund, we tend to be long-term investors; even so, volatility is inevitably unpleasant. Now and then if we are forced to make a change in our appointed managers, transition management is a tool that we often adopt. Other considerations for us include inflation, new products such as commodities and UCITS, and heightened risk.

**JIM KARELAS, MANAGING DIRECTOR AND HEAD OF ASIA-PACIFIC TRANSITION MANAGEMENT, CONVERGEX GROUP:** I have a dual-focused strategy right now which involves Asia and Australia separately. In Australia, we are looking to leverage the industry consolidation among super funds that is occurring at the moment. There is a high level of complexity and administration driving that process which offers us a lot of opportunities. At a wider Asia level, our process and scope is more educational. With the Asian customer base, there is still a bit of a learning curve with respect to transition management and a large knowledge transfer that must take place at the onset of building our relationship with them. So our dual strategy throughout the region involves a widely differing set of activities and objectives.

**NICK MCDONALD, PRINCIPAL, MERCER SENTINEL:** Transition management is a strong element in our service set in Asia, which involves consultancy services around investment operations and implementation. Right now, capital preservation for any asset owner has got to be key in a volatile market. Then it becomes a process of analysing the risk tools provided by transition managers and their ability to utilise them in different market conditions, not meeting the execution requirements of today.

**ADRIAN TENG, GROUP TREASURER, JARDINE MATHESON:** Uppermost in our thoughts is how to cope with increased volatility in the global market. What used to be a once in every three or five year occurrence is now happening on almost a daily basis; and you have to bear it in mind when you are managing a corporate pension plan. It is also a fine balancing act: safeguarding capital on the one hand and taking a risk to generate reasonable returns on the other for the benefit of our employees. It is a difficult tightrope to walk right now and, as Heman noted, in Hong Kong, rising

inflation is not helping. In this context therefore, we look at transition managers no longer as service providers, but as partners in helping us mitigate these very real challenges.

**JOHN MOORE, MANAGING DIRECTOR FOR RUSSELL INVESTMENTS, ASIA PACIFIC:** Some of the biggest challenges are related to the sheer complexity of events around the industry. Pointedly, this is not about specific countries in Asia, but rather across the board. Moreover, as Duncan notes, the focus on fixed income events and emerging markets, where liquidity is more of an issue, can present a challenge as well. Then, as everyone has mentioned, it is about volatility and how we deal with it during a transition. In that regard, it becomes very important how you put together a team that actually knows how to manage transitions in these dynamic times.

## TWIN PEAKS: RELATIONSHIPS AND TRANSITIONS

**JOHN MOORE:** Transitions in Asia are developing and evolving in the same way that they are in the US and Europe. Outside of Asia, especially in Europe, we see people moving towards a fiduciary-type model and in time that will all evolve in Asia as well. Clients nowadays depend on the transition manager a lot more during the pre-transition stages; leaning on them for advice because there are more complex instruments being used. It is as much about process as the actual transition. It is important that clients really look at their transition managers, and see how they're constructed as a team. For instance: when you're dealing in both the physical market and the derivative markets, how well are the two teams handling these elements? How well are the teams connected? How do they integrate their expertise? It is important to do this analysis because if the transition manager is to deliver an optimal outcome for the client, it is really important that these teams work together effectively; particularly in these volatile times.

**NICK MCDONALD:** Transition management in this region is often overlooked; in fact, it is sometimes an afterthought. I'm sure the asset owners in the room would say having a transition manager in place or a panel of transition managers in place allows them to be flexible. Their decisions will depend on their particular asset requirements, or their desire to be able to respond to market volatility and be able to implement that change quickly. Or, it may simply be a process of wanting to change managers and having a clear process already in place. Either way, to get to that point you have to do a lot of due diligence to achieve that flexibility. You have to reach an understanding as to who are the transition managers in the market and how their expertise can be brought to bear on your requirements.

**ADRIAN TENG:** At Jardines, we tend to look at very long-term relationship management. The transition manager that we've used, is one we have used for close to three decades. The team knows our portfolio extremely well and I don't have to explain anything whenever we do anything. It is a very easy process. Also in terms of evolution, corporations in Asia have



*Duncan Klein, head of transition management, Asia, JP Morgan. Photograph © FTSE Global Markets, November 2011.*



*John Moore, managing director for Russell Investments, Asia Pacific. Photograph © FTSE Global Markets, November 2011.*

slowly come up the curve with regards to managing transitions themselves and they do not always go out to a transition manager to do transitions, unless we're talking about large portfolio shares; such as, for instance, one company into another's group plan. The current changes in the macro-environment now forces you to be closer to your transition manager. They are used as a counsel, as an adviser and as plans become more sophisticated with regards to new asset classes, funds of private equity funds, and funds of hedge funds, which is always the most complex business. In comparison, equities and fixed income are fairly straightforward. That is the value-add that TM can bring to the table. For plain vanilla transactions on the other hand, it is really not a difficult process.

**NICK MCDONALD:** It is also ensuring that your transition manager keeps up the pace with that as well.

**DUNCAN KLEIN:** The transitions that we manage are less about asset manager change and more about interim asset management solutions that by nature allow us to intensify, consolidate, strengthen and deepen our relationship with our clients. To that effect, the roles and responsibilities of the transition manager are not only to implement restructures in a timely, cost efficient and transparent manner. They must also ensure the client is fully convinced that their transition manager is delivering an optimised trading strategy in line with client interest and away from internal trading limitations. Increasingly, we see client and transition manager partnerships strengthen as clients engage us earlier in the restructure discussions. Additionally, in today's volatile markets, clients are beginning to recognise the benefits in hiring a transition manager for short-term restructure implementation away from asset managers who manage their portfolios for the long term.

**JIM KARELAS:** My response is in two parts and that is only because I cover two distinct regions. Australia is definitely driven by the relationship between clients and transition managers. Australia is well-advanced with respect to transition management panels, and relationships are formed as a result. The clients treat transition managers like investment managers when it comes to appointing them to a panel. The appropriate due diligence and capability research is performed at a detailed level before any selection is made. What we've seen in Asia however, is that acceptance of this business and process, has been a lot slower. Even so, as clients start diversifying their plans, changing their asset allocation, changing their investment strategy and as a result reconfiguring their investment manager line-up, then the requirements of the transition manager become far more critical. Let's take, for argument's sake, a plan and it could be a sovereign wealth plan with traditional government bonds that are managed in-

ternally. They might start looking at diversifying their investment strategy potentially to increase their alpha or modifying their return profile to match certain liability requirements. They start investing into equities, hiring investment managers, and all of a sudden they start realising that the road to implement that strategy becomes a lot more difficult. Discussions then begin with transition managers.

**HEMAN WONG:** A long-term relationship is useful. If you have a long-term relationship with a transition manager and they know what you need to do, and particularly if the contract agreement has been established, you don't have to go through things over and over again. However, at a time like this when a lot of new challenges are in the market, complexity comes to the fore. If for instance you are investing in a group, like a specialist, there are legal restrictions and liquidity issues, which often require a very detailed discussion with a transition manager. The relationship is sometimes also driven by understanding and bringing new ideas or solutions to the table. In that sense you gradually build up confidence in the transition manager and the process. We appointed a new manager early in the year and the challenge for us is to bring the relationship together and look for natural fits with certain mandates. It is also important when you get into that relationship building that dialogue is frequent and detailed, even before a deal is contemplated. That dialogue then ratchets up when a deal is being contemplated. That process gives you a lot of confidence.

**JIM KARELAS:** As Heman rightly points out, what clients get when they employ a transition manager is a market and portfolio implementation specialist. Clients get access to the firm and its resources. We find clients are utilising transition managers to also access value-add resources and to market expertise, market intelligence and market colour. Clients are not only looking for formal research, but also bespoke research and/or market trends that may be beneficial in assisting investment teams with their investment strategies.

## **COST CONSCIOUSNESS AND CONSIDERATION**

**NICK MCDONALD:** The majority of Asian clients pay close attention to detail and to costs. Add to that a strong requirement for transparency. The more transparency that a transition manager gives to the client so that he can understand, for want of a better word, the numbers behind the strategy, behind the implementation, is key right now. Detail is king.

**JIM KARELAS:** Certainly clients in the region are a lot more focused on the accounting outcome pre- and post-transition. They like to drill down, as Nick says, into the detail ►►

and question particular prices. Having said that, I think it is important for a transition manager, before anything occurs, to set client expectations. You have to manage expectations by providing analysis of the client's portfolio from a price and valuation perspective, and let them know that the execution in the market may vary slightly from the actual accounting valuation. This is particularly the case with fixed income. In saying that, even standard reporting will provide significant detail and clients appreciate the analysis resulting from an accounting valuation versus market price perspective because it breaks out all of the costs associated with the trade from a market sense.

**JOHN MOORE:** There was an email sent out from the chairman of the T-Charter to clients after one of the T-Charter group's recent surveys which called for more transparency. All clients want full accounting transparency around a transition. Moreover, I think that clients will want more going forward, in terms of having analysis around the track records of individual transition managers; a sort of independent audit, that perhaps goes back as far as five years. I think transition managers will be analysed and evaluated in the same way that investment managers are analysed and vetted on their historical performance record. Once that is in place, then I think it creates more trust with the transition provider, particularly when you're going through the pre-transition and the post-transition reporting processes.

**DUNCAN KLEIN:** Asian clients do not like surprises when a transition manager presents the post-trade cost analysis. To this point, as Jim touched upon, we need to highlight any valuation price that we view as "off market" compared to our pre-trade prices that better capture dealer appetite for the assets within the current market. Any significant difference needs to be presented and explained to the client prior to trading. This is especially noticeable for illiquid fixed income assets that are less frequently traded or when market volatility is such that some corporate bonds trade like high yield bonds. In these cases there are fewer market makers willing to provide two-way markets and therefore quote a one-sided market (bid only or offer only) to reflect their long or short position or their overall net portfolio exposure to that issuer.

**HEMAN WONG:** We have a small team. We don't have an investment team and a finance team, it is always the investment team who's looking after transitions. We are pretty good on the pre-transition due diligence. I'm a demanding type of boss. I ask my own team to run the numbers even before a consultant runs the numbers. I will make my own guesses and by the time I ask my transition managers to submit reports, I have some idea as to whether they are telling me the full story or not. Obviously everybody has their own model, but I think that preparation in-house is important and we don't forego the responsibility. My members look at me for performance. Any shortage is a hit. That is the way I read it.

**ADRIAN TENG:** Our situation is similar. I manage the investment and the finance element of it. It all sits with me and so we execute as most efficiently, as cost-effectively as possible. We obviously try to do pre-work on our part before

we engage with transition managers for their advice and counsel. Obviously, they may be more sophisticated with regards to the risk management tools which may then be a potential upside to our initial costings.

## MEASURE FOR MEASURE: WHAT MAKES A GOOD TRANSITION?

**NICK MCDONALD:** From a consultant perspective, part of our valuation is about performance, past performance and track record. It becomes particularly pertinent when you look at pre-trade versus post-trade performance. The more confidence we have in pre-trade, in cost discovery, the easier it is to then move forward with a transition. If that is not there, it is harder to proceed. You can see this enormous difference in the developed markets in the bell curve *versus* an emerging market bell curve, for instance. It is actually quite wide and that makes the whole process more interesting.

**JOHN MOORE:** Of course, there are different bell curves or outcomes for different transitions, but it is exactly the same with investment managers. Their outcomes around emerging market investments *versus* say US large cap are going to be widely divergent; but what does it all mean? It is comparing apples with pears.

**HEMAN WONG:** I look on transition management in the same way that I would if I started a war. Before you start a war, you had better have undertaken detailed simulations and developed a clear strategy for victory. It is a dramatic example, but I expect the same approach from a transition manager. A good transition manager should explain to the client what kind of events might fall upon the day you start that war. Something might happen, especially at a time like this when the market is throwing up so many challenges. Having clear measurements, reports and analysis in place will give you the confidence and allow you to be prepared in the case of extreme market events coming on the day you started that war. Because once you press that button you can't unwind part of that what you have done.

**DUNCAN KLEIN:** Once you start the transition it is nigh impossible to back track, but during the preparation stage you've got time to think about what might hit you and in today's markets, it could be quite a few things—macro, micro, regional, political—you need to be ready for it. You need to consider the overall strategy you are presenting to your client in your pre-trade. The quality of the execution is directly dependent on the quality of the preparation. It is thinking about all the different models to help achieve the client's number one objective: and we've heard it both from Adrian and from Heman, that is, the protection of the value of their assets. That might involve considering hedging solutions to minimize volatility, if authorised by the client. Coming back to transparency, it is not just about the implementation shortfall standard, it is also looking at benchmarking the post-trade *versus* other execution benchmarks. If you're in a situation where you're buying and the market opens lower compared to the prior night's close, you'll always outperform your implementation shortfall benchmark. Even so, you have to put that in context with what the market



*Adrian Teng,  
group treasurer,  
Jardine Matheson.  
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actually did during your period of trading and that is another level of transparency we need.

**NICK MCDONALD:** You are right Duncan. It is not simply looking at the implementation shortfall, it is the trading strategies behind the result. That is because you can still have an implementation shortfall calculation that looks good but the strategy behind it isn't exactly up to par. That in turn goes back to how you're managing that risk at transition. That is where a lot of people in this region can fall down if they're not careful.

**ADRIAN TENG:** Key performance indicators (KPIs) have been broadly mentioned. There are fairly basic KPIs that one would measure, pre, post, cost, track record, level of service, level of research, market information and whether the transition manager is on the curve of new market developments, new asset classes. All of that forms the background of how we evaluate a longstanding relationship or a transition. Is there a right or wrong answer? I don't know. As Heman said, if we feel comfortable that the transition manager understands our culture, what we're seeking objectively, and that Jardines is a very risk-averse organisation, that is fine. If we think that a transition manager is putting risk on the table and something that is crazy in pursuit of a particular number, we will reject that outright. That is the important dynamic; not just numbers but the entirety of it. As someone said: it is an evolutionary process. When Jardines first entered its transition management contract 30 years ago, would you have known that they would stick with them for 30 years? Who knows, right? Unless another compelling transition manager comes to the table and offers a real reason to change, then there is really no incentive to do so on our part. Having said that, as one's asset volume increases, as one's level of asset sophistication increases, there is then a merit of considering having another transition manager as a stopgap, as a check and balance.

**JOHN MOORE:** As plans become more complex, and the market presents different types of events than you would have seen 30 years ago—which results in multiple asset allocation shifts—you are seeing clients looking at panels, wanting to be ready for different types of events. Others have panels because of due diligence, ahead of time, in order to be ready for any allocation changes and move quickly in response to market events.

## CLIENT-LED SERVICE EVOLUTION

**JIM KARELAS:** Within Asia, some of the countries that only recently started to utilise the transition management product are starting to diversify their portfolios and are now looking for transition management expertise in terms of re-

structuring assets. In that sense, we are looking at a set of clients who are new to transition management. In terms of other changing demands, obviously with the level of sophistication that has occurred with new technologies in the space, clients now expect their transition managers to have access to advanced trading technologies, have the ability to scour its network of different markets and exchanges while sourcing liquidity across the globe and execute at competitive prices. Additionally, we've seen increased client demand for interim solutions for asset management and on the hedging side of the business. We have also seen an increasing demand for interim client exposure management solutions that not only utilise futures or currency overlays, but also include ETFs.

**DUNCAN KLEIN:** What clients look for in the service is flawless project management as a transition requires coordination across numerous entities: the client, the transition manager, external fund managers (legacy and target) as well as the custodian. The role of the transition manager is therefore predominantly one of a project manager, ensuring clear communication at all stages to all interested parties. They are singularly accountable for the overall delivery across the multiple entities. The complexity of managing and delivering on time within the objectives and time frame of the client is complex and demanding. These days market volatility, exacerbates the complexity of the mandate.

**FRANCESCA CARNEVALE:** Are those requirements constant throughout the region; or do countries operate differently?

**DUNCAN KLEIN:** There is a relative inconsistency through the region with some clients systematically leveraging the skills set of a transition manager even for cash injection while others do not. I would say that across the region, clients have a better understanding of the concept and value of transition management but are still learning about the different execution models and levels of price transparency that the various transition managers are offering. With investments expanding into global markets across equities, emerging markets and fixed income, clients are engaging more transition managers by selecting panel solutions rather than appointing a single provider to cater to all asset classes as they recognise these differences.

**JOHN MOORE:** In terms of variations in Asia, it all hangs around local regulatory issues. Take Japan, for instance: if you compare Japan to Hong Kong, the way transitions are contracted is totally different than you would see here in Hong Kong. Moreover, as market complexity increases, transition managers, must now have global support and be able to manage their event live across the world, and able to pass things around the world with ease. When the financial crisis hit, some transition managers jumped out of this market and those tended to be operations without a strong global infrastructure. Asian clients are keenly aware that they also need global support when they do these types of events, particularly as you have more complex fixed income events involving swap and hedging strategies. ►►

**NICK MCDONALD:** We are looking at how transition managers manage across asset class exposure and across time zone exposure and the use of tools, either derivatives or ETFs, and from that perspective I see more complexity rather than less. Let's take fixed income. Adrian said it is reasonably straightforward but I would say there are a lot of complexities in terms of the different styles or models that are out there between an agency and principal and they have different trading roles. Does that favour the broker/dealer or the agency model?

**JOHN MOORE:** Is that because the broker/dealers can't put up any more balance sheets?

**NICK MCDONALD:** Perhaps one of the broker/dealers in the room might be able to elaborate...

**DUNCAN KLEIN:** Certainly, we enjoy the challenges that come with increasing complex deals, and as Nick notes, the necessity for a transition manager to adapt to client needs to ensure the best delivery. While John points to regulation, I would say each client is different. Some clients impose non-negotiable transition management agreements, others are more open to signing a transition manager's agreement and you need to be able to adjust to the client requirements from a legal perspective. Some clients require you to contract under their local law whereas you're delivering the transition out of a different jurisdiction. To have that flexibility within a global organisation is another opportunity to differentiate one provider from another.

**FRANCESCA CARNEVALE:** What's important to the client side? Is it an agency-style model, or is it a custodian or proprietary structure, that appeals to you most?

**HEMAN WONG:** We segregate our assets into specific asset classes and we are more sophisticated than some other clients. So when we look for a transition manager, we have to ask ourselves a few questions. Obviously cost is one thing that probably very often comes up. But what about sophistication around a specific asset class? That is a key concern. Now, people all say that they are good and everybody will tell you that they have cause of capability because their asset size is back-paid. You would expect the major players to be more or less the same, but it is not always the case. You might also expect that whoever gives me the cheapest quote will get my deal, but that is not always the case. We have to delve very deep into the process to decide what form of transition manager is right for us and when.

**ADRIAN TENG:** I always wonder, whenever questions like that are asked: does it really matter? All this marketing that transition managers spend on, does it really change the landscape? A bank is a bank. Who really cares what colour they are, as long as they can deliver and, in fact, more or less, by and large, services tend to be the same. Fundamentally banking and/or transition management is a people's business and it is the relationships they have developed that count. It is the understanding of and the awareness between the client and the provider and by and large that is why, when someone moves to another organisation, the business goes with him or her and fundamentally that is how I see banking services. However, I also agree with Heman. At the end of the day it is



Heman Wong,  
executive director,  
Hospital Authority  
Provident Fund, Hong  
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the level of reach and expertise that a firm can bring to the table and it really needs to fit with the client's profile. Not every client requires the same level of sophistication and secondly, I, like many others, are not spending hours in my day dealing with transitions. I don't think there's a right or wrong way of selecting a transition manager. Are you buying Chanel or Gucci? Who really cares? A shoe is a shoe and a handbag is a handbag. Yes there are nuances that you decide one way or the other and it is really that—it is nuances—but then it is really the relationship with the account manager that really drives the decision.

**NICK MCDONALD:** What you're saying is that at the end of the day the objectives of a transition prior to doing it is the critical factor and everything else will fall into place after that. It is setting those objectives upfront is key.

**ADRIAN TENG:** Yes, it is a combination of months of deliberation and finally, a community of 20 people have made a decision. Frankly, it is a real pain in my life, and then when everyone else is happy we pull the trigger and we go get a transition manager or a fund administrator or a custodian. Then it is about deciding which is the best way to execute the transition; we do not think it is the transition manager's right to tell us how to do it; but we expect him to advise us about the best methods and minimizing costs. Hey, and if we can make money out of a transition, all the better. And there are some companies that maybe look into that as one KPI.

## THE UNBEARABLE LIGHTNESS OF NEW OPPORTUNITIES

**JOHN MOORE:** We're seeing opportunities in Japan with clients starting to look at some of the major changes and starting to diversify a bit more than they traditionally have done. Around the corner, there are new regulations in train which will start allowing clients to transfer *in specie* assets into and out of trust funds. It will totally change the investment landscape there. That means real opportunity for some as the size of the pie changes, as does the way things are done in Japan. In Australia we are seeing a lot of funds consolidating, mainly smaller funds, either consolidating with larger or other funds for capacity reasons. Within Asia, the opportunities are really around clients putting more and more money offshore in a lot of the countries. Here in Hong Kong it is probably a little different. People have been investing offshore quite a bit for a while, but in a lot of the Asian countries you're seeing more clients putting more money offshore, whether it is in equities or fixed income or emerging markets.

**JIM KARELAS:** With fund consolidation there are multiple levels of complexity and the funds typically engage the transition manager early on in the process to come up with indicative cost analysis. The complexities and challenges for a transition manager are greater as there are typically changes from a custodial, administration, investment strategy and manager perspective. The landscape is changing for the smaller super funds and in order to survive, scalability becomes very important.

**DUNCAN KLEIN:** In Asia we're seeing quite a few opportunities, as John mentioned, in clients starting to inject cash in global mandates. Hopefully over the next 12 months they will start leveraging the services of transition managers to implement the cash injections for them, especially when they start doing it across four or five different asset managers, because there is a huge benefit for them in understanding the cost of implementation of their full cash injection. The cost associated with half a billion to a billion invested could be significant, especially in volatile markets where we are often seeing more than 100bps of intraday volatility across assets and foreign exchange.

## EXPANDING THE SERVICES SET IN TRANSITION MANAGEMENT

**JOHN MOORE:** Whether it is the need for interim management, or the evolution of the transition manager into a trusted adviser, the fact is that clients are sharing more and more information with their provider. In fact, I would venture that transition management is becoming more and more of an asset management assignment. Similarly, I see the emergence of a closer relationship, maybe even a symbiotic relationship, between transition managers and specialist consultants. Say consultants that specialise in hedge funds or alternative investment strategies. You're going to have portfolio managers that are working with the clients on their general strategies and then you're going to have specialists below that, that are really helping them in fixed income and commodities, property events and those sort of things.

**DUNCAN KLEIN:** John highlighted the importance of a global team. It is critical to ensure that your team evolves alongside your clients' requirements. In that regard it is vital that your team is capable of delivering services that meet this market complexity, while maintaining client confidentiality. What you don't want is a transition manager that does not have the skill sets within the team and starts leveraging other parts of the institution to overcome their internal TM shortfall. This breaks away client confidentiality and might introduce concerns around conflict of interest. Having a global, dedicated and segregated transition management team is increasingly important as clients' mandates become more complex and global.

**JOHN MOORE:** That is a very good point. You hear these days that everyone is becoming an agent and that can be somewhat misconstrued. Maybe the contracting entity itself is an agent and acting as an agent, but they are in fact accessing other parts of the organisation. Where you start



*Jim Karelas,  
managing director &  
head of Asia-Pacific  
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management,  
Converge Group.  
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sharing information that is not used in an agency capacity and that has got to be clear. Clients need to be aware of how their information's being used; that the team that they're using is rowing with them and that the contract they have with the transition manager is being adhered to around the globe within that transition manager's organisation.

**FRANCESCA CARNEVALE:** Is part of that ensuring that transition managers are adequately recompensed for their work, so that they are not tempted to find remuneration elsewhere?

**JIM KARELAS:** There was a time when clients essentially looked to transition managers to pay for their flow. A lot of those clients realised that they were not getting good execution and as a result clients have come full circle and understand that you don't get something for nothing. Thus commissions have steadily increased and transition managers are being remunerated better than they were in those 'zero to pay for flow days', but there is still a long way to go. Along with that, transition managers have emphasised, particularly post-2008, the real difference between cost and risk. It is one thing to come up with an estimated cost based upon your commission, your tax, your spreads and your market impact. It is another to sit down and ensure that a client understands what risk is involved in that trade and the gain or loss that can arise particularly from the greatest marginal contributors to risk. As transition managers we're not in the business of gambling with the clients' portfolios. We must ensure that the client adequately understands the risk and that the risk can essentially become a cost. Then the derivation of an appropriate trading strategy, coupled with a firm's ability to source liquidity and provide competitive pricing, means that clients are paying for specialist expertise. I think that clients are starting to realise that they need to adequately remunerate transition managers based on the level of work they do, but they also need to ensure that their transition managers are giving them the level of expertise, resources and knowledge applicable to that commission rate.

**JOHN MOORE:** More clients are becoming aware that it is not a free service, that you need to pay for it. However, this is not true across all parts of Asia. It is a work in progress. In some countries there is still that illusion that you can get things free. Ultimately it is about education. Investment consultants play a very good role in that, in helping educate as well and bringing everyone up to kind of the same level.

**DUNCAN KLEIN:** It comes back to the fundamental question of transparency. Being transparent about your costs and ensuring that clients understand the remunera- ►►

tion you're going to get from their flow. That has to be clearly distinguished versus a commission that might be imbedded in the bid-offer spread. As long as a client understands the remuneration side, they're willing to reward the transition manager for that and that is a key element in a region where clients need to understand that there's no transition that is free. It is about transparency and cost, and what's the right word? Honesty.

**NICK MCDONALD:** Integrity. I think it is straight down to accountability, and accountability, in a lot of these organisations, needs to not only be on the direct cost side of things, in other words looking at commission rates and things like that, but the actual success of the transition and the performance of the transition. Now, that disconnect can happen quite easily where you're dealing with a finance team versus an investment team. I'd be quite interested from our asset owners, how you connect both of those together and ensure that there is accountability.

**HEMAN WONG:** We talk about sophistication in terms of product, but we are also seeing more sophistication in terms of willingness to pay for services. In part, asset sizes are much bigger now and transition management is much more affordable. People also recognise that because of the large size of some transitions, the transition manager delivers very efficient implementation and that means cost-saving, which would not be achieved if they did it alone.

## WHAT DO YOU WORRY ABOUT? EVENTS, MARKET EVENTS?

**ADRIAN TENG:** Market evolution is beyond the controls of the transition manager themselves or the client. It is the market development that is pushing evolution. Markets have obviously become more connected, more volatile, there are macroeconomic developments that forces one to have to think a lot more proactively. Why would I put money in European equities for the next five years? That is not something I would want to do. Similar, pockets of US equities. And, even given all of that, why am I not putting my money in China? There are ways to try and capture the economic growth of China without putting my money there. It is these developments that are forcing people to think more carefully. QDII or QFII will develop, but it is not the easiest way to invest right now. Is the transition manager able to support that kind of asset classes or that kind of transaction? Institutions and people at the top of the game or ahead of the curve, with execution transparency, will be the winners going forward.

**NICK MCDONALD:** The key thing is, as with any market event for a transition manager, risk management. Let's use the example of European debt, which has moved markets 2% to 3% during a portfolio transition. It is the ability of your transition manager and the strategy and risk management tools that they have, to be able to manage these events, that is key. To me it is not necessarily the market event, it is how transition managers can manage that market event accordingly and us being able to assist in that.



*Nick McDonald,  
principal, Mercer Sentinel.  
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**JIM KARELAS:** Typically the events that drive transitions are investment strategy changes that result in asset allocation shifts and/or investment manager changes. I'd say in the next few months, if there are any particular investment managers that have been geared toward European sovereign debt and if those portfolios aren't changed very quickly, then those investment managers will be "on the nose", if they're not already. If there's going to be any particular market event, it'll be investment managers that have been geared toward those particular markets, and those that haven't shifted quickly enough. That will trigger a transition event from a market-driven event. Otherwise it is fundamentals; this means bad performance, changes within the investment managers shop with respect to either personnel or investment process or maybe clients are looking to adjust their return profile by adjusting their risk profile.

**DUNCAN KLEIN:** Clients who are typically invested in AAA are not getting the yield that they need any more, so they're looking to break away a little from AAA securities and start adding on a little more credit risk. The other thing that is really a hot topic in any transition is the foreign exchange volatility. With recent appreciation of their local currency versus USD, clients are holding back on their international investment exposure as they are concerned that the additional yield gained might be offset by the increasing strength of their based currency *versus* the non-based currencies.

**HEMAN WONG:** In a volatile environment that is not most ideal for transition management to be made. You typically will avoid those sort of days to start trading. Now, if an event comes down to the fact that an asset owner must make a transition, the chances are often you have to move inactive management into passive management because you need a quick fix. You need quick action.

**JIM KARELAS:** That is a very good point in terms of looking at what those transition costs are to the outer cost performance of moving managers.

**JOHN MOORE:** We're seeing more clients looking at breaking up their fixed income portfolios more into segments such as global fixed income, global government, global corporate and the like. They have a little more control over the risk management themselves and being able to allocate between the two directly and manage that risk versus allowing a single investment manager too to make those shifts in and out and have less control—as we continue to have debt issues in Europe—more and more clients are looking at those options, they have that flexibility in-house to make those asset allocation changes.

**NICK MCDONALD:** That is the new benchmark.■