

# Transition Management: *Defining Transparency*

by Michael Gardner



Transparency has always been an important element of transition management – but what does it really mean? Michael Gardner provides a definition.

Transparency has become a central topic of the transition management industry. This is underscored by the fact that transition providers go to great lengths to demonstrate the transparency of their process in comparison to other providers. Additionally, consultants and performance measurement firms are starting new businesses to validate aspects of transparency within transition management engagements. As a form of self-regulation, the transition management industry has formed the T-Charter group in order to standardize terms and processes for transition management events. And still, the issue of transparency remains one of the primary concerns to clients and the focus of differentiating debates amongst providers.

What we should really be defining is “what is transparency?” When a transition provider, or a client, refers to transparency, what do they mean? Usually, this question refers to transparency in relation to compensation and fees for transition management services; however, explicit fees are only one aspect of the larger question. To understand and assess ‘transparency’ other fundamental elements of the transition process should also be considered:

**Transition Management Systems** – Transition management is a resource intensive, ‘high touch’ business. The provider must perform a considerable amount of cost analysis prior to order generation, followed by iterative risk assessments of the actual trading activity, and ending with trade settlement directly into the client’s account(s). The end-to-end process is far more involved than merely a programme trade. To successfully implement a transition, a variety of robust analytical, order management, trading and messaging systems are required.

So, how do various transition managers source these systems? Are they built and maintained internally or are they purchased from 3rd party vendors? If the latter, is the transition manager

granted access to these systems as part of a larger business arrangement and if so, what are the ramifications of this type of agreement? An example is where an executing broker supplies system resources in the hope of receiving order flow from a transition manager. How does this arrangement affect the best execution decisions and/or the total cost of the event?

There is nothing inherently wrong with either of these scenarios. In fact, each has its merits, however disclosure of the trading model, and its implications, are key to achieving true transparency.

**Brokerage Allocation** – Trade allocation is the next consideration which may not always be transparent. Does the transition provider utilize one executing dealer, or many, and what is the rationale behind this decision? Some argue that an internal only execution venue is best, while others suggest that using multiple brokerage firms per trade is best. The arguments will vary by asset class and by specific market. Here again, transparency is important in order to understand the decision and its implications.

Is the provider that owns its execution infrastructure (and discourages the business from trading with others) doing so in an effort to maximize profitability? Conversely, where a transition provider does not have direct market memberships, outsourcing execution is their only option. In this case, the question is whether the business is free to pick and choose between trading platforms, and if so, how this affects the transition process and the costs?

**Transition Management Fees** – Finally, clients should know what fees are generated within the whole TM process, not just the explicit fees that are paid to the transition manager. Transitions are typically large, complex events that involve many moving parts working in unison, or multiple service providers working together:

- Transition management (TM) fees – what is the provider charging for their services?

- Execution of securities – Is this incorporated into the TM fee?
  - If the provider is also the trading broker, then the client should require that the TM fee is the only form of compensation for that business and all of its affiliates.
  - If the provider outsources execution, then the client should understand if this fee is paid as a share of the TM commission (where the TM provider absorbs the cost of execution) or whether the fee is implicitly applied to the trade price by the last dealing entity, outside the TM provider and in addition to the TM commission (where the client absorbs the cost of execution).
- Execution of foreign exchange and hedge transactions – How will these transactions be executed? Fees and execution methodology should be explicitly stated.

In summary, the transition management model should be a moot point as long as the provider can describe and attest to how their process works, how they source the necessary resources for the business and how all fees are incurred, including the final recipient of those fees. For years, the industry has discussed transparency with each provider selectively highlighting various aspects of the process, and brushing aside or ignoring the rest. Perhaps what we really need to standardize is the definition of transparency and consider how each transition provider manages all elements of the process. In this way, the comparison amongst providers becomes more differentiated and the true cost of the transition becomes more clear.

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