After the seismic shifts in the global markets through 2007 and 2008, who should have been surprised by the equally powerful changes running through transition management? Back in heady days of 2005/2006, transition managers sat prettily on a rising volume of business and a blossoming profile in the asset management industry. There was much to look forward to: a substantive movement away from direct benefit (DB) towards direct contribution (DC) pension schemes; the onset of a muscular and seemingly far-reaching trend away from passive towards active and high growth asset investment styles; the explosion of funds of funds and the materialisation of a raft of alternative investments in mainstream asset management. Photograph supplied by istockphoto.com, December 2008.

THE NEW ARC OF BUSINESS

Transition management has been buffeted by fair winds and foul through the last two years. Not all transition management houses have stayed the course; but those that are still in the business have benefited from rising volumes and report a positive outlook for 2009. Historically, transition management was used almost exclusively for the movement of equity portfolios, but nowadays the complexity of asset movements vary widely and include fixed income and more occasionally foreign exchange, derivatives and private equity. The complexion of the business changed substantially through 2008 and will continue to evolve over the coming year as transition managers increasingly focus on mitigating opportunity cost, market impact and other trading and investment risks. What now in 2009? Francesca Carnevale reports.

THE NEWS THAT Citi shut its transition management (TM) businesses in Europe and the US came in a 2008 year-end shocker for both asset managers and rival transition management teams. The industry was rocked in the immediate pre-Christmas run up by the announcement, as Citi was among the longest serving investment banking providers of transition management services and its TM team consistently ranked in the top five transition client surveys. The bank's Asia-Pacific transition management operations, run under Michael Jackett-Simpson will however remain open for business.

The closure of Citi's US and European TM operations ended extensive discussions (carried on through late November and December) over proposals to restructure the business model. Various options were reportedly considered, including relocating the teams into the bank's Global Transaction Services (GTS) operations (essentially custody) or move it directly into the bank's trading floor (which, as every follower of modern day post-T Charter transition management knows is something of a no-go). Some of the nine jobs at risk over the announcement however might be saved by this latter proposal.

Citi's decision comes after the bank announced substantive cuts in overall headcount within its global capital markets business, where employee numbers are reckoned to be reducing by up to 20% across the board. Even so, the decision was something of a surprise as Citi's transition management business was understood to be profitable as a business unit, with a high revenues to cost ratio throughout 2008. No one in Citi's TM team have been available for comment.

Citi's loss could be another financial institution's gain if the team is swept up *en masse*, with a bulky client portfolio in their pocket. Equally possible is that the team will be cherry picked for their particular expertise by any one of the extant TM businesses that are now enjoying the fruits of a highly concentrated market. However, transition managers say privately that they expect market consolidation to continue through 2009 and that the number of transition managers who actively pursue transition mandates will continue to drop over the next two years, especially among investment bank providers. "Given the current cost-cutting environment, along with the transition business's relatively slim margins," says one transition manager, "I expect one or two houses to make either a soft exit from the business, or be swallowed up in a larger bank merger."

Citi's move is interesting nonetheless and perhaps indicative of the sometimes ambivalent relationship between equity trading and transition management in investment banking operations. The often arcane nature of the portfolio transition process, which is highly methodical, thoughtful and project based, often escapes the day to day concerns of trading operations. Moreover, while responsible for a sizeable chunk of trading flow through trading desks, transition management teams operate at a substantial distance from cash equities and portfolio trading. Although most of the time the relationship between in-house TM teams and the trading desks is optimal; at crunch times when headcount against revenue and trading flow is calculated, the benefits of sometimes fee-based business over flow-based (commission) revenue can be overlooked. It is particularly pertinent at a time when the relationship between transition management and portfolio trading has rarely been closer.

John Minderides, global head of transition management, JPMorgan. Minderides is adamant however that the expertise of transition managers is not in alpha generation, "but in minimising the risks and cost of the transition and in finding necessary liquidity". While implementation shortfall remains the most cited headline risk and the main measure of the success of transitions, some of the greatest risks in a portfolio transition continue to be "market impact and opportunity cost," he says. Even so, Minderides concedes that transition managers have evolved into trusted advisers for pension funds as market circumstances have changed. Photograph kindly supplied by JPMorgan, December 2008.

Nomura, for instance, was quick to pick up on the possibilities offered by a shrinking TM provider landscape when it bought the European trading operations of Lehman Brothers in the autumn of last year. The transition management team at Nomura is already understood to have a number of transitions under its belt in its new guise and will officially open for business in the early months of 2009. Other houses, such as JPMorgan's TM business, have been leveraging the body count elsewhere. JPMorgan now counts Jody Windmiller (ex UBS and Bear Stearns) among its 26 strong global transition team and is continuing to expand headcount as more business gravitates towards key houses. "We took advantage of the Bear Stearns acquisition to restructure our team," notes John Minderides, global head of transition management at JPMorgan. "We have had a net/net increase of five people, slightly against the trend, and we have brought Mike Gardner to London from the US to add strength in Europe." he adds.

After the seismic shifts in the global markets through 2007 and 2008, who should have been surprised by the equally powerful changes running through transition management? Back in heady days of 2005/2006, transition managers sat prettily on a rising volume of business and a blossoming profile in the asset management industry. There was much to look forward to: a substantive movement away from direct benefit (DB) towards direct contribution (DC) pension schemes; the onset of a muscular and seemingly far-reaching trend away from passive towards active and high growth asset investment styles; the explosion of funds of funds and the materialisation of a raft of alternative investments in mainstream asset management.

Transition management looked set for a golden era. So much so, that it felt able to pull itself up by its bootstraps and connect in an extensive debate on the merits of the business practices of a by then overly bulky transition management service sector. The resulting T-Charter set a benchmark from which both asset owners and transition managers could engage in meaningful and measurable debate and from which emerged a set of governing principles that are now undergoing further revision and upgrading. In its current iteration, the T-Charter is chaired by Inalytics chief executive, Rick Di Mascio, who is leading a specialist working group (comprising transition managers and consultants as well as representation from the National Association of Pension Funds [NAPF]) which is honing the charter into a substantive mechanism for pension funds to help them identify key issues when transitioning assets, including actuarial evaluation assessments; asset and liabilities study evaluation and the hiring and firing of managers.

Now though, and rather like its charter, transition management itself is changing. There are fewer TM providers for one thing. At its peak four years ago beneficial owners had to choose from more than 29 headline providers of the service. Today some 17 transition management operations are listed on the Inalytics site (though as mentioned earlier, the European and US operations of Citi are now closed). Credit Suisse, another mainstay of transition management, restructured its operations, losing a few members of its London-based team headed by Graham Dixon, and restructuring all operations on global lines through its New York-based US team, guided by Hari Achuthan and Lance Vegna.

Second, there is a something of a fault line developing between the US and Europe in the scope, if not the practice of transition management. The US walks to the tune of a different beat where there is a different relationship between transition managers, which are regarded as fiduciaries, and trustees. Moreover, in the US, the evolution of trading and risk management technology has shifted the primary focus of transition management from operations to risk management, with the preservation of the value of a client's assets the most important aspect of the transition. In last year's report by the Boston based TABB Group on

Mark Dwyer, vice president UK sales, Mellon Transition Management, transitions involving non-governmental bonds sometimes forced transition managers to hold assets longer than usual. As Dwyer notes, "you can spend a long time looking for a competitive price for a particular bond," however, he adds, a lot of the issue is "price discovery. Photograph kindly supplied by Mellon Transition Management, December 2008.

The Optimal Transition: Mitigating Risk and Minimising Market Impact the introduction of new trading technologies, such as dark pools and crossing systems, were held to have helped minimise the execution risks associated with information leakage and opportunity cost. In addition, the report cited the agency-only brokerage model as being "on the cutting edge of trading technology," because of the need to be efficient at finding liquidity.

In the event, this was fine as far as it went with equity transitions and the US marketplace. In Europe, the heart of the matter lay elsewhere as fewer transitions were equity only. Over the last two years fixed income has become an escalating feature in portfolio transitions in Europe. "Fixed Income has accounted for around 50% of transition business in 2008," notes Lachlan French, head of TM at Barclays Global Investors (BGI). Moreover, alternative assets, such as hedge fund strategies and occasionally private equity have also featured with multiple asset class transitions increasingly the norm, "with some of the larger transitions involving multi-managers. We've restructured a broad range of strategies including active to passive equity and bonds, corporate bonds, two way flow in index linked bonds, government bonds, sovereign wealth funds and emerging market debt," explains French.

This growing level of complexity is set against particular market challenges, of which "Liquidity is the key challenge in this environment," notes Hari Achuthan, global head of transition management at Credit Suisse. In fixed income, for example, credit spreads have been healthy and

increased significantly compared with 2007, he notes with demand continuing high in 2008.

The market in asset backed and mortgage papers in particular stagnated, turning them into virtually untradeable assets. That means says Mark Dwyer, vice president UK sales, Mellon Transition Management, transitions involving non-governmental bonds sometimes forced transition managers to hold assets longer than usual. As Dwyer notes,"you can spend a long time looking for a competitive price for a particular bond," however, he adds, a lot of the issue is "price discovery. The recorded value you have for an asset is not necessarily the same as a price traded in the market; while this may be an opportunity for a buyer, it might also be a problem for the seller. Our job is to secure maximum value."

The rise of fixed income transitions does have an impact on who can deliver the best TM process and that means: "those houses with a strong fixed income capability who are also a strong counterparty," says Achuthan. The ability to tap into fixed income trading expertise or fixed income asset management expertise is key. Moreover, the growing complexity of some of the larger transition mandates sometimes require transition managers, "to integrate their approach with asset management skills," adds Mellon's Dwyer. That plays to the strength of houses such as BGI, BlackRock (for Merrill Lynch) or Standish (in the case of Mellon). Key to success in any transition, especially complex transitions, Achuthan adds is "the specialist expertise and experience he can provide in physicals and derivatives, dedicated resources and true multi-asset class capability".

JPMorgan's Minderides is adamant however that the expertise of transition managers is not in alpha generation, "but in minimising the risks and cost of the transition and in finding necessary liquidity". While minimising "market impact and opportunity cost" (implementation shortfall) remains the main measure of the success of transitions, some of the greatest risks in a portfolio transition continue to be market and exposure risks, the tracking errors between legacy and target portfolios and the corresponding delays in implementation, he says. Even so, Minderides concedes that transition managers have evolved into trusted advisers for pension funds as market circumstances have changed.

Going forward, the picture is not yet clear, though Credit Suisse's Achuthan thinks there will be something of a rebound in equities by the end of the first quarter this year, "or at least the beginning of the second quarter, though everyone is waiting for the markets to stabilise," he concedes. JPMorgan's Minderides believes that "when volatility reduces, then funds will likely need to buy equities to rebalance to their benchmarks," though he notes that the workings of benchmarks may need to be revisited after the current crisis is over. "Either there may be a demand for new indices or for the methodology of some existing indices to be revisited: current approaches to rebalancing exposures and weightings in markets that have moved dramatically can result in large increases in exposures to particular issues, which may not be desired from a specific risk perspective."

Lachlan French, head of TM at Barclays Global Investors (BGI). "We've restructured a broad range of strategies including active to passive equity and bonds, corporate bonds, two way flow in index linked bonds, government bonds, sovereign wealth funds and emerging market debt," explains French. Photograph kindly supplied by Barclays Global Investors, December 2008.

According to BGI's French, "The value of fixed income has increased as a percentage of the average fund. In general, I think we find people are moving back to basics and moving away from the more complex and opaque investment structures. We are also seeing funds taking advantage of investment anomalies as they occur, for example we have recently seen buyers of index linked gilts which are currently yielding more than index linked inflation swaps despite the superior credit risk. Will this increased weighting towards fixed income change? Will deficit schemes go into equities or bonds? These are the long term questions that need answers; but few are forthcoming. We will have to let the dust settle before the way forward in terms of asset allocation becomes clear."

In terms of transition management itself, some things will remain constant for the foreseeable future. Outside of Australia and New Zealand, which remain competitive markets, Asia remains a new frontier; though with fewer houses providing transitions, Europe, the US and the Middle East remain fertile grounds. "RFPs remain important," says Mellon's Dwyer, though as Dwyer and BGI's French note, some clients are by-passing the RFP altogether as repeat business and relationships come to the fore. As Dwyer observes: "there is the beginning of a flight to quality in transition management, and well-established houses with multi-asset capability will be the ones to benefit from this trend."