

# The expanding role of transition managers



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The transition management industry found itself in the news as never before as it struggled to agree a common set of standards known as the T-Charter. *Global Pensions* gathered some of the key players in the industry for a Chatham House rules debate. In keeping with these rules, no individuals are directly quoted, so as to facilitate free flowing and open discussion. Reporting by **Alex Beveridge**

Unsurprisingly, given the current market dislocation, volatility was a major topic amongst managers attending the *Global Pensions* transition management lunch debate.

Transition managers noted there was now a marked caution amongst some clients when it came to carrying out transitions. This was especially true when it came to fixed income, where there was hesitancy when it came to testing what bids there were in the market.

Managers agreed they had to spend more time explaining to clients the implications of market volatility, as well as explaining hedging strategies. Some pension funds were described as being very aware of the potential problems, while there was also a consensus there was a vital role for consultants to play in the organisation of transitions.

It was noted that over the last six months managers had been able to add a degree of realism to the debate over whether a pension fund should actually proceed with a transition. Providing a stop or go signal for clients was now seen as a valuable service in its own right.

Transition managers also claimed to be increasingly playing the role of adviser – sometimes at the risk of losing short term business – advising clients to stay put unless there was a desperately pressing reason to switch managers or re-allocate portfolios.

One player said that while many clients were very aware of the potential dangers of transitioning in a volatile market, others required a combination of both the transition manager and a consultant to explain the situation.

Good project management was also flagged as an ongoing issue managers had to work on – participants added it was vital a firm showed commitment to its transition management business.

## Fixed income

One manager noted that on a practical level, fixed income portfolios were presenting new challenges. He said portfolios which had credit which only a year ago was considered conservative now found it was no longer judged to be high quality.

The manager said his firm was attempting to segregate any credit aspect of a fixed income portfolio and asking the client for extra time to make the trade. He said that sometimes he could only get a bid when the market maker had the other side of the trade, a process which could take a several days. He went on to say there was often an attempt to segregate the hard to trade segments where possible, and then find a cash alternative to fund the new asset manager.

It was also claimed the credit crunch had scared trustees into questioning the actual value of their fixed income portfolios. He said that in the

current climate of absolute illiquidity there was a buyers' strike, meaning that some fixed income was only worth what people were willing to pay for it.

Given the unknown nature of the credit crunch, it was agreed it was incumbent on transition managers to use their experience of the changes in process to help both consultants and investors better understand the new dynamics of the market.

There was, according to one manager, a dawning realisation there was a cost to portfolio improvement, and that while this cost was once relatively minor, it was now growing.

It was also noted fixed income was now an increasingly important part of pension fund portfolios, especially as liability driven investment (LDI) gained popularity.

This meant pension funds paid closer attention to their fixed income managers' performance, leading in some cases to a greater willingness to dismiss even slightly underperforming managers. However, pension funds were warned this was no longer such a simple process, making it vital any changes were well thought through.

## Breaking the news

Panel members also discussed the fact many bond portfolio managers had incorporated some fairly esoteric instruments in their portfolios. It was suggested that in many cases clients were only now beginning to realise what they owned.

Ultimately, some panel members felt it would be the transition manager who would be the first person to let an investor know what the actual current value of a given part of their fixed income portfolio was worth.

Transition managers were having to ask the question: How are you actually going to manage the risk profile of this during the transition, when you don't know how to price the asset and it turns out some of the instruments are a bit obscure?

One transition manager said he had in effect talked himself out of doing transitions because



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he had pointed out to clients looking to switch fixed income manager that their current manager might actually start to perform in the current environment. He said it was sometimes unwise to trust the statistics of a new manager – given the actual valuation problems. When this was added to the fact the transition would also end up being expensive, clients sometimes calculated it was more prudent to stay put.

The panel agreed that in these cases most clients would value the advice they received from the transition managers and reward them with loyalty in the future.

### How the T-Charter has changed the perception of the industry

Panel members all agreed the T-Charter, the voluntary code of conduct, signed by the majority of transition managers in October 2007, had increased the level of trust pension funds had in transition managers.

Transition managers and consultants accepted the vast majority of clients only interacted with the transition management industry infrequently. It was also noted that even prior to the T-Charter, pension funds had not rejected using transition managers because of a lack of trust.

One veteran of the industry said he had noticed a shift in attitude from where transition managers were simply a necessary afterthought, to where they were often an integral part of the planning process. He said he had noticed this change across the globe.

There was also a change in the way transition managers were employed, with greater emphasis given to due diligence during manager searches and the increasing use of a panel of transition managers. This was all seen as evidence transition managers had moved up the value chain for pension funds.

It was also argued the publicity surrounding the introduction of the T-Charter, with the industry being seen to be actively trying to improve transparency, had helped highlight the usefulness of the services provided. In volatile or difficult markets, it was suggested transition managers were now regarded as a necessity and not a luxury.

Other panel members also believed transition managers were now able to add value to even relatively small pension funds. As investment returns become harder to come by, the point was put forward that a good transition could be the difference between a year of positive returns and a year of negative returns.

### The T-Charter – phase two

All of the participants at the debate were representatives of firms which had signed up to the T-Charter or been involved in its inception. It was felt that six months after the agreement had been reached, the time was now right for the group to reconvene and discuss issues related to measurement, both pre- and post-transition.

One participant was keen to push the objective of achieving a standard format for measurement.

There was also discussion as to whether there should be more work done on post-trade analysis and reporting. It was suggested most T-Charter signatories wanted to use implementation short-fall (IS) as the true measure of a transition's success.

Some said they had been taken by surprise at the level of interest expressed in the rest of the world – especially the US – in the T-Charter, with some pointing out that pension funds there faced very similar issues to their UK counterparts when it came to choosing and assessing transition managers.

While some people favoured broadening the reach of the T-Charter globally, others questioned whether this would impede future progress. This was because it would raise the number of participants, increasing the likelihood of disagreement.

Also on this point, concern was raised the T-Charter was not necessary in the US because ERISA regulations give such a clear idea of who or what a fiduciary is. However, the counter argument to this was the T-Charter was still a guide for pension funds when choosing a transition manager, and was not there to supersede any local legislation.

It was pointed out that legislation did not prevent a transition manager doing a bad job and the T-Charter helped pension funds understand the operational side of transitions.

### Advising pension funds

There was, according to one panel member, increasing use of transition managers at the asset allocation stage by some investors. This would occur when the client was considering moving into a new product or asset class. The transition manager could then give an idea of the cost of this switch, which in turn could inform the decision as to whether it was still worth pursuing an interest in a given product. It was suggested this kind of interaction meant transition managers and their clients got to understand the workings of each other's organisations better.

Some transition managers also felt their business often sat well within the pensions advisory section of their firms, this was particularly true of the investment banks.

Transition managers also claimed there was a place for them to help pension funds as they diversified their portfolios into alternatives. One manager pointed out there was often a significant time lag between a pension fund deciding to allocate to alternatives and implementation. He said transition managers offered products that could give exposure to alternatives while the pension fund actually went through the process of choosing a manager.

It was also said there was a service to be offered in the cases where pension funds wanted to extract themselves from what could be termed esoteric investments, where counterparties were not always immediately clear.

On another issue, the argument was mooted that there was some blurring of lines between transition management and asset management when transition managers held onto assets for a



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number of months to facilitate the best trade. It was agreed this should only happen with the full understanding of the client.

Amongst the transition managers, there was a degree of concern some investment consultants were not able to keep up with the rate of change in the industry. One manager complained that while some consultants had an entire team dedicated to researching and evaluating transition managers, other consultancies had just one person who researched them alongside other day to day responsibilities.