

IN TRANSITION

Topics in Transition Management



Mellon Transition Management Services

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FOREIGN RELATIONS:

Operational Challenges of Global Transitions

In last quarter's newsletter, we considered the question of when to implement asset transitions. It should go without saying that it's vital to confirm that markets are open before planning your next transition trade.

For single market restructurings, transition management may be considered one part portfolio management and one part project management. When the transition involves multiple markets, time zones, languages, and settlement conventions, it may be more accurate to describe transition management as one part portfolio management and *three* parts project management. Below are some of the items requiring special consideration when executing a multi-country transition.

Selected December 2006 Market Holidays

Sun	Mon	Tues	Wed	Thur	Fri	Sat
					1 Mexico	2
3	4 Sri Lanka	5 Thailand	6 Finland	7	8 Argentina Austria Chile Colombia Peru	9
10	11 Thailand Venezuela	12 Mexico	13	14	15	16 South Africa
17	18	19	20	21	22	23 Japan
24 Bulgaria Chile (E-H) Czech Republic Estonia	25 Argentina Australia Austria Belgium Brazil Canada Croatia Chile Colombia Croatia Czech Republic Egypt Estonia Greece Hong Kong Hungary India Indonesia Ireland Italy	26 Latvia Lithuania Luxembourg Malaysia Mauritius Mexico Peru Philippines Poland Singapore Slovak Republic South Africa South Korea Spain Sri Lanka Sweden Switzerland United States	27 Australia Austria Belgium Bulgaria Canada Croatia Czech Republic Estonia Denmark Finland Germany Greece	28 Italy Latvia Lithuania Luxembourg Netherlands New Zealand Norway Poland Portugal Slovak Republic South Africa Spain Sweden	29 Australia (H) Brazil Columbia Japan (E-H) South Korea (E)	30 Philippines
31					5	6



SUB-CUSTODIANS

Investors unfamiliar with trading markets outside of their home country be warned: don't take even the most basic tasks for granted! Many investors elect to hold global portfolios in commingled (or pooled) funds and with good reason – it can be costly and time consuming to open and maintain global investment accounts. This presents problems when it comes time to transition from one global portfolio to another as the necessary settlement instructions may not be in place to conduct the transition trading.

While non-domestic markets may celebrate unfamiliar holidays, ascertaining whether a given market is open on a given trade date is the easy part. Global transitions present many more imposing challenges.

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Any trading needs to be done in an account (typically a segregated transition account or the terminated manager's account), but in some markets, it may take days – even weeks – to process the necessary but sometimes Byzantine regulatory paperwork.

COUNTRY	TIME GENERALLY REQUIRED TO OPEN ACCOUNT
Brazil	5-7 business days
Chile	5-8 business days
China	3-5 business days
Egypt	5-7 business days
Hungary	3-5 business days
Malaysia	5-7 business days
Poland	3-8 business days
South Korea	5-10 business days
Switzerland	5-7 business days
Thailand	5-7 business days
Turkey	5-7 business days
Venezuela	6-8 weeks*

*That's right, weeks!

Source: MTMS, 2006

SETTLEMENT BLUES

Global capital markets have been moving toward universal standards in numerous respects, but many different markets still have varying settlement cycles which can present funding challenges around transitions. For example, Israeli equities settle next business day while South African equities settle on trade date plus five business days (T+5). If an investor is selling out of a South African equity portfolio and purchasing an Israeli equity portfolio, how does the transition manager address the funding mismatch created by the different settlement cycles? This problem becomes even more acute in countries like South Korea and Taiwan where purchases cannot be initiated until the exchange verifies that an investor has posted sufficient funding in the local currency.

Beyond varying settlement cycles, investors in transition need to be aware of settlement penalties that various exchanges may exact on investors who fail to meet these deadlines. On one end of the spectrum, the United States rarely enforces “buy-ins” or “sell-outs.”¹ On the other end, some countries impose a “no-fail” environment with draconian fines meted out for any violations. Below are some examples:

COUNTRY	POTENTIAL PENALTIES FOR SETTLEMENT FAILURES
Brazil	Fails on the Brazilian market are rare because the penalty fees are high. The <i>Bolsa de Valores de São Paulo</i> (BOVESPA) initiates an automatic buy-in on T+4 and imposes a penalty fee of .2 percent of the value of the transaction.
Egypt	For less liquid securities, should a trade fail on contractual settlement date, the Settlement Guarantee Fund will impose a daily delay charge of .5% of the total trade value until shares are delivered.
Indonesia	KPEI imposes a penalty system called “Alternate Cash Settlement (ACS)” whereby the selling party who fails to deliver stocks on settlement date (SD) obliges to compensate the buying party with cash on the same day. The ACS amount is 125 percent of the highest market value of the shares from cash market (SD=T+0) and regular market (SD=T+3) for the same settlement date.
Japan	If the failed position is not resolved by initial settlement date +4, the Japan Securities Clearing Corporation will institute a buy-in against the failed participant which is 10 percent above the closing price of the day for the particular security.

Source: Mellon Global Securities Services, 2006

¹ A “buy-in” can occur if a broker or dealer does not deliver a promised security to a purchaser. The purchaser can notify the agent, and within 48 hours of the notification can buy the security on the open market and charge the delinquent agent with any losses incurred. A “sell-out” is the inverse mechanism for failed receipts.

VARIOUS AND SUNDRY FEES, TAXES, LEVIES, AND DUTIES

As every worker around the world knows, each sovereign nation imposes, collects, spends, and regulates one thing in common: taxes. Regardless of what it's called (SEC Fee, PTM Levy, or VAT) it all means the same thing when it comes to transitions: lost value. In the US, the Securities and Exchange Commission (SEC), receives what is called an "SEC fee" on any sales of listed securities in order to "recover the costs incurred by the government, including the SEC, for supervising and regulating the securities markets and securities professionals".² Fortunately for investors, the fee is negligible and rarely impacts investment decisions.

In some countries, however, transaction surcharges can be so severe that transition managers may occasionally need to manage around them. The United Kingdom and Ireland, for example, impose significant stamp taxes on listed security purchases which can be especially problematic during a transition. For the uninitiated, the natural inclination with every transition is to identify and then transfer any securities which can be moved "in-kind" or "in-specie" from the legacy to target portfolio.

Such securities generally incur zero explicit or implicit cost – the equivalent of transition nirvana. In Ireland and the United Kingdom, however, such transfers – if they involved a commingled fund and a change of beneficial owner – could actually be subject to double taxation.

Generally, sub-custodians refer to transfers as sales and purchases. The existing custodian will put up a sale of the in-kind securities with the sub-custodian name as the nominee and then deliver on behalf of the client account. The receiving custodian will put up a purchase of the in-kind securities with their name as the nominee and for the benefit of their client account number. The sub-custodian may not post the charges until months after the transition event. For this reason, an expert transition manager may occasionally commit apostasy and actually recommend that legacy managers liquidate such securities and transfer cash to the new target managers in order to circumvent this pitfall.

RE-REGISTRATION MAZES

The cost of registering securities in the name of the beneficial owner varies from country to country. The below example quantifies how this may translate into an additional level of transition-related fees.

Country Code	Country	Sell Side	Buy Side	MARKET FEES & TAXES	Sell Fees	Buy Fees
GR	Greece	0.210%	0.060%	Transfer Fee: 0.06% Stamp Duty: 0.15% (Sell only)	1,943	-
HK	Hong Kong	0.110%	0.110%	Levy: 0.005% Transaction tax: 0.005% Stamp Duty: 0.1% (rounded up to the nearest dollar)	3,959.1	6,198
ID	Indonesia	0.159%	0.059%	Exchange fee: 0.01% & Levy: 0.03% & VAT: 0.019% & Sales tax: 0.1%	-	744
IE	Ireland	0.000%	1.000%	PTM Levy: 1 GBP Flat Fee On Consideration Over GBP 10,000 Reserve Tax: 1% (On Buys only)	-	7,703
MY	Malaysia	0.140%	0.140%	Stock Clearing Fee: 0.04% (maxed at MYR200) Transfer Stamp Duty: 0.1% (maxed at MYR200)	-	3,760
PT	Portugal	0.015%	0.015%	Stock Exchange Tax: 0.015%	112	158
CN	China	0.076%	0.076%	Clearing Fee: 0.05%, SE Fee: 0.0255%, VAT Duty: 0.0003%	-	4,189
ZA	South Africa	0.000%	0.250%	MST: 0.25% (On Buys only)	-	15,421
SE	Sweden	0.000%	0.000%	NIL	-	-
CH	Switzerland	0.010%	0.010%	Stock Exchange fee: 0.01%	1,830	756
TW	Taiwan	0.300%	0.000%	Sales Tax: 0.30%	-	-
TH	Thailand	0.018%	0.018%	VAT: 0.0175% (7% of local comm (0.25%))	-	222
GB	BRITAIN	0.000%	0.500%	PTM Levy: 0.25GBP Flat Fee On Consideration Over GBP 10,000 Reserve Tax: 0.5% (On Buys only)	-	90,226
					7,844	129,377

Source: MTMS 2006 based on a \$1 billion global transition

² <http://www.sec.gov/answers/sec31.htm>

NON-TRANSFERABLE SECURITIES

As noted above, for tax reasons, investors may be ill-advised to transfer securities between legacy and target portfolios in certain countries. In other countries, securities may be out-right or *de facto* non-transferable. For example, odd lot positions in Japan (generally anything less than 1,000 shares) cannot be transferred. This leaves the investor with the burden of going back to the issuing company to redeem any odd lot shares or to simply write off such positions.

Greek, Taiwanese, and South Korean securities may also be problematic to transfer so the transition manager must take great care when dealing with these countries.

GLOBAL SECURITIES ON LOAN

Finally, investors should remember that before initiating their next global transition they may need to allow additional time to call back any securities that they may have out on loan. Different countries may require different periods for notification either due to regulatory measures or practical considerations.

When It Comes to Transitions, Follow a Sound Foreign Policy

The world operates under many Geneva Conventions, Warsaw Pacts, Kyoto Protocols, and Basel Agreements. Expert transition managers can help clients facing global transitions to navigate the minefield of ever-changing rules and regulations – don't leave home without one!

MTMS offers global transition management services designed to assist clients rebalance asset allocations, enter new investment strategies, or liquidate existing portfolios. Mellon has provided transition services to clients since 1983. Headquartered in San Francisco and with a global presence, MTMS offers a proven process designed to mitigate operational risks, lower transaction costs and reduce the administrative burden for client sponsors.

Please feel free to contact us should you have any questions or desire additional information.

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