Talking Transitions *with* Penserra

SERIES 2 | ARTICLE XI

Transition Management – Making the Life of OCIOs Easier

With the growing demand for outsourced investing by plan sponsors in today's marketplace, it comes as no surprise that the challenges placed upon the outsourced providers (outsourced CIOs, or OCIOs) are arduous.

As a co-fiduciary to the plan assets, and having full discretion, these OCIOs must expeditiously implement the complexities of a customized investment solution while carefully managing a given risk budget. This can be particularly daunting during the onboarding stage of an engagement as existing (or legacy) investments are being shifted over to the targeted OCIO asset allocation model. By delegating this initial task of transitioning assets to a specialist with the proper expertise and skill set, it can demonstrate prudence on the part of OCIOs and even improve their competitive advantage.

▶ Reduced Onboarding Cost

As an extension to the various OCIO platforms out there, the use of transition management can be a very effective tool in managing the opportunity cost of executing an end strategy. An experienced transition manager, for instance, can provide a full analysis (both qualitative and quantitative) of the implementation, oversee the entire process from start to end, devise a cost-effective, risk controlled trading strategy and offer complete trade execution capabilities at the onset of an OCIO relationship. This can be advantageous to those OCIOs who pride themselves to converting their new clients over to the new model in their entirety (instead of in piecemeal), align performance tracking with their underlying investment managers, and want full control of the plan as quickly as possible.

Acting as a fiduciary, a transition manager can use cost models and risk datasets to determine the optimal trade-off between market impact and opportunity cost, and create a quantitative framework to specifically model portfolio liquidity, estimated trading costs, and the active risk between legacy and target portfolios. From there, a range of options can inform tactical recommendations about how, when, and where (i.e., execution venues) to trade. Through the use of sophisticated trading platforms and internalized applications, a transition manager is able to closely monitor the various markets/exchanges simultaneously and source liquidity with best execution in an effective fashion.

- Mapping and executing the logistics
- Dealing with investment managers, custody operational teams, and record-keepers
- Completing the various forms and letters of instruction
- Ensuring all parties complete deliverables within the given timeline

Transition managers both manage and coordinate transitions so that OCIOs to focus their own attention on what they do best.

Additionally, the commission rates of a transition manager tend to be lower and more competitive than those charged by traditional investment managers. As the only source of revenue earned for a transition manager, these rates include a bundled full-service package of project management, portfolio management, risk management and trading. This can significantly relieve OCIO staff members from the time-consuming efforts of dealing with the administrative and operational elements of onboarding at no incremental fee.

▶ Customized Risk Management

While OCIOs have the resources to identify, map and coordinate the various cash fund flows when redeeming investments to the new model, they are unlikely to have the experienced insight to handle potential exposure issues that may be arise.

A good example is where legacy investments from a new client are comprised of entirely multi-asset class mutual funds. If it is determined that these transactions can only be done in cash (with the final amount not finalized until after the NAV is struck late on redemption date) then, in order to line up the redemptions to the fundings, an estimated cash amount would be placed with each of the targeted investment managers based on how much cash is expected to be raised. This could potentially leave portions of the legacy investments out of the market. Once the actual proceeds from the redeeming mutual funds are known, subsequent cash contribution orders with the respective target investment managers can be placed as 'true-up' investments.

Now, if the aggregate 'true-up' investments (cash that was left un-invested) are deemed significant, a transition manager can offer temporary exposure solutions through the use of futures or ETFs until those funds are eventually invested with the targeted investment managers.

▶ Provide Flexible Funding Options

An extra layer of complexity can be added when legacy investment redemptions are made in securities (also known as 'inkind redemptions'). While this ability to accept investments in security portfolios can help mitigate out-of-market exposure for a new client, it can be burdensome to OCIOs. Along with the operational logistics involved with asset movements, one would need to properly evaluate the client's current holdings, identify any securities already held by the client that the targeted investment manager would like to continue to hold (a cost savings to the client), estimate the cost to sell the residual securities and cost to purchase the targeted investment manager's portfolio, evaluate the active market risk between what the client currently holds and what the targeted investment manager would like to hold instead, and full transparency as to the explicit and implicit costs of transitioning assets.

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By working with a transition manager, OCIOs can present the above projected costs and risk numbers as well as a strategy recommendation prior to the actual restructuring of the assets in the marketplace. After the completion of trading and transfer of the newly built portfolios to the targeted investment managers, a post transition analysis report would be generated to inevitably answer questions of "what did it cost?" and "how did the onboarding go?"

As a core function of their business, a transition manager is fully capable of managing a project involving cash, securities or both while being focused within the projected budget and timeframe.

▶ Conclusion

In many respects, the advantages of using a transition manager are very much the same as those marketed by OCIOs to plan sponsors – to efficiently 'fill in the gap' with experts and remove any undue risk placed on the plan assets. The ability to partner with a trusted provider, who can assess and manage risks, lower transaction costs, execute and report on performance, can be an appealing proposition to OCIOs looking for a comprehensive onboarding service offering and added benefits.

Note: Certain sections have either been paraphrased or taken as excerpts from previously written Penserra articles.

Turn to Penserra to deliver the investment, trading, and operational expertise you require for a seamless transition.

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