Talking Transitions *with* Penserra

SERIES 2 | ARTICLE IX

Understanding Defined Contribution Transitions

With more and more interest from plan sponsors, we have received a number of queries this year relating to transitions in a Defined Contributions (DC) plan. These include 401k-specific request for proposals, pre-trade bids, and opinions as subject matter experts ("Transition Managers grab more DC business." *Pensions & Investments*. June 2015). Plan sponsors want to know how DC transitions vary from Defined Benefit (DB) plans and what approach and experience is needed by a transition manager to successfully evaluate and execute such an event.

▶ Differentiating DB and DC transitions

While the investment approach to transitioning assets for a DC plan is very similar to the process for a DB plan structure, there are certainly a few key differences as the following table indicates.

	DB Transitions	DC Transitions
Trading Horizon	Flexible	Set trading period determined over a month in advance
Stakeholders	Plan sponsor, consultant, custodian, investment managers and transition manager	All parties identified to the left plus the recordkeeper
Planning and Coordination	Moderate (a week or less)	Extensive (6 - 8 weeks)
Types of Risk	Trading, investment and operational	Trading, investment, operational and headline (for the plan sponsor)
Recording Transition Cost	Absorbed with the investment	May be absorbed by the plan sponsor (with no impact to the underlying participants)
Reporting Requirements	Flexible (daily, weekly or monthly)	Stringent (daily)

▶ Approach by a Transition Manager

Given the unique elements inherent in DC transitions, including having to pre-notify all underlying participants, it is critically important for a transition manager to identify and mitigate all trading, investment and operational issues well in advance of the transition start date.

A transition manager must be well aware of the DC transition challenges, the special handling requirements, and ways to customize a solution given a set of expectations.

As part of orchestrating a DC transition, the following key areas must be actively addressed:

- Transition Scope Understand the asset type(s), legacy and target fund structures and fund deadlines/constraints.
- Custody/Record-keeper Requirements Confirm each group's needs to ensure accurate and timely trade processing, settlements and publishing of daily unit valuations (NAV).
- Exposure Management Identify any potential exposure issues as assets are being transitioned from the legacy to target portfolios; consider utilizing futures/ETFs (if allowed by the plan) to either maintain or gain temporary benchmark-like returns.
- Trading Analyze the securities to be traded to assess liquidity, problematic assets/markets, and create a thorough cost versus risk quantitative framework. Determine if a 'blackout' period (restricting all asset movements and participant activity) is warranted.
- Participant Activity If there is no blackout period, carefully manage the event's liquidity (to address daily participant flows) while maintaining appropriate exposure levels.

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▶ Experience Matters

A transition manager should be able to offer a comprehensive framework for managing and meeting the specific goals, objectives and constraints faced by DC plan sponsors. They must be well-versed to oversee the project management (planning and coordination) and operational intricacies, from start to end, providing:

- A project plan with a clear and defined timeline, all required deliverables/deadlines, mapped-out investment flows and key contacts.
- In-depth interaction with involved parties; includes updates and daily summaries to stakeholders.
- A trading strategy that is risk-controlled and as seamless for plan sponsors and their underlying participants as practicable.
- Careful cash and exposure management.

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

Contact Us
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