GOVERNANCE

The need to transition

From diversification to consolidation, Andrew Williams **explores the transition management trends across Europe**

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Transition management is the name commonly given to process of managing changes to a pension fund's portfolio of assets. So, what are the main recent trends in transition management amongst pension funds across Europe? What are the benefits and disadvantages of transition management? And where in Europe is the management process is being used the most?

Cost management

According to Citi head of transition management – EMEA, Artour Samsonov, the two main recent trends in transition management amongst the company's pension fund clients have been a greater focus on managing costs, including the pooling of resources across schemes and investment management teams, and a shift in investment focus from active to passive management – due to the "lower cost and strong performance of passive funds".

Elsewhere, Northern Trust global head of transition management Ben Jenkins reveals that a major current focus of the company's European clients is on asset allocation speed – with asset owners moving quicker when they need to make a change in response to a "more global marketplace" and "increased volatility".

"To make this successful, our clients are often engaging transition management services early to apply tactical hedges to achieve their desired asset allocation, ahead of making physical changes to their portfolios and asset managers," he says.

Jenkins also singles out increased asset diversification as another key trend – leading asset owners to use transition management services as a "particularly valuable solution in reducing operational risk" as they continue to expand asset allocations into new vehicles and regions.

Meanwhile, Russell Investments Implementation Services head of transition management – EMEA Chris Adolph argues that recent departures from the transition industry in EMEA in the form of State Street and Cantor Fitzgerald suggest that consolidation is still ongoing.

"In terms of investment trends, they very much mirror what's happening in the broader pension markets in the different regions within Europe. Broadly speaking the search for yield still dominates, so there remains an increase in transitions involving higher yielding fixed-income securities, like emerging market debt and high yield, as well as multi-asset transitions," he says.

"As transparency and governance continue to be a focus for pension funds, in some markets, like France and Italy, you are also seeing the development of a fully delegated version of transition management, where a brokerage approach has historically been more typical," he adds.

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Mitigating risks

Whichever investment or asset allocation trend is currently in favour, Jenkins believes that transition management has a crucial role to play in helping asset owners manage risk and cost when undertaking changes within their investment portfolios' allocation shift. In his view, the ability to provide risk mitigation solutions, including enhanced project management capabilities and trade execution, are key benefits for clients.

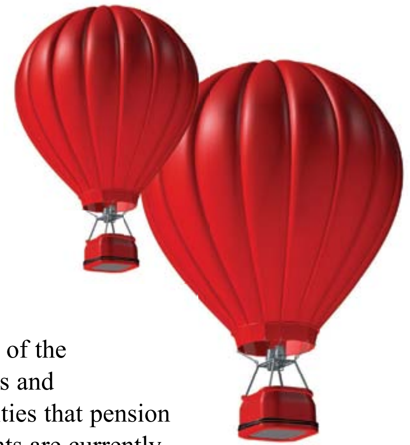
"Our goal as transition managers is to review and advise on the best ways to implement change across all asset classes, while providing transparent reporting and full accountability for performance. While the individual transition strategy will vary by client and their specific event needs, minimising costs and risks for client trades always applies," he says.

Adolph agrees that the main benefits of transition management lie in its ability to enable clients to manage the costs that can arise whenever assets are moved between portfolios or transacted, as well as the many potential risks associated with any restructuring of securities – including exposure risks arising as a result of operating in different markets in different time zones, which he says could lead to "unintended exposure and trading risks resulting from executing trades through a single venue rather than multiple platforms".

"Additional advantages include reducing the workload for clients at a particularly stressful time and providing sound governance, transparency and accountability," he says.

In addition to cost reduction and risk mitigation, BlackRock Transition Management global co-head Peter Loehnert also singles out enhanced end-to-end project management capabilities and the ability of dedicated transition managers to achieve "superior execution" as additional advantages of transition management.

"The main disadvantage of transition management is also its greatest strength – it shines a light on all sources of cost. In some cases, knowing the expected costs ahead of trading can be eye-opening and can



have an impact on the future decisions the investor may take. By identifying and documenting cost at the pre-trade stage, investors are equipped to take informed decisions," he adds.

European trends

In terms of popularity across Europe, Jenkins says that the most current activity is taking place in the UK and the Netherlands, where a number of ongoing changes in specific client segments (such as LGPS consolidation in the UK) are "leading to more structural, manager and asset allocation changes, and therefore more transition management activities". That said, he also stresses the importance of recognising the "increased interest and opportunity in specific client segments, such as the insurance and asset management communities".

"We are also seeing increased interest in transition management services from existing foreign exchange and institutional brokerage clients," he says.

Loehnert agrees that the UK and Northern Europe in particular, the Netherlands, Denmark and Scandinavia have traditionally been 'heavy users' of the service – a trend he reveals is "primarily dictated by the asset allocation prevalent in these markets, in addition to the operational structure of the funds".

"However, we are also seeing strong growth rates in Germany, Switzerland and Italy, where sophisticated investors are looking for innovative and cost-effective ways to restructure their portfolios," he says.

THE MAIN DISADVANTAGE OF TRANSITION MANAGEMENT IS ALSO ITS GREATEST STRENGTH – IT SHINES A LIGHT ON ALL SOURCES OF COST

Adolph also confirms the historical concentration of transition management in the more established pension markets in Northern European, such as the UK, the Netherlands, Denmark, Sweden, Germany and France. In his view, this is largely because these countries have "large pools of pension assets and use a multitude of different managers to invest those assets across multiple asset classes".

"It is commonplace in all these countries to use a transition manager not just when making large shifts between managers, but also between smaller ones and when one-sided events occur – that is, where cash is one side of the event," he says.

Increasing complexity

Looking ahead, Samsonov predicts that the cost-cutting trend will continue, with funds continuing to become more sophisticated and developing their own investment decision making and transition management capabilities. Meanwhile, Jenkins predicts that one of the most visible trends will be scheme consolidation, notably in the LGPS segment in the UK.

"Another notable trend is the increasing complexity of asset allocations. Clients are looking to us to help them with ever more complex events that involve multiple assets classes and often at least five to 10 managers being restructured," he says.

In light of the challenges and opportunities that pension fund clients are currently grappling with – including a new interest rate environment, geopolitical change and uncertainty and increased regulation – Loehnert expects there to be a continued focus on broadening investment strategies.

"This results in portfolio change and thus the need for a partner with a wide skillset to manage these changes. Liquidity challenges and volatility continue to be dominant themes for investors. By partnering with an experienced transition manager who can evidence track record and a wide access to liquidity, investors are equipped to address these challenges and achieve their goals," he says.

In the future, Adolph believes that transition management will continue to expand into the less-developed institutional pension markets; not just on the asset owner side but also on the asset management side.

"Transition management has also expanded into a more multi-asset discipline, with the use of derivatives for hedging common place. We see this broader view of transition managers as 'exposure managers' as one of the key trends over the next few years," he says.

"Furthermore, across Europe we are seeing the consolidation of pension schemes in order to reduce costs – and with this consolidation inevitably comes manager change. These one-off changes can be material at the overall scheme level and so close attention to the cost and risk involved is essential," he adds. ■