

Transition Management

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A Passion to Perform.

Deutsche Bank



Introduction

- ∅ Who, Why, How
- ∅ Implementation Shortfall
 - ∅ Time vs Risk
 - ∅ Execution Strategies / Other Issues
- ∅ Other Issues
 - ∅ Exposure Replication
 - ∅ Transition Custody
 - ∅ What Else ?

What is Transition Management?

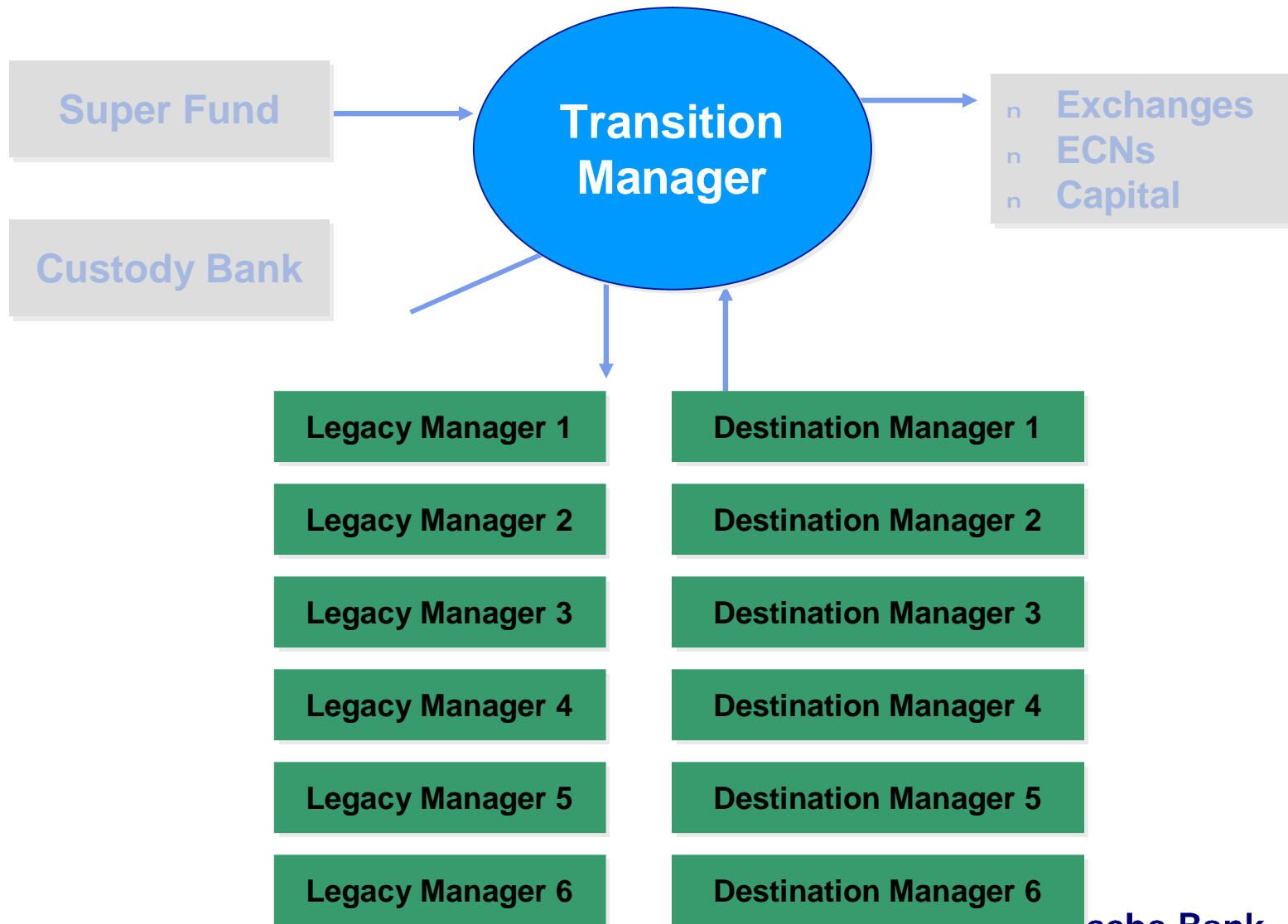


- n Transition Management is the coordinated use of multiple sources of liquidity to efficiently restructure assets
- n The Transition Manager is directly accountable to the asset owners for the analysis, strategy, project management and execution of the transition.

Who uses Transition Management?

- n Super Funds
- n Investment Managers – Master Trusts/Fund of Funds
- Insurance Companies
- n Hedge Funds

By 2001, most trustees adopted a new structure



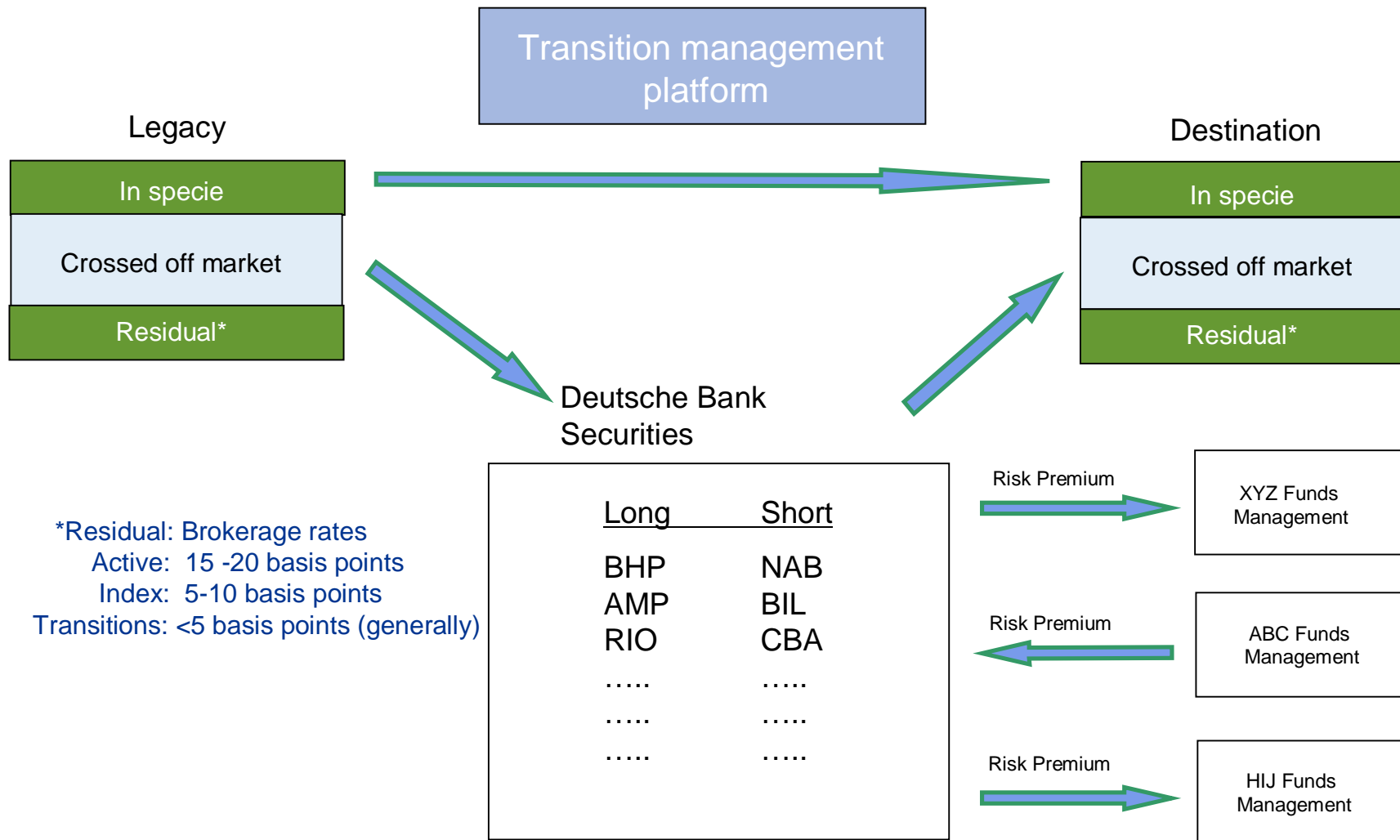
Benefits of Transition Management

Transition Management provides clients with three important benefits:

Why do clients use Transition Management?

Reduced Cost	Reduced Risk	Operational Ease
<ul style="list-style-type: none">Performance linked CompFewer shares traded in open marketLess CommissionLess Impact	<ul style="list-style-type: none">Assets remain Invested during TransitionNo Market TimingReduced risk vs. benchmark	<ul style="list-style-type: none">Single party accountabilityCoordination of custody bank, managers, settlements and cash flow

How does Transition Management work?



How does Transition Management work?

Trading of a typical transition involves a three step process:

- 1. Inspecie Crossings – match securities in legacy and destination portfolios.**
- 2. Crossing Transactions – TM aims to cross to securities in the market at benchmark prices. No market impact.**
- 3. Residual Trades - remaining securities traded in market on an agency basis**

Unmanaged Transition

	Legacy ASXS&P 200	Destination MSCI
Value:	A\$500m	A\$ 500m
Value Crossed	None	None
Value Traded:	\$500m	\$500m
Commission (10bps) :	\$500,000	\$500,000
Taxes	\$50,000	\$60,000
Market Impact	\$500,000	\$400,000
Estimated Cost:	\$1,050,000	\$960,000
Estimated Total Cost:	\$ 2.01m or 40bps	



Managed Transition

Managed Transition:	Legacy	Destination
	ASXS&P 200	MSCI
Value:	\$500m	\$500m
Value Crossed (25%):	\$125m	\$125m
Value Traded:	\$375m	\$375m
Commission (4 bps) :	\$150,000	\$150,000
Taxes	\$15,000	\$60,000
Market Impact	\$375,000	\$300,000
Estimated Cost:	\$540,000	\$410,000
Estimated Total Cost:	\$0.960 m or 9.6bps	

Estimated Savings from Transition: 1.05m or 21bps

Transition's are cheap vs cost of moving house!

	Legacy Collingwood	Destination Carlton
House		
Value:A\$500,000		
Value Crossed:	None	None
Value Traded	\$500,000	\$500,000
Commission (150 bps) :	\$7,500	\$0
Taxes	\$0	\$23,405
Legals/removalists	\$0	\$4,000
<hr/>		
Estimated Total Cost:	\$34,905 or 698bps !	

How Does Transition Management Lower Risk?

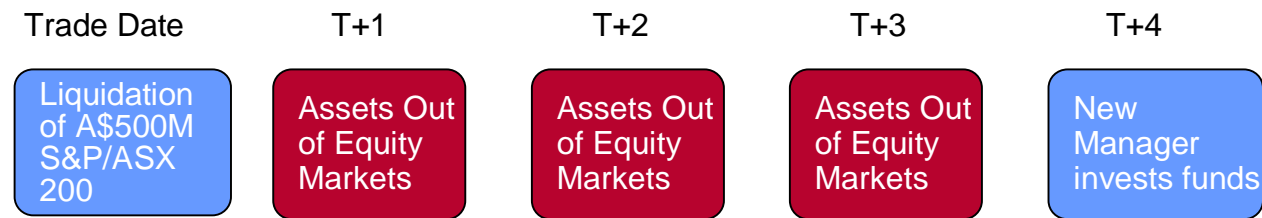
A properly managed transition can minimise or eliminate the opportunity costs of being out of the market

The greatest risk to clients repositioning assets is the risk of timing the markets. To reduce this risk, the TM structures the transition so that clients:

- Remain fully invested during transition
- Maintain asset allocation during transition

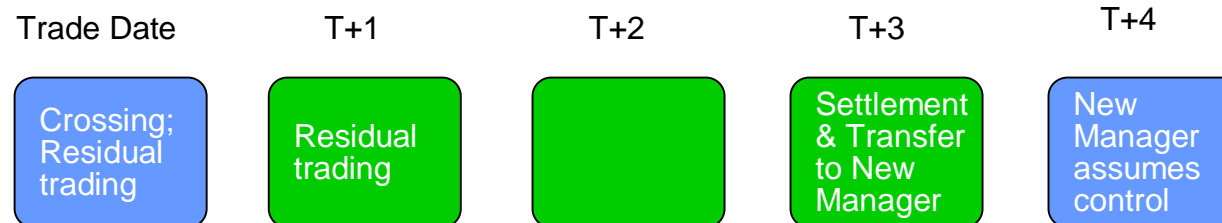
Non-managed Transition:

Client times market



Managed Transition:

Client remains fully invested



Minimise Risk

Market timing presents unnecessary risk when repositioning assets. Your TM team will work closely with you to design a comprehensive pre-trade strategy that optimizes your transition goals while minimizing market risk and costs.

Solve for Minimum Implementation Shortfall

Comprehensive real time risk management and trading systems are required to monitor and manage Implementation Shortfall

Remain Fully Invested During Transition

DTMG works closely with our clients to develop the optimal strategy to minimize Implementation Shortfall

Detailed execution analysis minimizes the implementation risk through the co-ordination of buys and sells to maintain maximum investment of assets throughout the transition

Includes both settlement and currency optimization

Maintain Asset Allocation

Single party control of transition ensures conformity to aggregate plan benchmarks across multiple managers

Operational Control

Continuous verification of asset availability resulting from corporate actions etc.

Operational Control

Transitioning assets requires comprehensive execution capabilities and global coordination, which can often represent a significant operational burden for asset owners.

Comprehensive Operational Control

TM provides administrative and operational coordination for all parties throughout each stage of the transition
A highly detailed process diagram and timeline are produced to map out the transition process in its entirety, ensuring that no deal is left unattended
Extensive preparation enables complete operational readiness by trade date

Single Party Project Management

TM provides for the management of all project aspects by one single team during every phase of the transition

In-Depth Settlement Expertise

Our proactive control environment accesses the significant global operational resources of Deutsche Bank
In-depth settlement, tax and operational knowledge in over 80 markets

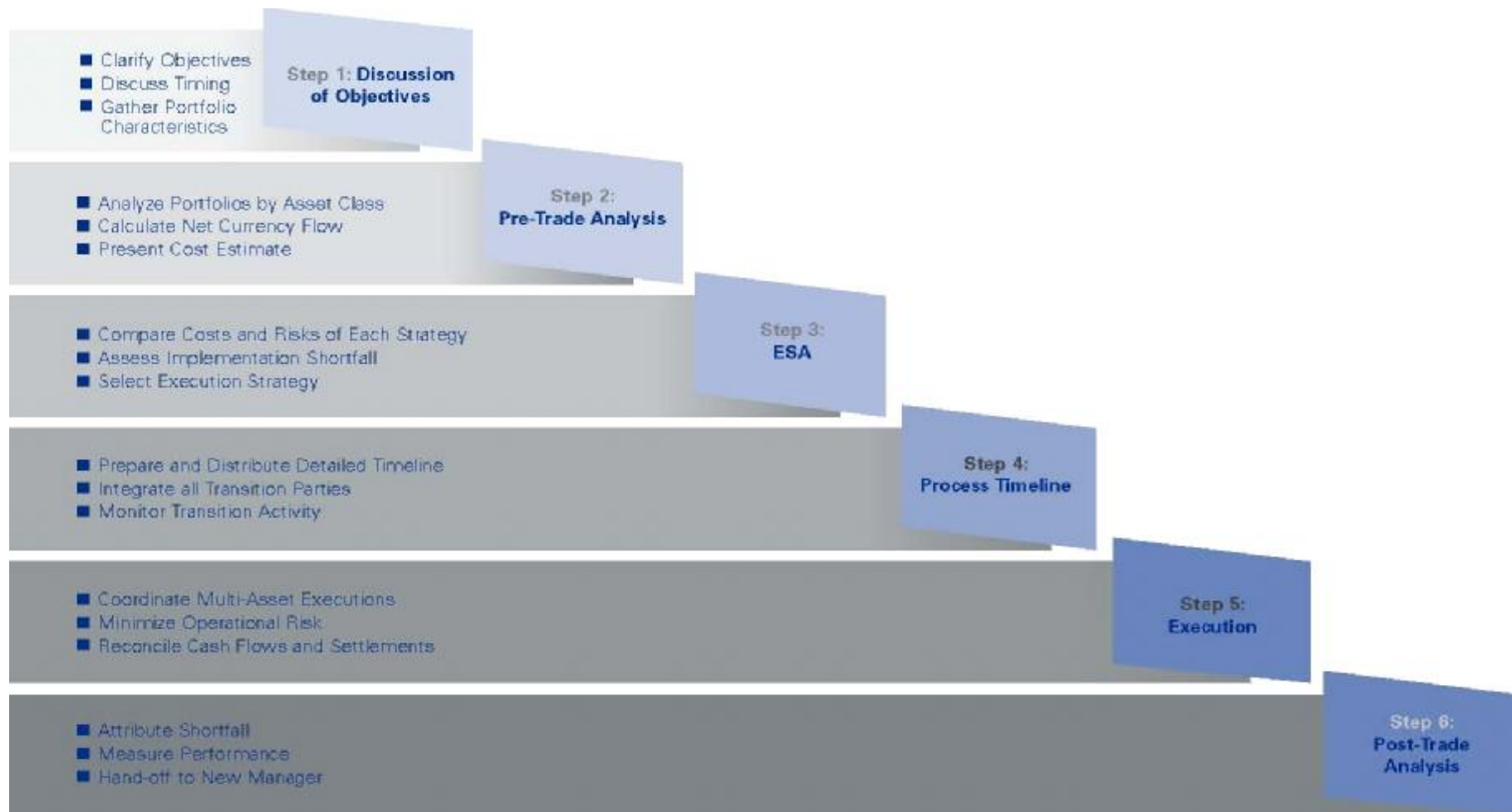
Extensive Custody Bank and Fund Manager Relationships

The operations team has existing relationships and experience in dealing with all major custodians
Deutsche Bank has existing trading and settlement relationships with all major fund managers

Transition – Cost/Risk by asset class

Asset Class	Risk	Physical Transition	Cost	Operational Complexity
Aussie Equity	High	Y	High	Low
Intl Equity	High	Y	High	High
Fixed Income	Low	Y	Low	High
Alternatives	Med	N	High	Cash
Listed Property	Med	Y	High	Low/High
Direct Property	Low	N	High	Cash

The Six Step Process



How can you benchmark your transition manager?

It is critical that Plan Sponsors benchmark their transition manager's performance. Below are a few points to consider:

Forest for the trees: Don't confuse execution benchmarks for transition cost:

Implementation shortfall is the most comprehensive measure of total cost

Your transition manager should provide firm estimates of implementation risk for each proposed strategy

Marketing or analysis? Beware of "too good to be true" estimates:

Benefit of a blind risk bid

Crossing at any cost?

Beware of benchmarks that can be manipulated:

Liquidity thresholds for all agency trades and crosses

What is Implementation Shortfall?

- n Implementation Shortfall (IS) is the measure of the true cost of a transition to an asset owner.
- n IS compares the performance of the two separate portfolios:
 1. The “perfect” paper portfolio:
This is the hypothetical portfolio that assumes the Asset owner was able to buy and sell all transition assets at zero cost, and impact at the closing value on T-1, the night before the transition
 2. The Actual transition portfolio:
The difference in performance between the perfect paper portfolio and the actual IS

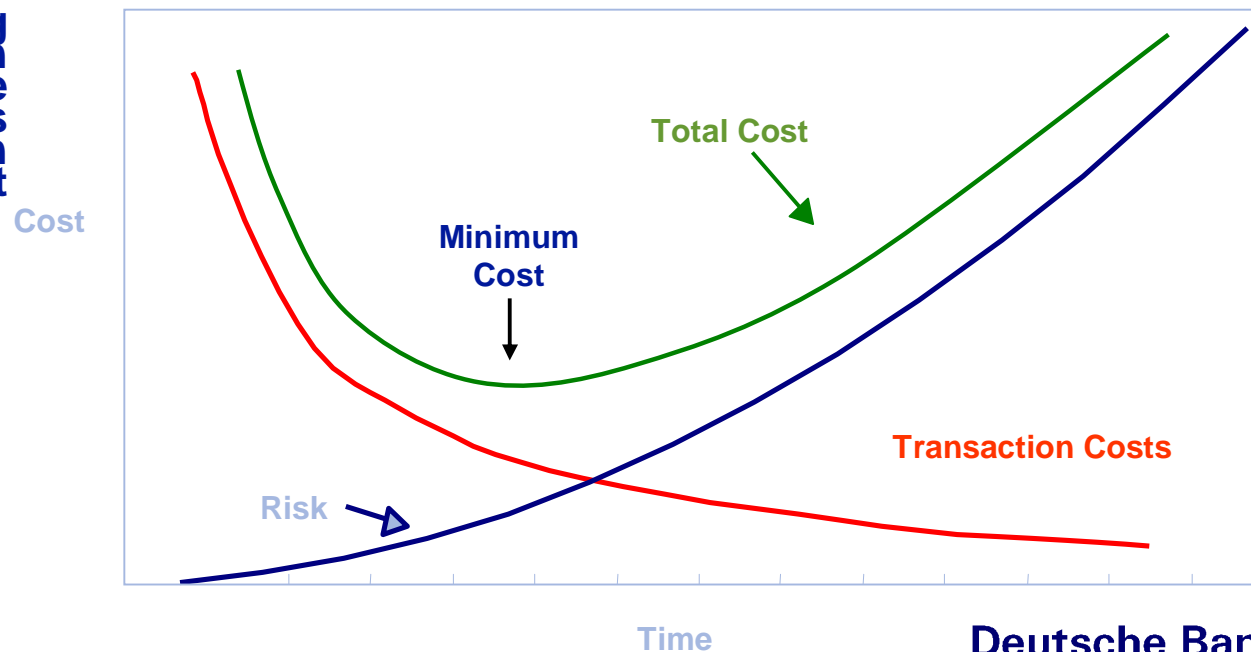
Implementation Shortfall – Time = Risk

The cost: risk trade off in a transition is essentially one between:

Premium of rapid execution with low mkt impact vs lower agency trading cost but increased time and higher opportunity cost.

A good transition manager will seek to suggest an execution methodology which balances these two costs, in order to reduce the total cost to a minimum:

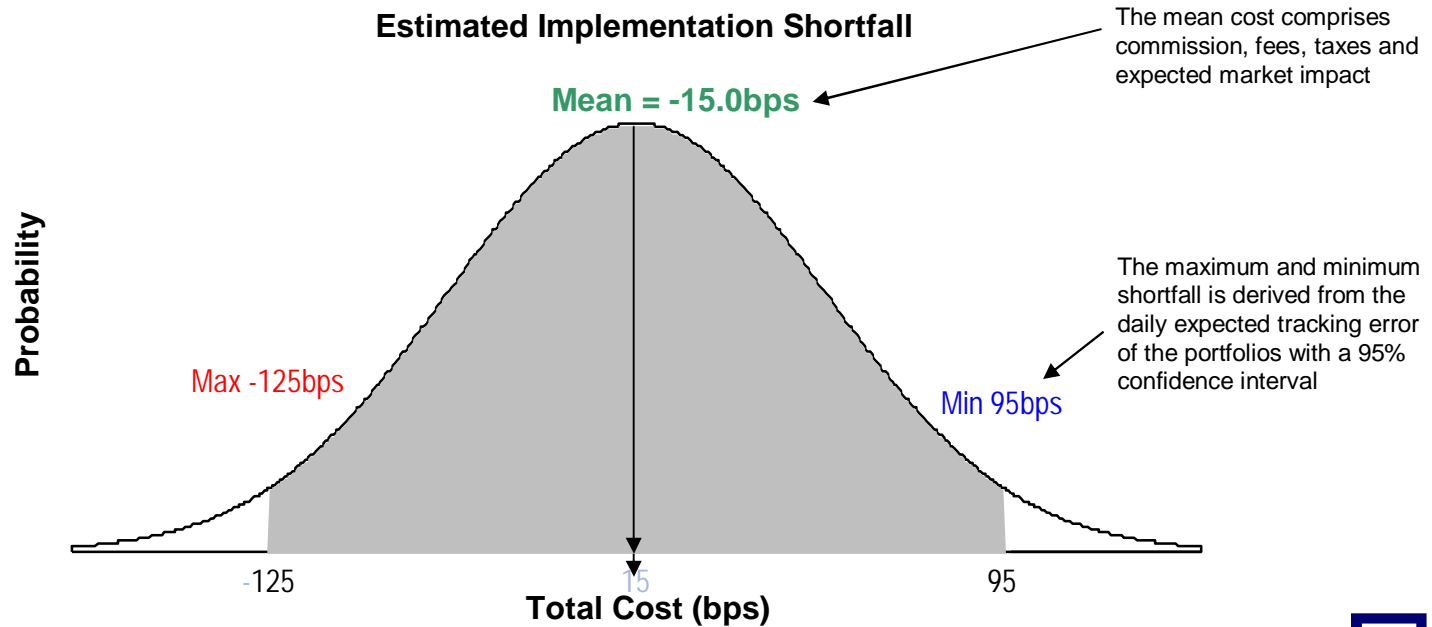
In considering execution methods, the crucial factor is how large an impact



Implementation Shortfall

As an example of the outcome of an implementation shortfall analysis, consider the following scenario:

Days to Trade	3	
Opportunity Cost (with 95% conf.)	+/- 110	bps
Maximum estimated shortfall	-125	bps
Minimum estimated shortfall	95	bps
Mean shortfall	-15	bps



Why is IS Important?

Example: Plan Sells \$500mm S&P 500
 Plan Buys \$500mm MSCI World

Multi-day Crossing Strategy

	T-1 Value	Timing	Trend	Impact & Commission	Value at Execution	Performance
Sell Portfolio	500	-7	-3	0	490	- 2%
Buy Portfolio	500	-2.0	+1	0	497	-0.15%
Implementation Shortfall:						7mm
						1.4%

- n No Commission
- n No “impact”
- n High Total Cost

Implementation Shortfall Analytics - ISA

n ISA helps plans estimate **Shortfall** for multiple transition scenarios

Transaction Costs

w Commission

- Market Impact

+

Estimated Risk (Opportunity Cost)

- Daily expected tracking error of Buy/Sell portfolio portfolio to Destination

= **Estimated Implementation Shortfall**

Implementation Shortfall Analysis

ISA Example

	Value	Benchmark	# of Names
Sell	\$500mm	S&P 500	75
Buy	\$500mm	MSCI World	180

Strategies Considered

	Benchmark	
Principal Bid - T - 1	T -1 Closing	Guaranteed, blind
Principal Bid - T	Trade Rate VWAP	Guaranteed, disclosed
Principal Bid Closed - T	Trade Close	G'ted Closing Price
Agency + Crossing <small>(5% ADV)</small>	Multi-day VWAP	All Crossing on VWAP

Example 1: Blind Principal Trade

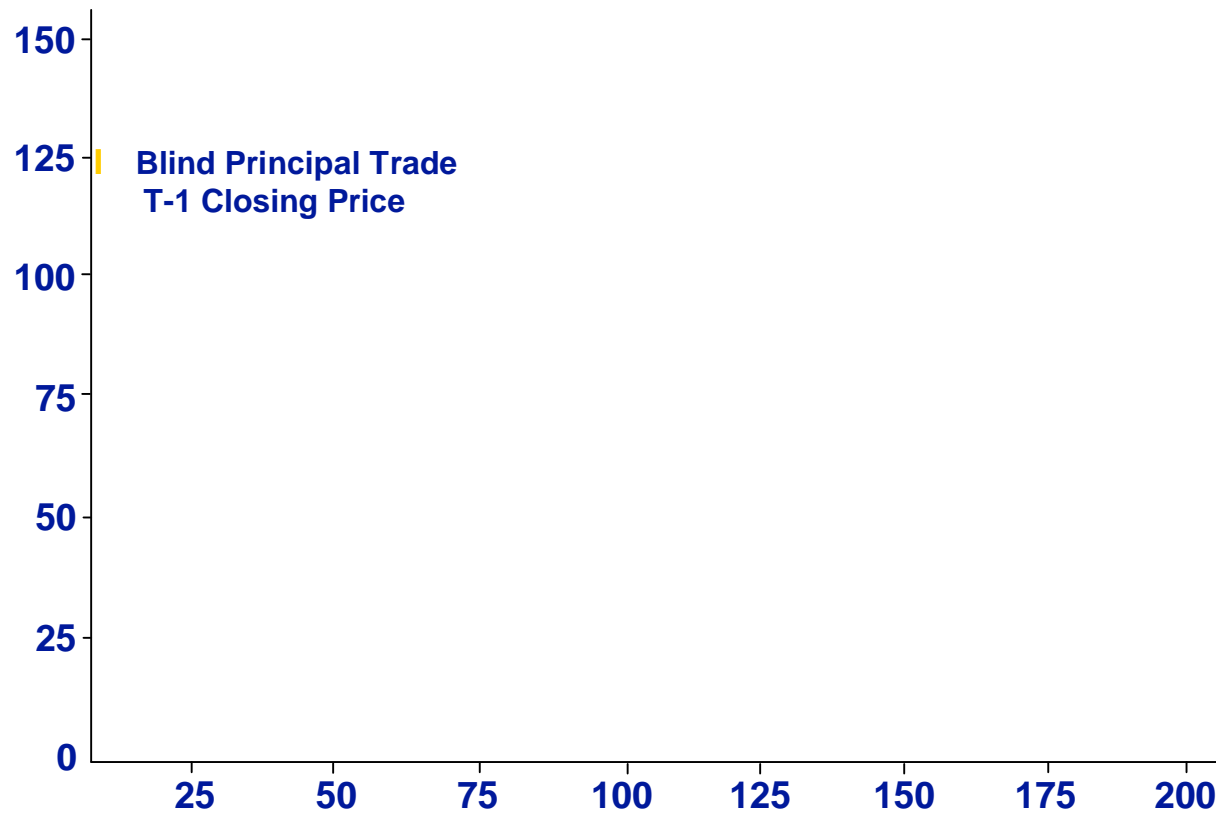
Benchmark: T-1 Closing Price

Days to Trade: 0 bps

Estimated Risk: 0 bps

Commission & Impact: 125 bps

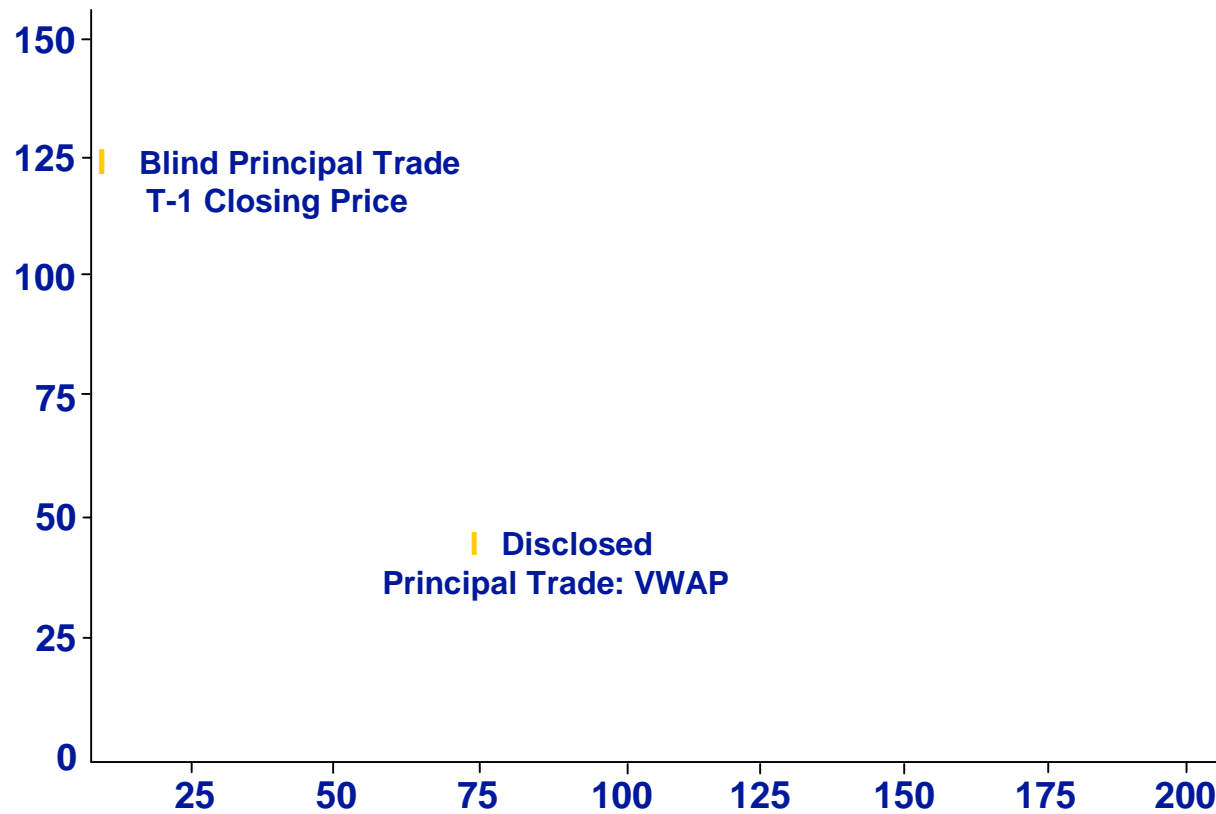
Mean Shortfall: 125 bps



Example 2: Disclosed Principal Trade

Benchmark: Trade Date VWAP

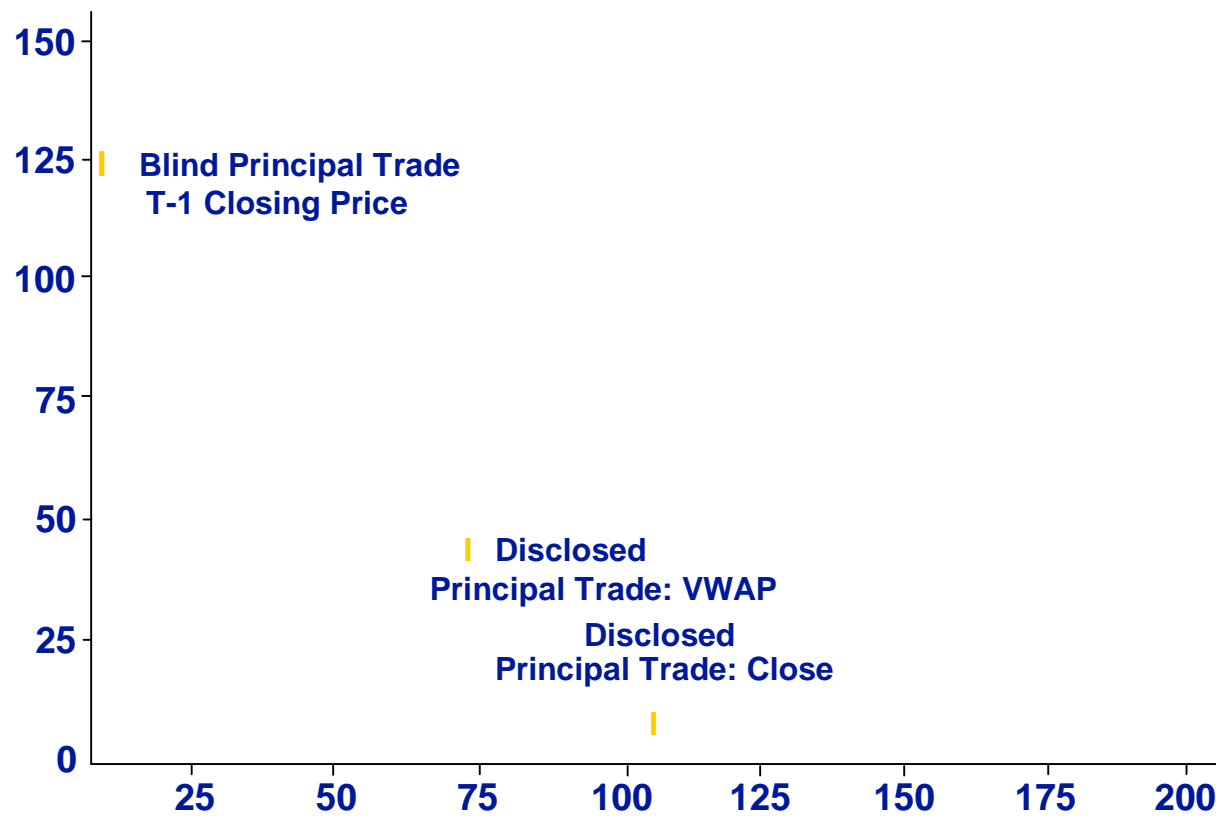
Days to Trade: 1
Estimated Risk: 75 bps
Commission & Impact: 40 bps
Mean Shortfall: 40 bps



Example 3: Disclosed Guaranteed Close

Benchmark: Multi-day VWAP

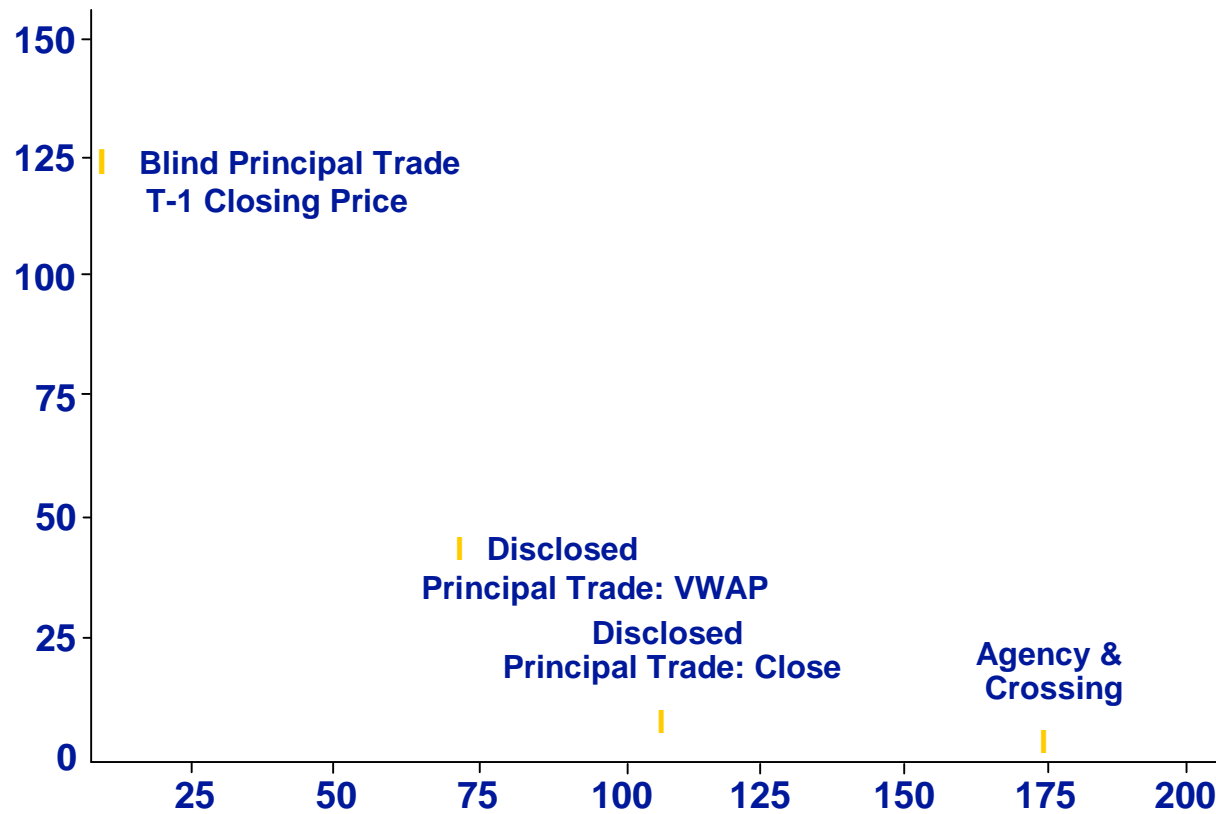
Trade to Date: 3
Estimated Risk: 110 bps
Commission & Impact: 11 bps
Mean Shortfall: 11 bps



Example 4: Agency & Crossing (15% ADV Limit)

Benchmark: Multi-day VWAP

Trade to Date: 6
Estimated Risk: 175 bps
Commission & Impact: 5 bps
Mean Shortfall: 5 bps



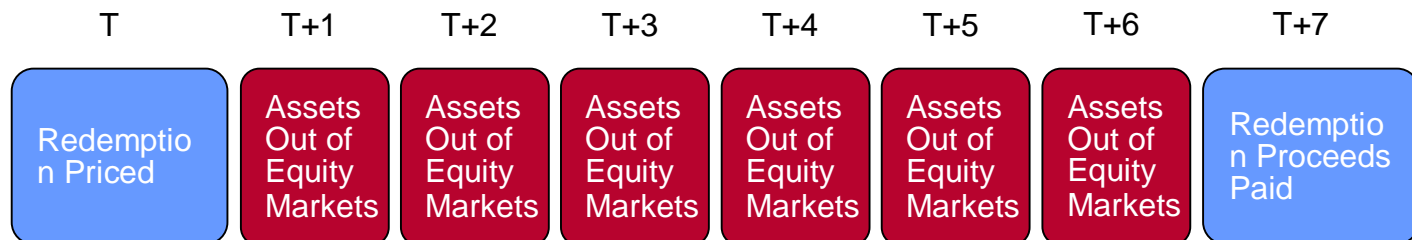
Transition Custody

- **Temporary custodial facilities can be provided for Australian equities where trustee holds assets in units trusts.**
- **Use of a temporary custodian will allow the assets to be physically transitioned**
- **Some transition managers can offer this service for a reduced cost providing significant savings.**

Exposure Replication

Asset owners should consider exposure replication strategies whenever there is the potential to be out of the market

The need for exposure replication arises whenever an asset owner has the potential to be out of the market.



In such instances the asset owner faces a two alternatives:

- Stay out of the market during the period of the transition
- Use an exposure replication strategy to maintain market exposure.

What is wrong with being out of the market?

Being out of the market
can have a number of
implications

Being out of the market can have a number of adverse implications for asset owners:

- trust deed requirements as to asset mix may not be satisfied
- fund performance may suffer as opportunities are missed, and such underperformance may be reflected in performance figures for many years to come.

These requirements have assumed a greater importance with the increase in volatility seen in markets over the past few years,

Other matters to consider?

Tax – 12 month holding rule can materially effect after tax return

Counterparty credit rating – now an issue

Timing – public holidays

More markets = more complex settlement

ID Countries – Korea, Taiwan, etc

Settlement dates – Equities T+3 , except Germany, HK, Korea T+2, Taiwan T+1, South Africa T+5

The strongest transition manager in the world

Transition Manager (signatories of T Charter)	Parent Company	Total Assets (in million USD)	Moody's Rating (current Long Term)	S&P Rating (current Long Term)
Deutsche Transition Management Group	Deutsche Bank (DBK GR Equity)	3,167,705	Aa1	AA
UBS	UBS (UBSN VX Equity)	3,563,177	Aa1	AA-
Russell Investment Management	Russell Investment Group (2142Z US Equity)	133,057	Aa1	n/a
Barclays Global Investors	Barclays (BARC LN Equity)	2,439,625	Aa2	AA-
JPMorgan	JP Morgan Chase & Co. (JPM US Equity)	1,562,147	Aa2	AA-
ABN AMRO (under restructure)	ABN AMRO Bank NV (AABA NA Equity)	1,607,431	Aa2	AA-
BNY Global Transition Management	Bank of New York Mellon (BK US Equity)	197,656	Aa2	A+
Mellon Transition Management	Bank of New York Mellon (BK US Equity)	197,656	Aa2	A+
Credit Suisse	Credit Suisse (CSGN VX Equity)	2,133,410	Aa2	A+
Citigroup Insurance & Pensions Group	Citigroup, Inc (C US Equity)	2,187,631	Aa3	AA-
Goldman Sachs	Goldman Sachs (GS US Equity)	1,119,796	Aa3	AA-
Morgan Stanley	Morgan Stanley Group (MS US Equity)	1,045,409	Aa3	AA-
State Street	State Street Corporation (STT US Equity)	142,543	Aa3	AA-
Northern Trust Global Investments Limited	Northern Trust Corporation (NTRS US Equity)	67,611	A1	AA-
Lehman Brothers	Lehman Brothers (LEH US Equity)	691,063	A1	A+
BlackRock	Merrill Lynch & Co. (MER US Equity)	1,020,050	A1	A+
Merrill Lynch	Merrill Lynch & Co. (MER US Equity)	1,020,050	A1	A+

The Team

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