Transition management keeps shrinking

BNY Mellon latest to exit as asset owners change how they do business

By RICK BAERT | March 31, 2014

Fewer providers are offering transition management services, reflecting changes in the U.S. defined benefit plan market that make it tougher to make money on the business.

The latest to exit the business, Bank of New York Mellon (BK) Corp. (BK), shocked many industry observers because its transition management unit was in an expansion mode less than a year earlier.

Executives interviewed for this story said the unit’s demise was the most prominent example of how changes in asset owners’ selection processes and the cyclical nature of transitions have made what had been an established business much more competitive, costly and tenuous.

The BNY Mellon announcement on March 12 that it would, over the next few months, shutter the San Francisco-based unit was the fourth by a transition manager since May 2013. Credit Suisse Group, J.P. Morgan Chase & Co. and ConvergEx Group last year announced they would close some or all of their transition management operations.

“Transition management is not a high-margin business and it’s not really going anywhere,” said an industry source who asked not to be identified. “There are higher-margin asset servicing businesses, like custody and securities lending, on which to focus ...

“Eventually, you have to consider whether transition management is diluting your business. That's probably what BNY Mellon did. How much does it cost BNY Mellon to cut or transfer 35 heads in a company that size, vs. continuing the business?” the source asked.

BNY Mellon's action is part of a broader trend, said Richard Prager, managing director and head of BlackRock (BLK) Inc. (BLK)'s trading and liquidity strategies group in New York. “The larger picture isn't transition management, but what's going on in the overall (finance) business ... What you're seeing is firms focusing on their core businesses where they have scale and competitive advantage.” BlackRock's $447.8 billion in transitions for the year ended Feb. 28, was above its average of $350.5 billion annually since the end of 2009.
Transition factors

Factors affecting transition management after the 2008-2009 financial crisis were:

- A decline in mandates from clients, with assets transferred by U.S. pension funds down 10% to 15% in 2013 (Pensions & Investments, Feb. 3);
- The shift by pension funds and other institutional investors to alternative investments from tradable securities where managers can conduct the entire transition;
- Strong equity markets that have reduced changes in asset allocations; and
- The ongoing trend among pension funds toward creating lists of transition managers from which to select when needed, usually based on best service and lowest cost.

At the $59.7 billion Massachusetts Pension Reserves Investment Management Board, Boston, it’s a “jump ball” among the eight firms on its transition management bench, said Michael Trotsky, executive director and chief investment officer. “We choose whoever comes back with the best plan and cost” for each transaction, he said. BNY Mellon, MassPRIM’s custodian, was one of the firms on its transition management list; without BNY Mellon, Mr. Trotsky said, the pension fund still has “an adequate number of suppliers to provide good competition for our business.”

In the past 12 months, MassPRIM did not perform any transitions requiring an external manager, which Mr. Trotsky said was “atypical. We normally do two to four” annually.

BNY Mellon is one of four transition managers the $7 billion New Hampshire Retirement System, Concord, has on its list. Marty Karlon, NHRS spokesman, said the pension fund will handle transitions with the three remaining firms — BlackRock (BLK), State Street Corp. (STT) and Abel/Noser Corp.

BNY Mellon’s exit “was a surprise to the industry,” said Paul Sachs, Philadelphia-based principal and senior member at Mercer Sentinel Group, which consults on custody and investment operations. “I have not talked to a provider or a consultant in this space that wasn’t surprised. It was common industry knowledge that they had been in hiring mode this year.”

Also, BNY Mellon had been acquiring asset servicing firms of late, chiefly the February purchase of the remaining 65% share of managed account and risk analytic service provider HedgeMark International it didn’t already own.

BNY Mellon said in a statement that the transition management unit was “not core” to its overall operations, although last June, Mark Keleher, CEO of the unit, said BNY Mellon would increase staff and
boost its investment in the unit to increase its business following Credit Suisse and J.P. Morgan's departures. Mike Dunn, BNY Mellon spokesman, said the firm would have no further comment; efforts to reach executives in the transition management unit were unsuccessful.

**Competitive business**

“Competition (in a shrinking market) has driven a lot of the margin out of the business,” said Nicholas Bonn, executive vice president, global head of transition management at State Street in Boston. “It's challenging for all of us. ... With margins low and volumes down, that challenges banks to ask if (transition management) is a strategic focus of their business. Every other player is looking at the same decision to make.”

Mr. Bonn said State Street is staying in the transition management business because of its “strategic nature,” leveraging its capabilities as a custodian and index manager. However, he said State Street is “smack dab in the middle” of evaluating its transition management business. “We do about 600 transitions a year, many of them for smaller clients with the same process and services as with larger clients. That's more challenging to our profitability. But we're not just going to focus on the bigger guy; we're just trying to figure out how to maintain the business for all clients while reducing costs.”

At Northern Trust Corp., Chicago, Grant Johnsey, senior vice president and head of sales and transition management, said there's new transition business to be had from: corporate plans shifting to liability-driven investing; defined contribution plans restructuring to include target-date funds, separate accounts and other customized investment options; the use of more outsourced CIOs; and transitions within funds of funds.

Northern Trust conducts about 300 transitions a year, and transition volumes rose 9.3% from June 30 to March 20.

Mr. Johnsey disagreed with those talking about reduced volumes. “I don't think there (are) less assets to be transitioned, but this is certainly a business that requires turnover in volume in the same way the brokerage (industry) does,” he said. “And you're going to see volumes ebb and flow over the course of a five- or 10-year period. So I don't view that as any sort of trend.”

Pension executives said they believe transition management is a “loss leader” in the investment management business, used by firms to help gain business for other services with higher margins.

Steve Kirschner, managing director, transition management, Russell Investments, Seattle, took issue with that assessment. “We believe that transition management absolutely is a viable industry and will be for a long time,” he said.
“We don't leverage another platform. It's not a loss-leading business for Russell.”

Another challenge is a trend seen among pension funds to conduct transition management internally through the use of exchange-traded funds or by money managers hired to take on new business.

Mr. Kirschner, however, said, “We don't see a big trend in-house.”

Thomas Schoenbeck, senior investment consultant at Hewitt EnnisKnupp, Chicago, said he hadn't seen a push by pension funds into using ETFs instead of transition managers. “In my opinion, I would still want a transition manager to move my client from a separate account to an ETF to make sure that it is done in a cost-effective way and that the client is kept exposed to the market to the greatest extent possible.”