



## Managing Risks and Transaction Costs During Manager Changes

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## Discussion Items

- ◆ What risks are involved in a manager change?
- ◆ How much does it really cost to switch managers?
- ◆ The impact of time on transaction costs
- ◆ Risk control leads to cost control
- ◆ Example of a global, multi-manager shift
- ◆ Conclusions and Discussion



## What Risks and Costs are Involved in a Manager Change?

- ◆ Accountability
- ◆ Custody Fees
- ◆ Opportunity Costs caused by delay
- ◆ Market Impact caused by trading too quickly
- ◆ Commissions
- ◆ Hedging and Liquidation Costs
- ◆ Potential Penalties/Operational Problems



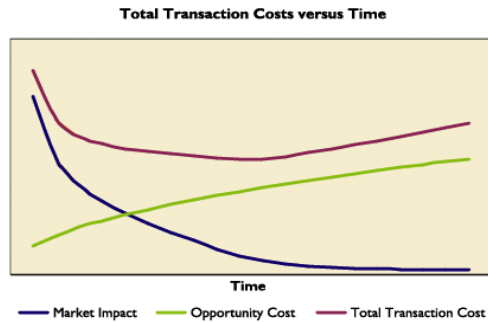
## How Much Does It Really Cost to Switch Managers?

- ◆ No composite data is available for transition trades
- ◆ Varies by size and liquidity of securities, as well as complexity and “hedgability” of trade
- ◆ However:
  - ◆ Plexus Data suggests the average block trade costs about 1.32%
  - ◆ Professor Don Keim of The Wharton School estimates Portfolio Trades cost on average around 1.87%\*

\*From “Packaging Liquidity: Blind Auctions and Transaction Costs Efficiencies.”



## The Impact of Time on Transaction Costs



- ◆ We can reduce market impact by increasing time, but increasing time increases potential opportunity costs.



## Risk Control Leads to Cost Control

- ◆ Opportunity Costs are driven by the differences between the legacy and target portfolios (asset class, currency, sector, individual weightings....)
- ◆ By hedging macro-differences and properly sequencing trade executions to correct micro differences, opportunity costs can be controlled over time
- ◆ By taking more time, more liquidity can be sourced, thereby reducing market impact costs



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## Example of a Global Multi Manager Shift

<u>Legacy</u>	<u>Target</u>
\$621mm U.S. Equity	\$310mm U.S. Equity \$186mm U.S. Bond \$125mm EAFE
<b>Total</b>	<b>\$621mm</b>

<u>Expected Trading Costs</u>	<u>Without hedging sequencing/risk control</u>	<u>With hedging sequencing/risk control</u>
Commissions	\$(386,303)	\$(362,303)
Bid-Offer	(424,769)	(302,737)
Market Impact	(749,859)	(567,596)
Expected Cost	<u>(1,560,931)</u>	<u>(1,232,361)</u>
Potential Opportunity Cost	±15,835,500	± 1,651,697
<b>Best Case</b>	<b>\$14,274,569</b>	<b>\$419,336</b>
<b>Expected Cost</b>	<b>(1,560,931)</b>	<b>(1,232,361)</b>
<b>Worst Case</b>	<b>\$(17,396,431)</b>	<b>\$(2,884,058)</b>

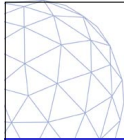
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## Example of a Global Multi Manager Shift (Cont'd)

<u>Actual Results</u>	
Trading Costs	\$(1,232,361)
Slippage	\$673,461
<b>Total Cost</b>	<b>\$(558,900)</b>
<b>Target Benchmark</b>	<b>1.75%</b>
<b>Actual Performance</b>	<b>1.66%</b>
<b>Cost of Trade</b>	<b>(.09%)</b>



## Conclusions

- ◆ There are more to trading costs than brokerage commissions
- ◆ It costs more to trade than most people realize
- ◆ These costs can be reduced significantly by proper trade management and risk control