



Insights on...

TRANSITION MANAGEMENT

HOW TO SELECT A TRANSITION MANAGER

Identifying the Best Transition Manager for Your Portfolio Restructuring Is as Much an Art as a Science

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Ben Jenkins
Strategist
Transition Management

*“Truly successful decision making relies on a balance between deliberate and instinctive thinking.”
Malcolm Gladwell, *Blink: The Power of Thinking without Thinking**

When selecting a transition manager, Malcolm Gladwell’s assertion is especially apt. The best decision often emerges from both deliberate (quantitative) and instinctive (qualitative) processes. For any particular transition event, there is no simple way to identify the best transition manager because the selection process, like the transition management field itself, is as much an art as a science.

Selecting a transition manager can be a daunting process. The goal is to identify the provider best suited to handle a potentially high-risk, high-cost asset allocation movement. The difficulty is compounded by the fact this is an infrequent decision for most institutional investors.

COMMON APPROACHES TO THE SELECTION PROCESS

For better or worse, the pre-trade report incorporates most aspects of the decision process. This has encouraged some transition providers to use their pre-trade report as a marketing vehicle focused on winning business, rather than as a means of objectively identifying and analyzing transition risks and costs. Because of this, commission costs and overall pre-trade cost estimates can become the primary differentiators among potential transition managers. Though these are important considerations in the decision-making process, they do have limitations.

COMMISSION (EXPLICIT) COSTS

Some investors still view commission costs as the primary – or only – differentiator when selecting a transition manager. Commissions are an obvious variable and, therefore, an easy point of focus. However, commissions alone do not provide sufficient guidance to make the most educated decision.

Many variables – including the transition manager’s business model (fiduciary vs. broker-dealer) – influence the commission rate and it is important to understand these underlying variables. Selecting a provider based solely on a low commission rate – without understanding the provider’s business strategy – is like buying a car based upon price, without evaluating its options or even how well it runs.

OVERALL PRE-TRADE COST ESTIMATES

The overall cost estimate (consisting of explicit, implicit and opportunity costs) is a primary aspect of a transition pre-trade and is important to understand as it relates to a transition assignment. The lowest cost estimate may not always reflect the inherent risk and related costs of a given transition. Just because one pre-trade estimate is lower than another, it does not mean the results will be better. Quite the opposite may be true if the lower bid does not control for crucial risk factors, such as sector or market imbalances.

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If time does not permit a comprehensive review, then identify the two or three core factors that matter most.

Transition managers use a variety of analytical systems to estimate bid/ask and market impact costs. Provider estimates can vary widely based upon factors such as model type and historic time period. Comparing transition providers’ overall cost estimates – without understanding the methodology and risk drivers behind the cost estimates – can lead to inaccurate outcomes.

A BETTER APPROACH

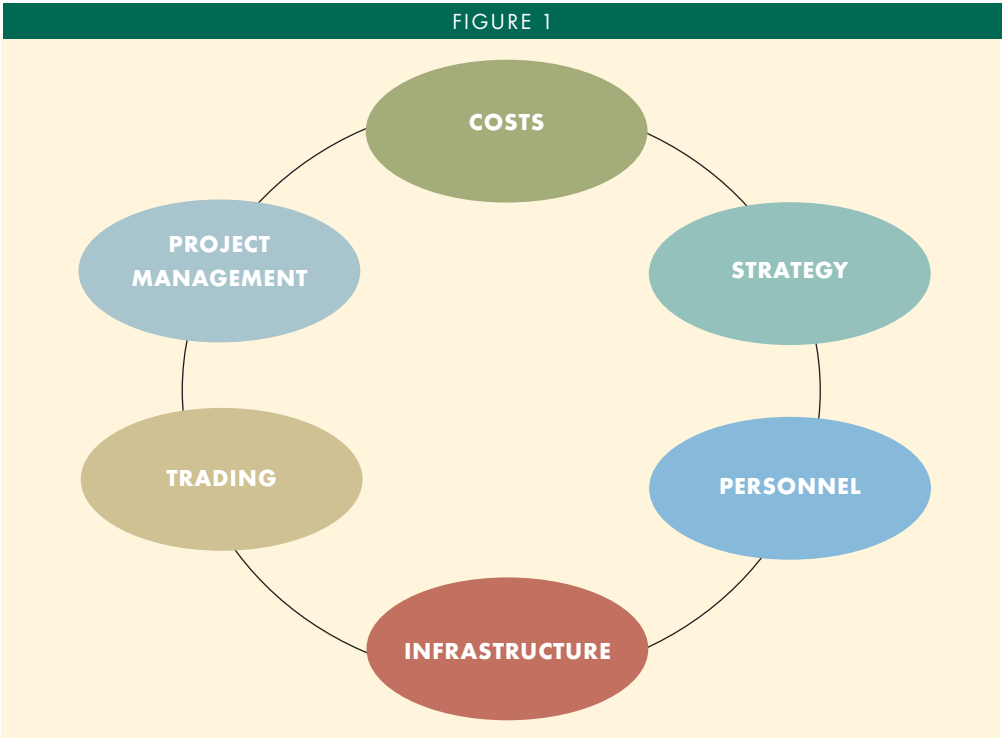
The process of selecting a transition manager is similar to that used when selecting a new investment manager. The decision to pick an investment manager does not only focus on projections of alpha or management fees because these factors do not represent the full value and benefit of the managers, including people and process.

An emphasis on commission rates and pre-trade cost estimates is similarly limiting when picking a transition manager. Instead, the transition manager selection process must incorporate the quantitative factors mentioned above as well as more qualitative factors, including people, infrastructure and process (see Figure 1).

Selection Criteria

The transition manager should be selected well in advance of the event. When a transition is imminent, it can be challenging to consider the many mission-critical criteria involved.

Any given transition event involves an enormous array of unique complexities. Therefore, you must understand the core factors that matter most for your transition event. If time does not permit a comprehensive review, then identify the two or three core factors that matter most. The following questions will help you evaluate the offerings of various transition managers relative to your needs.



PRE-TRADE COST ESTIMATES

- **What are the total costs?** Check that costs reasonably reflect the trading strategy and estimated pace of trade execution.
- **How are the costs derived?** Get an explanation of analytical models and historic timeframes used for cost estimates.

STRATEGY

- **Are the primary risk factors identified and addressed?** Evaluate major potential costs, risks and solutions.
- **Is a unique approach to transition execution provided?** While not applicable for every transition, proprietary solutions or manager-specific offerings can be powerful differentiators.

PERSONNEL

- **What is the transition group's team structure and turnover?** Understand how an event is handled internally, who works on each event, and the frequency of team turnover.
- **What is the team's tenure and experience?** Get details of the team's experience specific to the transition management field and broad investment experience. Given the myriad of risks and factors associated with every transition event, the team's diversity of experiences is an absolute necessity.

INFRASTRUCTURE

- **How does the transition group fit into the firm's corporate structure?** If the transition group is part of a larger organization, find out how established and integrated the group is within its parent company.
- **What is the transition group's business model?** Understand how the transition manager will approach the event (e.g., as a broker-dealer versus as your fiduciary).
- **How is the transition group compensated?** Demand full revenue transparency. Understanding how the transition group generates revenue can shed light on its proposed approach.

TRADING

- **What are the recommended execution venues?** Identify where the transition manager expects to execute the transition.
- **Are the recommended execution venues reasonable?** Ensure the venues (including crossing) make sense within the overall scope of the transition strategy and event objectives.

PROJECT MANAGEMENT

- **How is coordination and planning identified?** Find out at an early stage about timeline preparation and operational expertise.

These questions will help you evaluate the offerings of various transition managers relative to your needs.

- **What support does the transition manager include?** Identify the parts of the asset allocation the provider will manage as part of the overall solution. Potential aspects include oversight of non-market vehicles (e.g., hedge funds, private equity), custodial changes and change in legal ownership or plan structure.

On-site visits or conference calls can often assist with this process of selecting a transition manager. In addition, prior experience with a transition manager can be very beneficial for insight into how events are handled from start to finish. Note that these core factors can change for each transition event.

BLENDING ART AND SCIENCE

Transition management is a critical aspect of the asset allocation process. As such, when selecting a transition manager, a diligent, well-considered approach must be taken.

Using a wide range of criteria that blends both quantitative and qualitative considerations will help you select the best provider for your transition event. If you do not have time to fully explore all questions with potential transition managers, use at least a few core factors that are relevant for the transition at hand. With some preparation and a knowledge of what matters most, you can successfully select a transition manager.

FOR MORE INFORMATION

To discuss this matter in further detail, please contact Northern Trust's Transition Management group at 312-557-5173 or ntgi_transition_management@ntrs.com.

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