

2Q2014 IAC Meeting Materials

IAC Meeting – August 19, 2014

Transition Management Presentation



Transition Management

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Agenda

- ▶ SBI use of Transition Management
- ▶ Review of Transition Management:
 - Overview
 - Costs
 - Liquidity sources
- ▶ SBI Staff Considerations:
 - Transition manager bench
 - Third-party transaction cost measurement
 - IAC discussion
- ▶ Next steps

SBI use of Transition Management

- ▶ Periodically the SBI must move pension assets to rebalance, implement investment policy changes and fund/terminate managers
- ▶ Asset restructurings have been completed by internal staff, investment managers or, in more complex situations, by a transition manager
- ▶ Historically, SBI has used transition management for equity transitions but not for bond portfolio transitions

SBI use of Transition Management

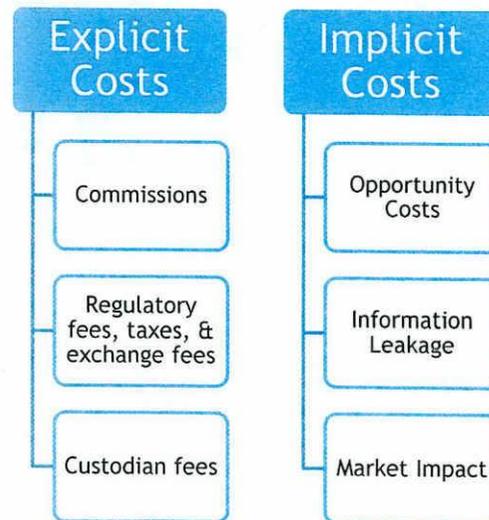
- ▶ In 2013, the SBI transitioned over \$1.5 billion in assets with a transition manager
- ▶ Calendar year through July 2014, the SBI has transitioned over \$1.1B
- ▶ Currently, State Street Global Markets is the only transition manager under contract

Transition Management - Overview

- ▶ A transition manager acts as a very short-term asset manager and helps to effectively:
 - Manage transition costs including market impact
 - Reduce volatility
 - Manage settlement and operational risks
 - Act as a fiduciary
 - ensuring best execution
 - disclosing all sources of revenue
 - applying appropriate risk management tools

Transition Management - Costs

- ▶ Implementation Shortfall (IS) is the most accepted measurement of transition costs
- ▶ IS measures assets/portfolio value at the end of the transition to the value of the portfolio assuming an immediate shift at zero cost to the target portfolio



Transition Management - Liquidity sources

- ▶ In-kind transfers
- ▶ Internal crossing
- ▶ External crossing
- ▶ Open market transactions
- ▶ Non-displayed liquidity
- ▶ Principal trades

SBI Staff Considerations - Transition manager bench

- ▶ Staff is considering establishing a transition manager bench in order to help:
 - ensure a more competitive bidding process, and
 - address the business risks associated with utilizing only one vendor

- ▶ The SBI received RFI responses from:

Abel/Noser Corporation

Russell Implementation Services Inc.

Citigroup Global Markets Inc.

Pavilion Global Markets Ltd.

Blackrock, Inc.

Northern Trust

Capital Institutional Services, Inc. (CAPIS)

BNY Mellon

State Street Bank and Trust

Loop Capital Markets

Vertas Brokerage Consulting

Staff Considerations - Transition manager bench

- ▶ Key RFI evaluation criteria will include the following:
 - Sufficient transition activity in domestic equity, international equity and fixed income
 - A proven ability to handle large transitions as part of normal transition flow, i.e. not an outlier
 - Dedicated transition management staff
 - Robust back office and trading platforms
 - Proven ability to effectively use synthetic instruments

Staff Considerations - Third-party transaction cost measurement

- ▶ Transition managers' business practices have been scrutinized as a result of Dodd-Frank
- ▶ Potential benefits:
 - Standardized pre-trade estimates
 - In depth post transaction analysis
 - Improved disclosure of implicit costs
 - Independent historical universe
 - Independent audits

Independent transaction cost provider may improve transparency

Staff Considerations - IAC discussion

- ▶ How do IAC members handle transition management?
 - Manage internally, use one transition manager or a bench of managers? If bench, how many providers?
 - How is bidding process implemented with a bench of providers? What are the pros and cons of bidding method?

- ▶ What has been the experience of IAC members with third-party transaction cost measurement?

Next Steps

- ▶ Staff will incorporate feedback provided by the IAC related to:
 - the RFI process and establishing a bench of transition management providers
 - potential implementation of a third-party transaction cost measurement provider

- ▶ Staff will present findings at the November meeting for IAC consideration and recommendation to the Board in December