

Northern Trust International Insight

ISSUE 2 August 2005

WELCOME to the second edition of *International Insight* – the quarterly newsletter for Northern Trust’s global client community.

2005 is proving to be an exciting year for Northern Trust. Our presence in the Asia Pacific region has been strengthened by our new representative office in Beijing, and our preparations to establish a presence in the Netherlands are progressing well. Northern Trust’s acquisition of Baring Financial Services Group earlier in the year has enhanced our expertise in the administration of hedge funds, property funds and private equity. Our integration plans are on track and our excitement continues to grow as we work closer with our new clients and colleagues.

We continue to focus on developing solutions to meet important client needs – recently broadening the capabilities of our cross-border pension pooling product to include US ERISA defined benefit retirement plans, and creating a liability driven investment solution which has received particular interest from our Dutch pension fund clients. We also seek to help our clients in other ways, for example, through the provision of educational conferences and training sessions.

I hope you enjoy this issue of *International Insight*, and I look forward to hearing your news, views or ideas on how this newsletter can better work for you.



Rick Waddell, Head of Corporate and Institutional Services

Doors open in Beijing

NORTHERN Trust officially established its presence in mainland China with a special event in the capital, Beijing.

On June 3, as the afternoon sun graced the broad marble steps leading up to the Grand Hall of People in Tiananmen Square, Northern Trust staff welcomed more than 140 financial industry guests to the Northern Trust Beijing representative office inauguration ceremony.

eminent speakers

After a formal greeting by Kevin Tan, Northern Trust Chief Representative in China, and Nycho Han, Assistant Representative in China, guests enjoyed speeches from a host of eminent speakers, including Ms Shen Xiaonan, Director-General of Finance and Accounting from China’s National Council for Social Security Fund; Mr David Sedney, Deputy Chief of Mission for the US Embassy to China; Mr Shen Binxi, Deputy Director-General of the People’s Bank of China and Mr William A. Osborn, Northern Trust’s Chairman and CEO.

Mr Osborn emphasised the importance of China to Northern Trust’s continuing growth in Asia. He said: “The new office in Beijing complements our



A promising future: (Left) Kevin Tan and William A. Osborn turn the ship’s wheel to lower the anchor signifying Northern Trust’s arrival in Beijing.

Asian offices in Singapore, Hong Kong and Tokyo as we further implement our global business strategy.”

Our arrival in this new, exciting ‘port’ was signified by the lowering of Northern Trust’s anchor logo from a ship’s bow painted onto a stage backdrop.

Mr Tan, said: “It was an extremely successful event, giving Northern Trust the opportunity to introduce itself to the Chinese business community.”

■ **For further information on Northern Trust in China, please contact Kevin Tan on (86 10) 8520 0060 or at kevin_tan@ntrs.com.**

Setting high standards

NORTHERN Trust has been named one of the ‘100 Best Corporate Citizens’ by *Business Ethics* magazine.

The survey has gained recognition as an indicator of best practices in the area of corporate social responsibility.

“At Northern Trust we are committed to setting the highest standards for excellence in corporate responsibility and ethics,” said William A. Osborn, Northern Trust Chairman and CEO, following the announcement.

“This recognition is a testament to our corporate culture of caring for the communities in which we serve, our commitment to diversity and fairness in the workplace, and the business integrity of our employees around the world.”

US ERISA pooling initiative

NORTHERN Trust is a pioneer in the development of global pension management services. Key among these is cross-border pension pooling for multinational companies.

Northern Trust recently developed the first proprietary solution to allow multinational organisations to commingle US ERISA (Employee Retirement Income Securities Act of 1974) defined

benefit retirement plan assets, with assets from non-US subsidiaries, in a single offshore pooling vehicle.

A pooled structure is created to support investment strategies that are of interest to a

number of a multinational's subsidiary plans. By aggregating assets of different pension funds in a pooled vehicle, economies of scale are achieved. Multinational corporations benefit from cost reductions and administrative efficiencies as investment managers are now looking over one account with a larger pool of assets from several countries. Further, a multinational is able to exercise greater governance and risk management over the assets in the pool.

The subsidiaries' investment committees or trustee boards remain involved as they decide whether or not to invest in the pooled vehicle, in which sub funds (mandates) to invest, and how much to invest. The subsidiaries maintain control over asset allocation.

Kathy Dugan, Northern Trust's Multinational Product Manager, said: "Shortly after we launched the first cross-border pooling vehicle

in 2002, US-based multinationals began asking Northern Trust to come up with a solution that would enable their ERISA plans to participate."

Northern Trust's in-house ERISA experts developed the capability in response to this client demand.

The new Northern Trust ERISA solution for cross-border pension pooling will allow more multinational companies to capitalise on the benefits of bringing cross-border assets together for investment management purposes, as inclusion of the US plan, for many, will provide the scale necessary for the economies to be realised.

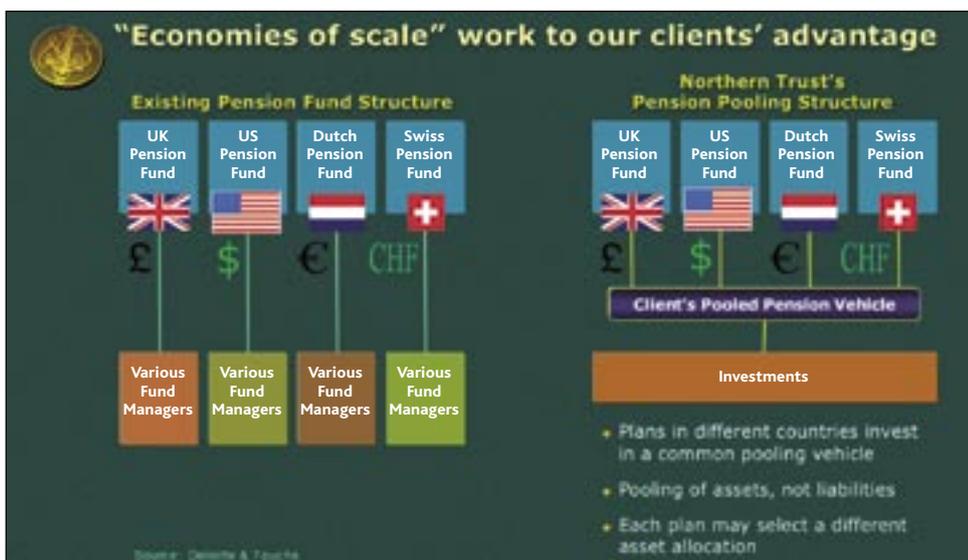
As the first, and only, custodian to support cross-border pension pooling vehicles for multinational clients, Northern Trust continues to expand

its pooling product offering. In addition to the ERISA solution, we are also currently implementing tax-transparent vehicles for companies who wish to offer global equity mandates through a pooled vehicle to their pension plans worldwide.

Northern Trust offers a complete range of services to support the complex pension needs of multinationals including:

- Local and global custody services, providing consistent valuation, reporting and control for significant asset pools.
- Consolidated multinational headquarters reporting, offering online access to worldwide pension plan information.
- Cross-border pension pooling.
- **For further information, please contact Michelle Teteak at 312-444-3506 or at mmt2@ntrs.com.**

“As the first, and only, custodian to support cross-border pension pooling vehicles for multinational clients...”



Hold the dates

NORTHERN Trust will hold three client events in September as follows:

- September 7-9 – three-day Institutional Client Conference at the Hyatt Regency, Chicago.
- September 14 – this is the new date for Northern Trust's client party, aboard the Silver Sturgeon on the River Thames in London. This party was postponed from July 7 due to the terrorist attacks which occurred that day. Revised invitations will be sent out.
- September 29 –European Client Conference at Vinopolis, 1 Bank End, London. This one-day event will be followed by a wine-tasting with Oz Clarke from the BBC's Food & Drink programme.

Growth prompts move

NORTHERN Trust's Singapore Branch has moved into a new office to support its continued growth in the Asia Pacific region.

The office is on the 12th Floor of One George Street, a brand-new building in the city's financial district, which is custom-designed for financial institutions with state-of-the-art technology features and lifestyle facilities.

The building recently won the Green Mark Gold award from the Building and Construction Authority of Singapore (BCA) for being environmentally friendly.

Lawrence Au, Northern Trust's General Manager for the Asia Pacific region, said: "The move to a new, bigger and modern office is a strong testimony of our commitment to our clients and our positive business outlook for the Asia region."

P&O cruising ahead with trustee training

NORTHERN Trust global custody client, P&O, is cruising ahead in its preparations for government legislation due to take effect in 2007. This is when all pension schemes will need to have one third of their Board of Trustees as member-nominated directors.

Following a review of their own board arrangements, P&O concluded that new member-nominated trustees were required. However, fully recognising the importance and increasing emphasis on trustee competency and training, P&O asked Northern Trust to help them design a training programme that would equip trustees with a sound knowledge of their responsibilities.

In February 2005, 10 aspiring P&O pension fund trustees attended a full-day educational workshop at Northern Trust's offices in Canary Wharf, London. Presentations included global custody and core services, basic asset classes and a demonstration of the lifecycle of a trade, as well as a tour of Northern Trust's global operations centre. In addition, Northern Trust Global Investments presented a session on asset

allocation and investment strategy. The global custody programme was developed by Northern Trust custody relationship manager, Elizabeth Westwood, who said: "P&O are taking their trustee responsibilities very seriously and are keen to ensure that members of the trustee board are

properly equipped and keep their knowledge current in an ever-changing marketplace."

All trustees are now required to complete a certain number of hours of training, as part of their continuing professional development.

Rita Powell, Group Head of Pensions at P&O, said: "The feedback from our member-nominated trustees was positive.

"They found the various sessions informative and interesting and were particularly fascinated by the operations tour."

■ **If you would like further information on trustee training provided by Northern Trust, please contact your relationship manager.**

"P&O are taking their trustee responsibilities very seriously and are keen to ensure that members of the trustee board are properly equipped..."

Positive conference feedback

THIS year's Nordic Conference has been hailed a great success for clients, prospects and Northern Trust staff.

The event, which took place in June in the Swedish capital, Stockholm, attracted 35 clients and prospects from the Nordic countries for a packed day of seminars and sessions, covering topical issues, client case studies and updates on Northern Trust activities.

providing updates

The Head of Corporate and Institutional Services, Rick Waddell, and the Head of the International Business Unit, Steve Potter, addressed the conference, providing updates on Northern Trust services and the European market.

The day culminated with drinks on the venue's verandah – which enjoyed sweeping views over Stockholm – and dinner and entertainment at a local restaurant.

Anne-Lise Winge, Head of European Sales, said: "This annual event is appreciated by clients and prospects as a day of interaction and education. It also ensures people can meet Northern Trust staff for an exchange of information on products and services, and is an opportunity for Northern Trust to receive feedback from clients – and to end by having fun together.



Grand views in Stockholm: Kungliga Slottet (The Royal Palace).

"It was an interactive and useful experience, which helped ensure we are ahead of what clients require."

Feedback from clients was encouraging. Sven Askenberger, Chief Operating Officer, Tredje AP-Fonden (AP3), said of the event: "It was very well organised, with a good mix of points on the agenda. It was also good to meet other Northern Trust customers."

■ **Northern Trust reinforced its commitment to the Swiss market by holding its first conference in the country.**

The event, on July 5 at the Beau Rivage Palace Hotel, featured a half-day conference followed by dinner, and attracted a mixture of multinational pension fund clients, private wealth contacts, fund managers and prospective clients.

Feedback from attendees was very positive.

Northern Trust Global Investments (NTGI) is the asset management arm of Northern Trust. It manages over US\$590 billion (as at June 30 2005) placing it in the top 10 asset management firms worldwide. NTGI's capabilities span active equity investment, fixed interest, indexation and quantitative strategies, securities lending, transition management, commission recapture and a separate manager of managers business.

In this issue, Simon Hutchinson, Transition Management Strategist, Europe, Northern Trust Global Investments, looks at the issue of hidden costs involved in transitioning a portfolio.

What lies below the waterline

AS the Titanic found to its cost, moving through the iceberg filled waters of the North Atlantic can be treacherous.

The iceberg of transaction costs is a widely understood concept; transitioning your pension assets in today's financial markets can be expensive and the Titanic's fate awaits those that fail to navigate and correctly manage the process.

beware hidden costs

The notion that a transition needs to be "managed" is accepted by consultants and clients. Competition within the transition management space is fierce and much of the focus is on explicit commission rates, which are continually driven down. However, the commission cost is generally the smallest part of the transaction cost iceberg.

To start, when do you need to employ a transition manager and what is its role? The transition manager acts as an interim fund manager and manages the process of restructuring

a portfolio, whether it is when an investment manager is changed or during an asset allocation shift. The added value of the transition manager is to ensure all costs are managed, while providing transparency over the process.

It is the role of the transition manager to ensure clients understand the cost components and the performance consequences of varying strategies. The total cost of any transition can only be seen when the components below the waterline, i.e. spread, market impact and opportunity cost, are known.

Spread is the difference between the cost of buying and selling a security.

This cost is variable and depends very much on the type and liquidity of a security. It is the transition manager's role to estimate spreads and where possible work to reduce their size.

The quicker the

execution in the market, the higher the market impact cost tends to be, whereas the longer the trading timeline, the lower the market impact cost. Crossing networks are a way of reducing spreads and market impact, however, very high cross rates may only be achieved over extended periods. So, when setting the trading strategy, the transition manager should discuss the expected timeline and client's risk appetite. In executing these strategies, attention needs to be focused not only on the likely market impact and spread savings, but also on increased risk of exposure to opportunity cost.

Opportunity cost is potentially the biggest and most unpredictable portion of the cost iceberg. It is, in reality, the cost of not trading. By increasing the time taken to implement a restructure, over and above the necessary implementation phase, you are increasing your risk to opportunity cost.

During a transition, clients aim to restructure using the most cost-effective method. It is the role of the transition manager to identify and provide interim management solutions to take the fund through the transition process and minimise all the iceberg's costs – particularly those hidden below the waterline.



Simon Hutchinson,
Transition Management
Strategist, Europe, Northern
Trust Global Investments.

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Honours – 'Best in Class'

NORTHERN Trust has won three 'Best in Class' honours in *PLANSPONSOR* magazine's second annual transition management survey – in the pre-trade, execution and post-trade categories. Northern Trust also achieved the highest ranking of any provider for 'quality of reporting' within the pre-trade category.

*'Best in Class' honours in *PLANSPONSOR* magazine's second annual Transition Management survey 2005, based on responses from 204 institutional clients representing more than US\$164 billion in portfolio transitions in 2004.

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Going Dutch...

A change in regulations has prompted a surge of interest in liability driven investments across the Netherlands. Northern Trust is on hand to provide a complete range of solutions...

DUTCH pension fund clients are showing a great interest in liability driven investment solutions.

Northern Trust is in a good position to provide asset management, asset servicing and performance/risk analytics solutions, as stand-alone or as a total outsourcing solution.

The reason driving Dutch interest lies in a change in the regulations known as FTK*.

Currently, the biggest risk in pension fund portfolios is interest rate risk. The liabilities have a high duration and

are consequently very interest rate sensitive. The long-term rates have declined steadily in recent years, so the value of the liabilities has gone up. Interest rates are low, but could go lower. If this happens, the funding position of many Dutch pension funds is in danger.

interest rates

Pension funds are, therefore, looking to manage this risk. What options do they have? Longer dated bonds may provide one answer and there is a lot of demand for these, however, there is insufficient supply. Most pension funds are, therefore, looking to the interest rates swap market. These markets are far more liquid and provide opportunities for tailored solutions. However, swaps can be complicated to implement and monitor. For this reason many asset managers are looking to provide solutions to make things more straightforward.

The Northern Trust Global Investments (NTGI) solution is a straightforward, transparent and cost-effective one. We propose that clients implement a portfolio of interest rate swaps as an overlay structure. Clients may

decide to keep their existing portfolios, or liquidate them in part to match the liabilities.

The overlay structure is a segregated portfolio of interest rate swaps, managed and custodied by Northern Trust. This portfolio will be constructed in such a way that the liabilities are nominally matched.

NTGI ensures that fund liabilities are matched at all times and reports to their clients accordingly. We have the asset management and asset servicing expertise and world class

technology to enable us to do this by monitoring asset risks versus a given stream of liabilities. These liabilities are first modelled as a portfolio. By applying our own risk models and analytic tools we can calculate the probability of underfunding of the assets versus the modelled liabilities.

Once the interest rate risk has been eliminated we can work with clients to allocate risk elsewhere in order to generate

additional returns. This can be done in various ways, including implementing credit and currency overlays.

Given the healthy funding position of most Dutch pension funds, some trustees will have a risk budget allowing part of the portfolio to be invested in equity funds, hedge fund strategies or other alternative investments to generate additional alpha. These return portfolios can be implemented using in-house strategies or using external managers via our Manager of Managers programme.

By combining our asset management and asset servicing expertise we aim to offer an innovative, integrated solution which stands out in the marketplace.



By Heico de Boer, European Business Development, Northern Trust Global Investments (Europe) Limited

“*NTGI ensures that the fund liabilities are matched at all times and reports to their clients accordingly.*”

Professional trio appointed

NORTHERN Trust has appointed three client service professionals to focus on our growing Dutch custody client base.

Frans Hofkens joins as a senior relationship manager, while Christophe De Brabanter and Dennis Presburg join as account managers.

All three will be based in London initially. In 2006, our Dutch relationship managers will relocate to the Netherlands in line with Northern Trust's plans to open an office in Amsterdam. This office will represent the firm's asset servicing and asset management businesses and provide enhanced client service capabilities to, and a permanent sales presence in, the Dutch market.

Mr Hofkens comes to Northern Trust from Citibank, and was previously at ABN Amro in Amsterdam. Mr Presburg comes from KAS Bank in Amsterdam, where he was a senior account manager for the institutional group.

Mr De Brabanter previously worked in State Street's client services department in London.

Partner profile

Kevin Tan

OUR people are the heart of our organisation. In each issue we introduce a Northern Trust partner to reflect the wealth of expertise available to our clients.



Job title:

Chief Representative, The Northern Trust Company Beijing Representative Office.

What does your job involve?

Building relationships and networks within China, facilitating our strategy in China, and identifying additional opportunities in China.

What does Northern Trust offer China?

Experience, technology and skills to support China's growing institutional market and unique solutions to the Chinese Capital Markets. We've provided consultation to China's National Council for Social Security Fund to develop risk management processes, and worked with them to create a framework for overseas investments.

What are your key qualities?

The ability to actively listen, and come up with creative, effective, and practical win-win solutions.

What's the most rewarding part of your job?

Seeing the China team develop – I enjoy working with people. It is also rewarding to know that we are having an impact not only on Northern Trust, but also on China.

What have you brought to the job from your previous roles?

I had the unique opportunity to work with China's National Council for Social Security Fund because I was a risk management consultant. My risk management focus allowed me to be valuable to the Chinese, helping us develop a strong network within Beijing.

What are your hobbies – and what do you enjoy doing outside of work?

I enjoy meeting new, interesting people. I think of myself as a 'Jack of all trades, master of none' – so my bowling score and my golf score are about the same. I enjoy sand volleyball, soccer, fishing, chess and karate.

If you could invite any person to dinner – living or dead – who would it be?

I would invite Chairman Mao Tse Tung. I am fascinated by Chinese culture. I would like to better understand China's history and the early days of the Chinese Communist Party.

Alternative thinking helps to maximise returns

THE alternative fund sector has brought about a paradigm shift in the global fund management landscape.

The significance of this change can be compared to the effect mobile phones have had on landlines and laptops on desktop computers; both survive but the model of the established player has had to adapt to the new reality.

The bear market, which followed the rise of established markets in the late 90s, has seen spectacular growth for this alternative fund sector, particularly for hedge and fund of hedge funds.

strong inflows

Over 8,000 hedge funds have been established representing over US\$1 trillion of assets. Private equity and property have also attracted strong inflows as the appeal of double-digit, non-correlated returns, compares favourably with falling and volatile, traditional markets.

This year, press comment has turned more negative, particularly to hedge funds, as commentators suggest that some of the shine has come off the alternative sector. These comments are being driven by a recovery in traditional markets coupled with concerns over whether the weight of money flowing into the alternative sector can be effectively invested.

While there is evidence to suggest that the growth of hedge funds, private equity and real estate will slow down from the record allocations seen in recent years, there is no disputing the fact that asset classes will retain their new-found prominence, as the shift towards absolute return drives private and institutional investors to thinking alike.



Impressive sight: Trafalgar Court, Northern Trust's office in Guernsey.

The evidence on both sides of the Atlantic is that allocations will remain positive – not withstanding concerns over reductions.

What is also clear is that mainstream fund managers are adopting hedge fund-type strategies and structures within their offering, and are not just providing access through fund of hedge fund investments, as was the case initially.

We are also seeing hedge funds diversify into long-only and private equity.

There will be changes – indeed the key challenge

of these asset classes is that exacting returns requires an adaptable and intelligent investment process. Investors will seek out the best of breed in their search for absolute returns.

■ Northern Trust provides highly focused fund administration services to hedge funds, private equity, property and fund of funds. For more information please contact Mark Huntley on: +44 (0) 1481 745530.



This means identifying investment talent and ensuring that the fund structure, its operation, and governance are of the highest quality.

alternative funds

Each step in the chain is key to delivering the absolute returns of investment and security – and there is much to suggest that it is in the operational areas where the real risk in alternative funds exists.

Ultimately, successful alternative investment funds are characterised by the talent and adaptability of the fund manager. By combining this with the clear process, procedures and corporate governance of a knowledgeable fund administrator, investors' interests can be suitably protected, maximising their return.