

City of San Jose Retirement Plans

May 27, 2020

Custody Search

Background

- In January 2019, San Jose Staff and Meketa Investment Group (Meketa) issued a Request for Proposal (“RFP”) for Custodial Services. We provided additional information on the Plans’ custody needs and responded to questions over the course of the following several weeks, and then sent a follow-up request for information to the respondents in early April 2019.
- Next, San Jose Staff and Meketa Investment Group reviewed the six resulting proposals and responses to follow-up questions (including from incumbent State Street Bank), in order to evaluate the following criteria: organizational stability, relationship management, servicing capabilities, differentiating characteristics, prior client experience, turnover statistics, and proposed fees.
- In December 2019, a selection committee made up of Staff members from Investment and Accounting groups interviewed semi-finalists, while representatives from Meketa participated by phone. Then, in early 2020, Staff performed onsite meetings with the semi-finalists.
- San Jose Staff and Meketa then worked together to arrive at three finalists: State Street (incumbent), Northern Trust, and BNY Mellon. A variety of information and comparisons of the finalists can be found on the following slides.

Selecting a Custodian

- The primary service provided by custodians is the safe keeping and recording of assets. In today's world, custody services are highly automated. A top-tier custodian will:
 - Maintain ongoing investment in state-of-the-art technology (including disaster recovery and cyber security systems).
 - Work on a direct automated basis with the Plans' money managers and consultant.
 - Provide accurate statements and accounting information in a timely manner every month.
 - Appoint a dedicated team that will respond to client requests in a timely manner.
 - Offer additional services, such as performance measurement, benefit payments, and securities lending.

Firm Overviews

	State Street	Northern Trust	BNY
Firm Headquarters	Boston, MA	Chicago, IL	New York, NY
Master Trust/Custody Location	Kansas City, MO	Chicago, IL	Los Angeles, CA
Firm Inception	1792	1889	1794
Total Custody Assets	\$25.3 trillion	\$7.6 trillion	\$33.1 trillion
Global Sub-Custodian	Network	Network	Network
Ownership	Public (STT)	Public (NTRS)	Public (BK)
Credit Rating (S&P Senior Debt)	AA-	AA-	AA-
Tier 1 Capital Ratio	17.9%	14.8%	12.7%

Firm Overviews

- State Street, Northern Trust, and BNY are all global custodian banks with stable Tier 1 Capital Ratios, and they offer many additional services directly through the banks.
 - It is important to note these providers vary greatly in size, with BNY being the largest at \$33.1 trillion in custody assets.
- The required Tier 1 Capital Ratio to be classified as “Well Capitalized” is 6.0%, as administered by the Federal Reserve Bank regulatory authorities, with all custodian banks shown exceeding this requirement.
- BNY is the only finalist with a primary location on the West coast.

Firm Statistics

	State Street	Northern Trust	BNY
% of Revenues from Custody	83% ¹	63%	75%
Public Funds % of Assets	11%	22%	6%
% of Clients with assets \$1 billion - \$10 billion	161	641	296
Past 5-year Custodial Client Growth (net)	-19	+355	+37

- Each custody provider shown offers similar services, has many years of experience in the custody banking business, and derives substantial revenue from their custody businesses.
- Northern Trust and BNY have increased their client base with net gains over the past five years, while State Street has experienced a net decline.

¹ Custody services are rolled up into Investment Servicing line of business.

Accounting, Reporting, and Systems

	State Street	Northern Trust	BNY
Audited Statements Timeline?	5-7 business days	3-5 business days	3-5 business days
Excel API Access	Yes	Yes	Yes
Ability To Create Custom Reports Online?	Yes	Yes	Yes
Real Time Data Available Online?	Yes	Yes	Yes
Is SAS-70, SSAE 18, SSAE 16 Reporting	Yes	Yes	Yes
Excel files available for DOL Form 5500?	Yes	Yes	Yes
View only access for auditors?	Yes	Yes	Yes
GAAP, FASB, and GASB compliance?	Yes	Yes	Yes
Adequate Disaster Recovery Processes	Yes	Yes	Yes
Fiduciary Liability Insurance Coverage (millions)	\$200	\$100	\$100
Errors & Omissions Insurance Coverage (millions)	\$75	\$100	\$100

- All respondents offer an online reporting system. Generally, information is available in real time. For monthly audited reports, the time frame of availability is within 3-7 business days for all respondents.
- All providers offer similar reporting capabilities and disaster recovery processes, while insurance coverage amounts vary slightly among the custody providers.

Client Servicing

	State Street	Northern Trust	BNY
Number of Custody Employees	26,612	13,372	19,300
Proposed Core Client Team Members:	4	4	2
Avg years of Experience	16	13	19
Avg # of Clients Serviced	NA	8	8
Location	Kansas City, MO	Chicago, IL	Los Angeles, CA and Pittsburgh, PA

- It is crucial that the Plans' custodian provide excellent client service. This includes, but is not limited to, prompt responses to client inquiries.
- All custodians have identified a core client team to service the Plans.
 - All of the client teams are supported by large teams at each custody provider.

Fee Summary

	State Street	Northern Trust	BNY
Proposed Transition Timeline	N/A	8 weeks	60 days
Federated Pension Proposed Fee	\$302,651	\$164,646	\$172,246
Federated Health Care Trust Proposed Fee	\$124,781	\$22,620	\$34,502
Police & Fire Retirement Proposed Fee	\$330,686	\$277,423	\$218,465
Police & Fire Health Care Trust Proposed Fee	\$81,732	\$10,932	\$24,769
Estimated Total Fees:	\$839,850	\$475,621	\$449,982

- The table above shows the proposed fees following San Jose Staff's fee negotiation process.

Summary

- Meketa Investment Group concurs with San Jose Staff's recommendation that the Plans hire BNY as their new custody provider.
- Top-tier custodians are able to provide highly automated custodial data. It is important to provide accurate and timely statements, preferably with online access to data. Additionally, exceptional client service is critical in a custodial relationship, including quick responses to client inquiries, and accuracy in recordkeeping and effecting transactions. Our clients who use BNY have been generally satisfied with the accuracy and responsiveness of their custody teams.
- Changing custodians requires a significant time commitment at the outset, and can cause a great deal of operational headaches for staff members. There is also no guarantee that a new custodian will offer improved service over the incumbent. However, switching to BNY is estimated to save nearly \$400,000 per year in fees for the San Jose Plans.
- We look forward to discussing this recommendation with the Investment Committee members.