



**STATE OF HAWAII**  
EMPLOYEES' RETIREMENT SYSTEM  
November 2, 2012

ADDENDUM NO. 2  
Request for Expression of Interest,  
Issued October 1, 2012  
for the Employees' Retirement System  
State of Hawaii

OFFERORS:

In accordance with Section IIG of the Request for Expression of Interest, issued October 1, 2012, the Employees' Retirement System of the State of Hawaii (ERS) is providing the following responses to questions from potential offerors:

1. Question: Who ends up signing the contract with the winning bank?  
Response: The contracting agency, i.e., the "STATE," is the ERS. There will be two signatories for the ERS: (1) a member of the ERS Board of Trustees; and (2) the Administrator, Assistant Administrator, or Director of Finance.
2. Question: Does ERS have CAFR's for 2010 and 2011? If so, could you kindly consider distributing to all potential bidders as soon as possible.  
Response: ERS does not have CAFRS for 2010 or 2011 at this time. We expect to have a CAFR for 2010 sometime in December 2012 and are targeting January 2013 for completion of the CAFR for 2011.
3. Question: Can we request a performance report or benchmark list to get a clear understanding of the market data required?  
Response: Yes, see the web site <http://ers.ehawaii.gov/investments/performance>.
4. Question: On the website, the latest CAFR was 2009. Is there a more recent version?  
Response: See Response No. 2.
5. Question: Do you have any legacy investments or unrealized losses (Lehman exposure) that will need to be financed?



Employees' Retirement System  
of the State of Hawaii

Response: No, ERS does not finance investments under the custody agreement. Please note that certain real estate and private equity investment managers are allowed to use leverage within certain limited partnerships, limited liability companies or corporations. For custody and performance reporting purposes of the custodian, the investment activities and cash flows are reported as a single investment (security holding) for each entity using the equity method of accounting. For example, the investment will show the net fair value of ERS investment and reflect the net income/loss earned on the investment. (Refer to investment managers Heitman, LaSalle, Invesco and Hancock that include limited partnerships, limited liability companies, or corporations where the ERS owns over 99% of the investment.)

For financial reporting purposes, ERS reports the financial activities for certain investments (e.g. limited partnership interests) on the consolidated method of accounting in accordance with generally accepted accounting principles (GAAP). This includes a “look-through” to the partnership assets, liabilities, income and expenses and reporting the “gross” amount on the ERS financial statements.

6. Question: Please provide a list of all anticipated investments that would need to move from the current service provider?

Response: Please refer to Attachment 4 - Asset Holding of ERS – (custodyeoi-attach4.xls) for ERS’s holdings as of June 30, 2012 for a representative list of assets. Individual security positions are identified in Column A of the Excel file as either “Custody” or “Securities Held Elsewhere (SHE)” for purposes of this EOI. The table on pages 4-6 of the Request for EOI includes information at the manager/account level.

7. Question: Will you place any limits on the service provider related to total outstanding balances, minimum spreads, counterparty limits, proxy voting, etc.

Response: The ERS does not generally place limits on the loan volume, minimum spreads on contracts or proxy voting. ERS expects the securities lending service provider to establish and maintain prudent limits for loans to counterparties. Although the ERS wants all lendable assets held by the custodian to be available for securities lending activities, ERS reserves the right to restrict lending activities upon notification to the securities lending service provider. The ERS's proxy voting policy is included under section C.12.A of the ERS Investment Policy, Guidelines, and Procedures manual.

8. Question: Please provide gross income earned, net of borrower rebates for Fiscal Year, 2010, 2011.

Response: The following is a summary of the ERS's securities lending activity for the fiscal years ended June 30, 2010, 2011 and 2012. (Amounts are reported on the accrual basis of accounting and may be unaudited.)

	2010	2011	2012
Securities lending income	\$2,742,533	\$3,225,088	\$2,839,531
Borrower rebates	( 502,726)	(496,217)	(1,408,982)
Securities lending income after rebates	3,245,259	3,721,305	4,248,513
Management fees to securities lending agent	455,912	558,216	636,919
Net income from securities lending income for ERS	\$2,789,347	\$3,163,089	\$3,611,594

9. Question: Does [ERS] have a preference for a commingled or Separate account for management of collateral?

Response: The ERS prefers a separate account for collateral unless it is more optimal to use a commingled vehicle.

10. Question: Is [ERS] looking for a backward looking estimate based on historical performance or a forward looking estimate based on current performance?

Response: Please provide estimates based on both methods.

11. Question: Are exclusive arrangements permitted?

Response: The ERS Board of Trustees has not decided whether or on what terms to permit exclusive arrangements.

12. Question: Are individual US government loans, initially collateralized at 102%, allowed to float to 100% collateralization as long as collateralization remains at the 102% level in aggregate at borrower?

Response: The securities lending agreement may provide that the collateral requirements of a borrower be the aggregate collateral required for all loans to the borrower.

Collateral requirements must be determined based on the currency of collateral received (e.g. United States dollar, Euro) and the collateral requirements of the security lent (e.g. 102% vs 105%).

13. Question: There is an attachment 2 to the RFP that outlines policies and guidelines for securities lending. However, a separate contract for these services is indicated. May we receive a copy of that contract for review please?

Response: The contract form attached to the Request for EOI will be used as the basis for both the custodial and securities lending contracts.

14. Question: Section 88-121.5(4) of the Hawaii Revised Statutes indicates that any income and profits earned on collateral shall be retained for the benefit of the system. Please clarify that the securities lending agent can be entitled to deduct borrower rebates and its fee from such income and profits.

Response: Section 88-121.5(5), Hawaii Revised Statutes (HRS), does not prohibit the securities lending agent from deducting borrower rebates and the securities lending agent's fee from income and profits earned on securities lending collateral.

15. Question: Section 88-121.5(6) of the Hawaii Revised Statutes indicates that if the borrower fails to return the loaned securities upon termination of the loan period, the borrower shall forfeit to the system the collateral deposited. Please clarify that the securities lending agreement may stipulate that collateral in excess of borrower obligations will be returned to the borrower.

Response: The securities lending agreement may provide that, if the borrower fails to return the loaned securities upon termination of the loan period, the collateral will be applied to satisfying the borrower's obligations and any excess collateral will be returned to the borrower.

16. Question: Please confirm timing of reporting for month-end audited accounting statements. The RFP indicates 7<sup>th</sup> business day for both online and hardcopy reports however hardcopies are mailed and therefore always lag behind online reports.

Response: Online and hardcopy reports are due on the 7th business day.

17. Question: Does [ERS] require their investment managers to provide reconciliations of holdings prior to the 7<sup>th</sup> business day NAV deadline? What reporting does [ERS] require from their custodian around investment manager reconciliations?

Response: The ERS does not currently require investment managers to provide the reconciliations prior to the 7th business day. Some of ERS's current

managers are performing this task, and ERS is working towards having all managers provide reconciliations earlier.

Managers are required to provide the custodian with a detailed list of holdings monthly. The custodian is responsible for performing the reconciliation. The custodian may review and use reconciliation by the manager, provided that the manager's reconciliation contains sufficient details and is received timely. At a minimum, the custodian is required to provide ERS with a summary, within 30 days of the month end, of the reconciliation results for all accounts, including a summary of source of reconciliation (i.e. manager or custodian, date received, and differences).

For more information refer to reporting requirements section for fixed income and equity managers in section C.6 of the ERS Investment Policy, Guidelines, and Procedures manual.

18. Question: For all commingled funds and private assets held, are monthly statements detailing market value and transaction detail made available by the investment manager or partnership by the 7<sup>th</sup> business day? If not, what's [ERS's] expectation for finalizing the plan's NAV when statements lag past the 7<sup>th</sup> business day?

Response: If the statements for the ERS assets not held by the custodian are not available to the custodian by the 7<sup>th</sup> business day, the custodian should let the ERS know who has not provided the statements timely and when the statements are expected to be available. Generally if the statements are delayed for only a few days, ERS will keep the total fund books open. If not, the monthly reports will be closed.

However, please note that a delay in one investment manager account should not affect closing of the other investment accounts, the availability of online reports, or the availability of online consolidated reporting if the delayed investment manager is not included in the consolidation.

19. Question: Section II subpart D of the EOI (page 8) describes "Phase 5" of the evaluation process by stating "[A] contract will be negotiated including fees, with the first ranked candidate". However, the "Acceptance of Proposal and Execution of Contract" section of Section II of the EOI (page 10) provides that contracts will be forwarded to the successful offeror for execution and the contract will be returned within 10 days after receipt by the offeror. Would you confirm that there will be an opportunity to negotiate the final agreement to be signed by the parties?

Response: There will be an opportunity to negotiate the final agreement; however, in no case will the negotiation result in a higher fee than the fee contained in the proposal. Furthermore, if a satisfactory contract is not negotiated within what the ERS Administrator believes is a reasonable time,

negotiations will be terminated and negotiations with the next ranked candidate will be commenced.

20. Question: Accounts & Market Value: Please provide the following information to a. and b.

a. Market value of actively managed non-US assets by country.

Response: Please refer to Attachment 4 - Asset Holding of ERS – (custodyeoi-attach4.xls) for ERS's holdings as of June 30, 2012 for a representative list of assets. Individual security positions are identified in Column A of the excel as either "Custody" or "Securities Held Elsewhere (SHE)" for purposes of this EOI. The file contains multiple security identifiers and attributes for each individual holding (such as currency, country of risk or country of incorporation).

b. Number of passively managed funds by type (mutual funds, commingled funds, limited partnerships, hedge funds, etc.). Please note that we are primarily interested in the total number of fund investments you have and not the number of accounts you hold the fund investments in (if the totals vary)

Response: As of June 30, 2012 there were about 220 investments – please refer to Attachment 4 (described in the response to part a, above).

21. Question: Transactions: You have supplied the total number of buy and sale transactions, would you please provide further breakdown by country?

Response: Refer to "Trades Other Country" in Attachment 9, ERS Investment Statistics for total buy and sale transactions. Amounts included in the 29,500 (16,000 buys plus 13,500 sales) transactions:

- Difference of 22,300 transactions (Trades Other Country) from total 29,500 transactions represents trades in the United States.
- Countries included in Other category (with less than 25 trades) include Argentina, Austria, Bermuda, Columbia, Czech Republic, Egypt, Hungary, Iceland, Ireland, Kazakhstan, Lithuania, Morocco, Netherlands, New Zealand, Peru, Portugal, and Slovakia
- About 1,100 of the 29,500 transactions are for derivative transactions (buys and sales) for overnight repurchase agreements, swaps and swaptions (such as credit default swaps, interest rate swaps, total return swaps).
  - Separate counts for currency exchange contracts (4,500) and write options/futures (1,500) are not included in the 29,500 trades.

Please note that past investment activity and transaction counts may not be a good prediction of future investment activity that may be significantly different due to a number of factors including, but not limited to, changing

investment market and economic conditions, investment valuations; investment portfolio rebalancing; changes in investment managers.

21a. Question: Transactions: Were the 4,500 currency exchange contracts executed with the current custodian or a third party? If both, please supply the number of contracts per custodian vs. third party.

Response: About 40 per cent of the currency exchange contracts were executed with the custodian.

Please note that past investment activity and transaction counts may not be a good prediction of future investment activity that may be significantly different due to a number of factors including, but not limited to, changing investment market and economic conditions, investment valuations; investment portfolio rebalancing; changes in investment managers.

21b. Question: Transactions: Please supply:

(1) Number of Income and Dividends received per annum

Response: There were about 10,600 fixed income interest income transactions, 4,700 equity dividend transactions, and 600 income transactions on other asset classes. This excludes short-term investment income transactions (as ERS automatically transfers excess cash to a short-term investment fund with the custodian), interest purchased/sold, derivative commissions, and mark-to-market transactions.

Please note that past investment activity and transaction counts may not be a good prediction of future investment activity that may be significantly different due to a number of factors including, but not limited to, changing investment market and economic conditions, investment valuations; investment portfolio rebalancing; changes in investment managers.

(2) Number of Derivative transactions

Response: See Response Nos. 21 and 21a.

22. Question: Accounting: Do you require daily or monthly audited accounting records?

Response: The ERS requires monthly audited accounting reports, but reserves the right to obtain on a more frequent basis if required.

23. Question: Performance Measurement and related services: Will you want performance measurement, analytics, etc. on all accounts, including SHE's? To what level (asset class, sector/country, security)?

- Response: The ERS requires performance measurement, analytics, etc. for all accounts, including SHE's, at the asset class, sector, country, and security levels.
- 23a. Question: Do you have Custom Benchmark Performance: If yes, how many custom benchmarks?
- Response: See Response No. 3.
- 23b. Question: In [section J.6] of the Services section, it is noted that you require historical returns and fund holdings on all accounts. What is the start date of the history you require and by "fund holdings" do you mean holdings and transaction from a performance perspective?
- Response: Monthly performance returns will be provided to the custodian for prior periods at the sub-asset class and investment manager level as available. Please note the start date on historical returns will vary by class and manager, with the earliest start date being February 28, 1979 for the Diversified Income asset class and PIMCO investment manager. Information at the "fund holdings" level is desired from the start of custodial services. Please refer to the implementation dates on the performance report discussed in Response No. 3..
- 23c. Question: Would you like Portfolio and Security Analytics monthly or daily and will this service be for all accounts?
- Response: These services are required monthly for audited statements on all accounts and assets. Please describe what daily services and features your company and systems provide.
- 23d. Question: Will you require performance and related services on consolidation/composites? If so, how many?
- Response: Performance measurement and related services are required on consolidation/composites. At a minimum, these services are required on the ERS investment portfolio and by asset class/sub-asset class. Currently ERS has less than 10 consolidations/composites for accounting, performance, and reporting purposes.
- Please describe your services and system features that would provide the ERS with performance measurement services for a new consolidation or on an ad-hoc query basis.
24. Question: Securities Lending: Do you currently participate in securities lending with your current custodian? If so, please share the lending split that is currently in place.
- Response: Northern Trust, the ERS's current custodian, provides securities lending services for the ERS. ERS receives 85% of income after rebates, and Northern Trust receives a management fee of 15% of the income after rebates.

25. Question: Terms and Conditions: Can ERS identify those laws of Hawaii that it believes should be applicable to arrangements where the service provider is performing the services outside of Hawaii? While we would recognize that the services contract would be subject to interpretation under the laws of the State of Hawaii how far does this provision extend. For example, is it ERS' intent that Hawaii's laws apply to employees of the service provider that perform services under the contract and who are located in another state? Or do Hawaii's laws apply to a service provider headquartered outside of the state and performing services under the contract outside of the state? Please clarify if there are some parameters for identifying the laws which are intended to be covered by this provision of the EOI.

Response: The Hawaii laws that could apply include laws relating to: workers' compensation (chapter 386, HRS); unemployment compensation (chapter 383, HRS); payment of wages and benefits (including chapters 392 and 393, HRS); and safety (chapter 396, HRS); and laws relating to income (chapter 235, HRS) and general excise taxes (chapter 237, HRS). The ERS is unable to advise offerors as to which, if any, of these or other Hawaii laws are applicable to any particular offeror. The contractor will be required to certify that the services to be performed under the contract will be performed under the following conditions:

- i. Wages. The services to be rendered shall be performed by employees paid at wages or salaries not less than the wages paid to public officers and employees for similar work.
- ii. Compliance with labor laws. All applicable laws of the federal and state governments relating to workers' compensation, unemployment compensation, payment of wages, and safety will be fully complied with.

25a. Question: The "Contract for Goods and Service, Section E., asks if a performance bond will be in place. Is a performance bond a requirement of the EOI?

Response: Performance and payment bonds will not be required.

25b. Question: General Conditions document section 2.e. – for purposes of this EOI, would the "Contractor" be exempt from this requirement? If not, at what point would these certificates be required?

Response: The tax clearance certificate referred to in General Condition 2.e is a statutory requirement for entry into a contract with the ERS. HRS § 103-53. Compliance with this requirement is provided through a "Certificate of Vendor Compliance" obtained through Hawaii Compliance Express: <http://vendors.ehawaii.gov>. (Note that Hawaii Compliance Express is intended to facilitate compliance with certain requirements for procurements subject to the Hawaii Public Procurement Code (chapter 103D, HRS). Although this Request for Expression of Interest is not subject to chapter 103D, HRS, Hawaii Compliance Express is currently

the only way of providing the tax clearance required by HRS § 103.53.) The Certificate of Vendor Compliance must be provided upon execution of the contract. To avoid delay in the effective date of the contract, offerors should plan on providing the Certificate of Vendor Compliance upon notification that they are the successful offeror. If the ERS Administrator determines that the top ranked offeror is unable to provide a timely Certificate of Vendor Compliance, the ERS Administrator may enter into negotiations with the next ranked offeror and the contract may be awarded to such offeror upon negotiation of a satisfactory contract.

26. Question: What is required when you state [in Section V.C.5]: “provide acknowledgement of notice of payment”?
- Response: At a minimum there should be a payment/remittance notification sent to payee with the payment that includes sufficient detail for the payee. In addition, confirmation is given to ERS when checks have been mailed. If the transaction is processed manually by the custodian (i.e. from faxed instructions), then confirmation to ERS is required when payment is processed.
27. Question: [In Section V.G.5,] you note “all reports will comply with the Department of Labor reporting requirements.” Does [ERS] want to be treated as an ERISA-like Trust and will you require a 5500 annual report?
- Response: The term "ERISA-like Trust" has not been defined. We are therefore unable to respond to the first portion of the question. The ERS will not require a Form 5500, Annual Return/Report of Employee Benefit Plan.
28. Question: [Section V.G.10] provides that “[p]erformance measurement, attribution, risk management and other analytic reports in the format acceptable to ERS.” May we request samples of the formats?
- Response: We will not be providing sample formats. Rather, the ERS is looking to the custodian to provide reports that will be operationally effective.
29. Question: Please provide sample reports of any custom reports required.
- Response: Requirements for future reports will be based on your system capabilities and the type of requests the ERS receives.
30. Question: Please state how many users would require on-line access.
- Response: Approximately 12-20 ERS staff will require on-line access. In addition, ERS contracts with approximately 40 separate companies as investment managers, investment consultants and service providers that will require on-line access.

Very truly yours,



Wesley K. Machida  
Administrator