



STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

April 17, 2018

ADDENDUM NO. 2

To

Employees' Retirement System of the State of Hawaii
Global Custody Services and Securities Lending
Request for Expression of Interest 2018
Issued March 20, 2018

OFFERORS:

In accordance with II. General Overview, Section G of the Request for Expression of Interest 2018 the Employees' Retirement System of the State of Hawaii (ERS) is providing the following responses to questions from potential offerors:

1) **QUESTION:**

Would you kindly clarify which Sections you would like answered when responding solely in connection with providing (third-party) securities lending services? We assume Sections A (Background), N (Securities Lending), P (Transition/Conversion), and Q (Terms and Conditions of Contract) apply, but are there other Sections (or specific additional questions) you would like answered?

RESPONSE:

Relevant questions within: A (Background), B (Personnel), C (Clients), D (Internal Controls and Risk Management) E (Administration and Client Relations), H (Investment Guidelines Compliance and Monitoring), L (Accounting and Reporting) N (Securities Lending), P (Transition/Conversion), and Q (Terms and Conditions of Contract)

2) **QUESTION:**

Please provide the approximate average daily balance of funds invested in the custodians sweep.

RESPONSE:

The approximate average daily balance of funds invested in the custodian's sweep (including ERS's operational requirements but excluding securities lending) is estimated to be \$350 million.



Employees' Retirement System
of the State of Hawaii

3) **QUESTION:**

Please identify any data linkages you have with your custodian or outside service providers (i.e. GL feeds, CRO month-end security reports etc.).

RESPONSE:

The data linkages will be

Incoming CRO NAV feed (BNY Mellon, Administrator) (daily), CRO holdings detail feed (BNY Mellon, Administrator) (monthly)

Outgoing ERS GL Feed; Bloomberg holdings detail feed (daily), Aladdin (by Blackrock) holdings detail feed (daily), FRM CRO Platform Manager holdings detail feed (quarterly)

4) **QUESTION:**

Regarding your Private Equity portfolio administered by Hamilton Lane, will the custodian book a single value representing all the LP's or record all of the LP's individually?

RESPONSE:

Record all LPs individually, including but not limited to the portfolio administered by Hamilton Lane. Currently, all LPs are tracked in individual accounts.

5) **QUESTION:**

For the LP's administered by Hamilton Lane, will you require the custodian to track capital calls or will that be done by Hamilton Lane? If done by Hamilton Lane, who will be responsible for initiating the payment of funds?

RESPONSE:

Hamilton Lane is responsible to track capital calls for LPs overseen by them. The LP notifies Hamilton Lane, the custodian and ERS of capital calls and distributions, as applicable. Hamilton Lane notifies ERS and the custodian of required capital calls; ERS authorizes the payment of funds; and the custodian is responsible to verify payment authorization with the LP notice since the custodian usually has several clients invested in the LP.

6) **QUESTION:**

Please confirm how many Limited Partnerships you hold that are separate from those in the portfolio administered by Hamilton Lane?

RESPONSE:

Refer to Question 21.

7) QUESTION:

Will 3rd party tracking and reporting of the fund's overall private markets portfolio (including Hamilton Lane portfolio) be a requirement?

RESPONSE:

No, however you may list any capabilities your firm has.

8) QUESTION:

In Attachment #9 – ERS Investment Statistics/Options Futures, please provide the number of Options that are Exchange Traded-vs-OTC.

RESPONSE:

The 4,500 Option Transactions are expected to be 4,300 for Exchange Traded vs 200 for OTC, or 95% and 5%, respectively.

9) QUESTION:

Section II. Submission of the Response - What format should the 18 hardcopies be in - Word or Excel? If Excel are we able to open the cells in the excel document to fit more of our responses?

RESPONSE:

Word format, please limit your response in electronic Excel Format to the capacity of the cells.

10) QUESTION:

Section V. Accounting indicate Master Trust Accounting – Basis of allocating net assets, net investment income, and gains and losses to three or more participating plans (e.g., sub accounts) in the master trust. ERS does not have a master trust structure in place today, do you anticipate establishing a master trust structure in the future?

RESPONSE:

While the ERS does not presently have a Master Trust structure in place today, we do not know if this may change during the period of the new contract. Please discuss your firm's capabilities as requested in the questionnaire.

11) QUESTION:

Section V. Reporting Requirements to provide certification from the "trustee" that the reported information is complete and accurate. Please provide clarification that the contractor's capacity is expected to act as "custodian" and not "trustee"?

RESPONSE:

Yes, confirming the contractor is expected to act in the capacity of custodian.

12) QUESTION:

Attachment 9, Transactions. Please confirm that the Transactions listing Trades – Buys at 28,000 and Trades – Sales at 28,000 totaling 56,000 are all U.S. domestic trades? And that the volumes provided under Trades Other Country are in addition to this 56,000 U.S. trades total?

RESPONSE:

No, the amounts are not added together. The 22,690 transaction volumes listed under Trades Other Country are part of the 56,000, leaving 33,310 estimated for U.S. domestic trades.

13) QUESTION:

Please provide a breakdown of market value by country.

RESPONSE:

Refer to Attachment 4, 2018 Asset Holdings of ERS since this list contains the holdings for the ERS as of January 31, 2018.

Actual holdings and balances will change based on actual trading and investment activity of the investment managers.

14) QUESTION:

We noticed your fiscal year end requirements and the fact that the cutover would be on January 1. Is there any flexibility to move this in line with you fiscal year end to ensure there is less work required on Hawaii staff if a cutover is required based on your decision?

RESPONSE:

No.

15) QUESTION:

We have a significant amount of clients with assets greater than 5b and will likely not be able to provide all client's details as requested. Can you confirm an acceptable amount of references for us to provide to ensure we are not held unresponsive?

RESPONSE:

At least six U.S. public funds.

16) QUESTION:

Do you require IRRs for your alternative assets?

RESPONSE:

Yes, the system should be able to track both Internal Rate of Return and Time Weighted Returns.

17) QUESTION:

Do you have any requirements for private asset fee transparency?

RESPONSE:

Yes.

18) QUESTION:

How does your organization trade FX today?

RESPONSE:

ERS does not manage any FX activity in-house.

The investment managers are given full discretion to manage the assets within their respective investment mandate including trading foreign exchange (FX), if applicable.

If the investment manager does not designate a trade for FX, ERS has standing instructions for FX transactions to be “netted” by currency at certain times of the day. Any remainder after netting is then converted per the standing instructions; and ERS pays a set basis point fee (by currency) on the FX converted.

19) QUESTION:

Are you interested in additional governance and oversight tools for your hedge fund portfolio?

RESPONSE:

None, other than the ability to import CRO instruments into your holdings-based analytical system on a monthly basis, but indicate what other resources you have available.

20) QUESTION:

How do you finance any short positions within your portfolio?

RESPONSE:

The investment managers are given full discretion, and are expected, to manage the assets within their respective investment mandate (and account).

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, 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.

21) QUESTION:

Page 4-6, Overview: Can HIERS please confirm that there are 38 separately-managed accounts and 32 commingled funds?

RESPONSE:

As of September 2017. The number of separate accounts will fluctuate slightly, but should remain static over time, while the number of private market commingled funds is expected to increase modestly each year as commitments are made to new funds.

Note that there are approximately 190 private equity funds (commingled) and real estate funds/entities (commingled/separate) that are held in the separate accounts of Hamilton Lane, Heitman Capital, Invesco, and Stafford; these funds will have to be tracked separately in the custody system.

22) QUESTION:

Page 4-6, Overview: What is the average vintage year for HIERS' alternative investments? And what format is it maintained?

RESPONSE:

Vintage years for funds with positive market value range from 1998 to 2018; average vintage year is 2013; Hamilton Lane maintains all the historical cash flow data for each fund in their proprietary database. For private equity, in many instances the data begins in 2013, as information before that time period was not transferred or verifiable during the change in custodians.

23) QUESTION:

Page 4, Overview: Please provide additional details on the Crisis Risk Offset Program. For accounting purposes, are these the same as other commingled funds? Where is the statement coming from with the position, transaction activity and valuations? Is this client-supplied or manager-supplied? When is the statement available? Where are the 4,000 securities coming from? Who provides the underlying holdings information?

RESPONSE:

Refer to Section I: The Crisis Risk Offset Program (CRO) in the ERS BOT Policies and Procedures Manual that is located on the ERS website as listed in Attachment 8, ERS Board of Trustees Investment Practices. To manage the assets assigned to the CRO class component, the ERS currently uses a CRO Platform Manager and nine (9) external investment managers (each as a separate Delaware LLC wholly owned by ERS).

The Bank of New York Mellon as the Administrator of these CRO LLCs, provides reporting (from their Advent Geneva computer module/system) to the ERS, the CRO Platform Manager and The Bank of New York Mellon as ERS Master Custodian (being procured under this EOI).

The CRO LLCs via the CRO Administrator currently provide a 5th day statement for month end processing for posting to the ERS Master Custodian monthly reports, and a Final Monthly on the eighth day. The June year-end report is posted with the Final Monthly information.

For accounting purposes, the ERS Master Custodian currently uses the BNYM Administrator Reports for monthly reporting at the fund level, and does not track the underlying securities in detail in accounting reports.

The holdings details at the securities level for the CRO LLCs is provided by the BNYM Administrator for loading into the ERS Master Custodian system for compliance and performance modules.

24) QUESTION:

Page 14, Services, Section A, Question 9: Is HIERS looking for the custodian to do plan accounting or does HIERS do this in-house? If the custodian is expected to perform this service, does HIERS require unitized or allocated plan accounting?

RESPONSE:

Refer to question 10.

25) QUESTION:

Page 14, Services, Section A, Questions 9: Please send a copy of HIERS' current plan accounting reports and schematic. How many investment options are available to the plans? Is it just one for the master trust overall or is the master trust further divided into additional investment options?

RESPONSE:

Refer to question 10.

26) QUESTION:

Page 14, Services, section B, Questions 4: Can HIERS clarify which parties it expects to serve as transition managers?

RESPONSE:

Asset transition managers are typically used to restructure ERS's portfolios as a result of manager performance or strategic allocation changes. The goal is to maintain exposure to the market at all times (i.e., minimize time in cash assets) and furthermore to minimize transaction costs, including, without limitation, commissions, market impact, and opportunity cost.

27) QUESTION:

Page 14, Services, Section C, Question 1: Does the service for a 'Short Term Investment Fund' pertain solely to a dedicated STIF (managed by HIERS) or would proprietary and/or third-party managed money market funds also be in scope for sweep options?

RESPONSE:

Includes proprietary and/or third party managed money market funds (not ERS managed STIF).

28) QUESTION:

Page 17, Services, Section G , Question 12: Does HIERS require monthly or daily compliance services?

RESPONSE:

Daily

29) QUESTION:

Page 19, Services, Section J, Questions 12: Does the reference to "databases" mean underlying holdings of a fund that are in custody elsewhere? Please specify the type of analytics required.

RESPONSE:

Holdings-based analytics include, but are not limited to, currency exposures, country exposures, sector exposures, various durations, average maturity, commodity exposures, etc. so that your analytic systems can incorporate the custody elsewhere assets with the custody assets in your in-house analytics system. The custody elsewhere assets are the nine CRO accounts and the Legal & General account.

30) QUESTION:

Page 25, Questionnaire, Section G, Question 39: For clarification, can HIERS provide an example of a custodian-imposed security type restriction?

RESPONSE:

No, this is up to the responders to indicate whether they have any security types that they cannot custody.

31) QUESTION:

Page 26, Questionnaire, Section G, Question 45: Does HIERS manage any spot related FX activity in-house?

RESPONSE:

Refer to Question 18.

32) QUESTION:

Page 26, Questionnaire Section G, Question 45: Does HIERS manage any spot related FX activity in-house?

RESPONSE:

Refer to Question 18.

33) QUESTION:

Page 26, Questionnaire, Section G, Question 45 Can HIERS please provide the annual spot FX volume (USD\$ equivalent) by market for the FX activity that is currently executed through the custodian versus a third party?

RESPONSE:

Total FX volume (USD\$ equivalent with greater than \$1 million for the market), including spot FX transactions, executed through the custodian versus a third party by market for one year.

Currency	Buy FX (\$million)	Sell FX (\$million)
AUSTRALIAN DOLLAR	175	161
BRAZIL REAL	8	14
CANADIAN DOLLAR	21	14
CHILEAN PESO	3	4
DANISH KRONE	5	8
EGYPTIAN POUND	1	5
EURO CURRENCY UNIT	421	361
HONG KONG DOLLAR	9	1
INDONESIAN RUPIAH	10	14
JAPANESE YEN	82	61
MALAYSIAN RINGGIT	1	3
NEW TAIWAN DOLLAR	54	46
NEW ZEALAND DOLLAR	246	212
NORWEGIAN KRONE	78	96
PHILIPPINES PESO	1	9
POLISH ZLOTY	175	172
POUND STERLING	145	173
QATARI RIYAL	1	2
SINGAPORE DOLLAR	2	4
SOUTH AFRICAN RAND	337	313
SOUTH KOREAN WON	69	39
SWEDISH KRONA	8	19
SWISS FRANC	3	3
THAILAND BAHT	15	8
UAE DIRHAM	2	3

34) QUESTION:

Page 26, Questionnaire, Section H, Question 49: What type of “risk control” services does HIERS require?

RESPONSE:

Guideline compliance monitoring as specified within the ERS BOT Policies and Procedures Manual.

35) QUESTION:

Page 26, Questionnaire, Section H, Question 50: Please describe HIERS’ current end-to-end operating, accounting, cash management and reporting workflow for the private equity, real estate and infrastructure close-ended fund and direct investments. What functions are performed by HIERS’ providers or in-house?

RESPONSE:

See Responses to Question 5 and 36 for additional information.

The ERS notifies the custodian of funds approved for investment. The ERS and/or investment consultant tracks investment activity.

The investment manager (such as fund or LP) notifies the ERS, ERS investment consultant (per investment mandate), and the ERS custodian of capital calls and distributions, as applicable. The investment consultant approves the calls and distributions and notifies ERS within the mandate; ERS authorizes the payment of funds; and the custodian is responsible to verify payment authorization with the LP notice since the custodian usually has several clients invested in the LP. The custodian is responsible for updating valuations for distributions and contributions as they occur.

The investment manager provides monthly or quarterly reports to ERS, ERS investment consultant and the ERS custodian. The ERS records investment/accounting activity from the investment manager reports. The custodian is responsible to record investment/accounting activity by investment upon receipt of the investment manager reports; reconciling with activity that occurred since the previous investment manager report. The custodian performs a monthly close on all accounts.

The information from the monthly accounting close by the custodian flows to the custodian performance system and reports.

36) QUESTION:

Page 26, Questionnaire, Section H, Question 50: Does HIERS require:

- Capital Call and Distribution capital event cash/transaction management; if so, who will initiate cash flows?
- Valuation roll-forwards, if so, monthly or daily?
- Online Document Management
- Fund Level Performance (IRR, multiple)
- Underlying Portfolio Company Reporting
- Access to Private IQ

RESPONSE:

Yes.

See Response to Question 5; custodian is responsible for updating valuations for distributions and contributions as they occur; no online document management other than maintaining documents related to subscriptions, redemptions, and quarterly valuations; Ability to generate time-weighted and IRR performance are required not multiples); currently no underlying portfolio company reporting, however Private IQ may be needed in the future. Capabilities in these areas may be included in the response

37) **QUESTION:**

Page 40, Attachment 4: Under Cash and STIF balances, please provide a breakdown of foreign currencies held by the investment managers.

RESPONSE:

Refer to Question 13.

38) **QUESTION:**

Page 40, Attachment 4: Please elaborate on how cash is managed currently and provide a break-down of average balances by short-term instrument (i.e. on-balance sheet deposit program, money market mutual fund, CDs, repos, commercial paper, etc.).

RESPONSE:

Refer to Question 13 and 18.

39) **QUESTION:**

Page 43, Attachment 7, part 10:What additional losses do you anticipate from put sales, if any?

RESPONSE:

Refer to Question 20.

40) **QUESTION:**

Page 46, Attachment 7, Part 11: What level of asset servicing does HIERS expect from the custodian for the private placement portfolio (basic recordkeeping, income processing, corporate action processing, etc.)? Should asset servicing be required on issues registered in the custodian's nominee? Please provide annual volumes for paydowns, redemptions and transactions.

RESPONSE:

Refer to Question 5 and 36. The requirements are the same as for any other private equity fund; the custodian only needs to provide the accounting, performance measurement, cash flow management, net asset value, gains and losses (realized & unrealized) and capital account reconciliation at the fund level only.

41) **QUESTION:**

Attachment 4: Please provide annual volume of manual transactions and asset servicing events by event type (dividends, redemptions, etc.).

RESPONSE:

ERS does not track manual transactions since these are dependent on the operations of the custodian and investment managers.

For annual volumes of asset servicing events by event type, please refer to:

- Attachment 9, ERS Investment Statistics,
- Questions 8, 12, and 33, and
- the following table of Asset Servicing Events not included in Attachment 9.

Asset Servicing Event (Not included in Attachment 9, ERS Investment Statistics)	Count
Corporate Actions	1,800
Dividends	8,000
Futures Activities (Open/Close Trades)	2,300
Interest	14,000
Principal Payments / Maturities	6,800
Receipts, Disbursements and Other Adjustments on securities (Including but not limited to Inflation Adjustments Securities, Futures Contracts, Swap Contracts)	32,000

42) **QUESTION:**

Attachment 4: How does HIERS currently invest in or access the Chinese market (QFII, RQFII, CIBM Direct scheme or China Connect)?

RESPONSE:

China Connect

43) QUESTION:

Attachment 4: Do any of the securities in the portfolio generate income outside of the expected income (amortization) schedule? Is there an expectation for the custodian to reflect the current face values as part of standard reporting?

RESPONSE:

Not currently, however this may change since certain types of these securities are allowed in the investment policy. Yes there is an expectation for this as part of standard reporting.

44) QUESTION:

Page 49, Services, section A, Question 9: Please confirm if HIERS currently invests in swaps or plans to do so in the future. If so, what is the anticipated volume? Is HIERS interested in independent valuation of the swaps?

RESPONSE:

Yes, ERS currently invests in swaps, including, but not limited to, Interest Rate Swaps, Credit Default Swaps, Total Return Swaps. The volume is dependent on the investment managers that have full discretion.

45) QUESTION:

Page 49, Services, Section A, Question 9: Please provide detail of HIERS' bank loan exposure, if any.

RESPONSE:

Refer to Attachment 4, 2018 Asset Holdings of ERS since this list contains the holdings for the ERS as of January 31, 2018.

Actual holdings and balances will change based on actual trading and investment activity of the investment managers.

46) QUESTION:

HIERS Contract for Goods and Services: Is HIERS permitted to consider lien and set off provisions in order to allow for a broader spectrum of provision of services and/or to facilitate the settlement of securities transactions?

RESPONSE:

Any consideration would be dependent on the specific facts at issue.

47) QUESTION:

HIERS Contract for Goods and Services: Is HIERS permitted to exercise sovereign immunity rights with regard to contractual obligations?

RESPONSE:

The HIERS invokes and asserts its sovereign immunity when applicable.

48) QUESTION:

What hours of business for Client Service Management does HIERS require?

RESPONSE:

6:30 a.m. (H.S.T.) to 4:30 p.m. (H.S.T.) is ideal.

49) QUESTION:

Please describe HIERS' process and anticipated timeframe to select a permanent CIO. In what stage of this process is HIERS in now?

RESPONSE:

The ERS' Board of Trustees (BOT) appoints the Chief Investment Officer (CIO), and has hired an executive search firm to assist in its search for a CIO. The ERS is currently in the recruitment phase and is expected to make an appointment in summer of 2018.

50) QUESTION:

Will HIERS publish their CAFR within 365 days after each fiscal year-end?

RESPONSE:

ERS's goal is to publish within 365 days.