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June 28, 2016

Via Hand Delivery

Joshua Putnam
Chair, Executive Subcommittee Chair
Legislative Oversight Committee
PO Box 11867
Columbia, SC 29211

Re: Document requested dated May 21, 2016

Dear Chairman Putnam:

Enclosed please find a flash drive containing the second set of documents that we have compiled and reviewed in response to the Committee's letter dated May 31, 2016. The flash drive contains documents numbered 2756-3406 (Parts 16 – Part 20) in five separate files (the first flash drive contained Parts 1-5, the second flash drive contained Parts 6-15) as follows:

- Part 16 – A. Jordan (documents 2756-2926)
- Part 17 – A. Jordan (documents 2927-3000)
- Part 18 – A. Jordan (documents 3001-3185)
- Part 19 – A. Jordan (documents 3186-3248)
- Part 20 – D. Lybrand (documents 3249-3406)

We have reviewed the documents for any attorney-client privilege, attorney work product, or other contractual restrictions on disclosure. However, please note that if we have inadvertently included any confidential documents in the enclosed that we have not prospectively waived any privilege or other right to confidentiality. We will continue to transmit documents to your office as we get them prepared. Thank you.

Sincerely,

Signature Redacted

Betsy Johnson Burn
Acting Chief Legal Officer

Enclosure

cc: Michael Hitchcock, CEO

From: [Abesamis, Bo](#)
To: [Rebecca Gunnlaugsson](#); [Bill.Leidinger@sto.sc.gov](#)
Cc: [Swilley-Burke, Gwelda](#); [Douglas W. Lybrand](#); [Tammy Nichols](#); [Faith Wright](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Hershel Harper](#)
Subject: RE: Follow-Up
Date: Wednesday, May 23, 2012 1:42:35 PM

Rebecca,

Thanks for checking, I am in conference call right now for 2 hours and will get back to you at the end of the day or first thing tomorrow morning.

From: Rebecca Gunnlaugsson [<mailto:RGunnlaugsson@ic.sc.gov>]
Sent: Wednesday, May 23, 2012 10:36 AM
To: Abesamis, Bo; [Bill.Leidinger@sto.sc.gov](#)
Cc: Swilley-Burke, Gwelda; Douglas W. Lybrand; Tammy Nichols; Faith Wright; Condon, Bill; Tahiliani, Shakun; Hershel Harper
Subject: RE: Follow-Up

Bo,

Thank you so much! This information is exceptionally helpful. Can I ask a couple of questions?

On page 2, you say: "Based on responses to the RFP, net revenue estimates (after revenue split) is around \$2 to \$5 million per year based on an overnight indemnified REPO program using the current investment structure of the Trust Fund and applicable to separate accounts only". In the Evaluation Matrix on page 20, however, the line "Overnight Intrinsic 20bps – REPO" has much lower estimates ranging from \$908k to \$2.28m. I thought this was the line we were to be reviewing. Is there a different line instead?

On page 4, you reference an Astec Consulting survey from 5 years ago. Since 5 years ago was 2007 —pre-crisis, do you know if there is anything more recent to show current usage of securities lending agents?

Your answer to #5 seems to indicate to me that securities lending for public funds is quite often done to offset custodial expenses. Since our Commissioners have voted to have all sec lending revenue flow directly to the Trust Fund (making all custodial and ancillary expenses and on-budget item), it seems sec lending comes down to risk management and revenue generation. Correct?

Again, thank you immensely!

Rebecca

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Wednesday, May 23, 2012 1:09 PM
To: Rebecca Gunnlaugsson; [Bill.Leidinger@sto.sc.gov](#)
Cc: Swilley-Burke, Gwelda; Douglas W. Lybrand; Rebecca Gunnlaugsson; Tammy Nichols; Faith Wright; Condon, Bill; Tahiliani, Shakun; Hershel Harper
Subject: Follow-Up
Importance: High

Rebecca and Bill,

This is to answer the questions that was brought to my attention yesterday after our meeting.

BO

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

101 California Street
Suite 3500
San Francisco, CA 94111
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F. 415.291.4016

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From: [Abesamis, Bo](#)
To: [Rebecca Gunnlaugsson](#); Bill.Leidinger@sto.sc.gov
Cc: [Swilley-Burke, Gwelda](#); [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Hershel Harper](#)
Subject: Follow-Up
Date: Wednesday, May 23, 2012 1:10:07 PM
Attachments: [Callan Memorandum DRAFT SC Follow-Up Items May-23-2012.pdf](#)
[Callan Research SeclendingAskTheExpert-March2008.pdf](#)
Importance: High

Rebecca and Bill,

This is to answer the questions that was brought to my attention yesterday after our meeting.

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Bo Abesamis | Executive Vice President
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Memorandum **DRAFT**

CONFIDENTIAL

To: Bill Leidinger and Rebecca Gunnlaugsson
From: Bo Abesamis
CC: Hershel Harper, Doug Lybrand, Bill Condon, Tammy Nichols, Faith Wright, Shakun Tahiliani, and Gwelda Swilley-Burke
Date: May 23, 2012
Subject: **Follow-Up Items on Securities Lending**

Please find the below answers to the questions raised by the Investment Commission specific to follow-up items raised in our meeting May 22, 2012.

1. Under what conditions and what investment guidelines should RSIC engage in a securities lending program?

Callan has been a firm believer that risk management takes precedence over revenue generation. A lending agent can have huge blocks of securities out-on-loan and is charged to reinvest large amounts of cash collateral on any given day. The lending agent can be the single largest investment manager of a client. Fund sponsors have not really factored securities lending into their risk budgeting exercise. As a result of the credit and liquidity crisis, fund sponsors' comfort levels are changing and some are indeed questioning the ongoing risk/reward trade-off of their securities lending programs. Securities Lending has Asymmetric Risk wherein cash collateral losses are skewed to the disadvantage of a client and not the provider. There is no free lunch with securities lending. We do believe that a program focused on risk management is far superior to a revenue-driven program.

Within this construct, RSIC should consider implementing an Indemnified REPO (overnight reinvest) collateralized by US Treasury/Government Securities.

- Cash collateral guidelines need to be retooled to match a de-risking strategy. Seek a fully indemnified REPO program to better manage liquidity, credit and interest rate risk. The program would be in a dedicated separate account structure to control risks (i.e., credit, liquidity and interest rate risks) and achieve a higher level of transparency.
- RSIC should further tighten borrower default indemnification clause. The intent is to ensure that collateral (cash and non-cash) pledged by borrowers are perfected to the advantage of the Trust Fund and in order to mitigate the issues surrounding "bankruptcy stay" by SIPC Guidelines and the ambiguity of the Dodd Frank Rule 165 regarding the orderly liquidation of a financial institution. This would be subject to legal review and approval.
- Non-cash collateral would only be accepted if perfected and indemnified.

- Term loans would have to be fully matched and have a short duration of less than a week and only allowed for a maximum 20% of overall out on loan balances.

2. What is the anticipated revenue from a securities lending program, given the current portfolio of the Trust Fund? What does this translate to from a return on investment or yield perspective?

Based on responses to the RFP, net revenue estimates (after revenue split) is around \$2 to \$5 million per year based on an overnight indemnified REPO program using the current investment structure of the Trust Fund and applicable to separate accounts only. This is around 1 to 2 bps of total Trust Fund assets.

Albeit securities lending should be treated as an investment management function and can add value, it takes a backseat from the interest of investment managers and the plan/fund itself. Remember that securities lending is an ancillary process to generate incremental revenue. Revenue estimates are subject to a myriad of variables, such as:

- changes in economic, interest rate, credit, liquidity & market conditions,
- portfolio turnover of the security holdings,
- asset allocation and manager changes,
- portfolio structure,
- statutory changes which includes state, federal, securities law and Federal Reserve guidelines can have an impact,
- policy limits and active proxy voting,
- cross border changes in regulatory environment, market practice, tax and dividend treatments,
- actual cash collateral reinvestment guidelines of the plan sponsor or fund may be inconsistent with a securities lending provider's program structure,
- potential impact of bankruptcies and fraud,
- organizational changes (program and personnel structure) within the securities lending provider can affect both product and performance.

Institutional investors or funds taking a conservative stance cannot be criticized for prioritizing risk management before revenues when it comes to securities lending. Callan believes that securities lending revenue estimates are after all just estimates. In light of the disparity in the securities lending revenue estimates, it would be safe to use the numbers as the probable range of potential outcomes. However, it is dangerous to rely on any specific revenue estimate. Revenue estimates frequently depend on assumptions of interest rate spreads, utilization, and market conditions that may not be true going forward. It has always been Callan's policy to warn clients that complete or heavy reliance on revenue

estimates as a major decision variable may not be the most prudent route to take. Securities lending involves risks.

3. What options does the RSIC have to increase revenue from securities lending (i.e.- converting co-mingled investments to managed accounts)? What are the pros and cons of such options?

The underlying driver of securities lending is separate accounts. Only securities in separate accounts are available to lend. Non-US securities, US Treasury/Government securities, and micro- to small-cap securities are highly lendable. For example, if non-US securities are in separate accounts, the potential increase in lending revenue can equate to 2x to 3x above the indemnified REPO estimates. Commingled funds¹ are not lendable because they are classified as line item portfolios or "not in bank" assets under custody. The decision to either use commingled funds or separate accounts is a function is at the discretion of RSIC and should take into account the underlying mandate of the portfolio manager. Clients who pursue separate accounts (mostly for traditional asset classes) do so for transparency, compliance and control purposes. Commingled funds are often used if the mandate is constrained to such vehicle or it is most expedient, and asset management fees are clearly cheaper.

4. What qualifications of a 3rd party securities lending agent should be required?

The qualifications should be consistent for both custody and/or 3rd party lending agent programs. As was discussed during the presentations by the short list of providers in Columbia, the following are critical –

- Able to meet a de-risked program rooted on an intrinsic value program.
- Able to manage cash collateral using an indemnified REPO reinvestment guideline.
- Able to clearly articulate risk management and revenue generation consistent with a risk averse program.
- Able to provide full transparency to the program.
- Able to have clear core competency of personnel, program philosophy and compliance discipline.
- Able to demonstrate the organization's commitment to securities lending.

¹ Most commingled funds participate in securities lending under the discretion of the investment manager. The investment manager lends the securities of within their commingled funds in order to achieve an alpha component or to offset costs, specifically custody and administration costs.

5. What are the benefits of choosing Deutsche Bank over a bundled custody/sec lending solution with SS or BNY Mellon? How will the existing losses in the collateral pool be handled if we change providers?

Based on what the Evaluation Committee shared with Callan, Deutsche met all of the items listed above and able to meet an intrinsic value driven program that is both disciplined and risk averse. They went above and beyond to demonstrate the guts of their program and why they deserve the assignment.

Based on Callan's understanding of the current state of the program, loan balances have to be maintained in order not to trigger the realization of unrealized losses. This is also contingent on how the State would like to handle the Lehman losses going forward.

The decision to unbundle or bundle securities lending with custody is driven by two factors: alpha generation (maximize revenue), or operational and cost considerations.

Based on a formal survey by Astec Consulting (a division of SunGard who sells technology to securities lending providers) five years ago, the usage of custody vs. 3rd party securities lending agents is as follows. (1) Tax-Exempt Funds: 90% of plans utilize the custodian for securities lending services, while the remaining 10% employ a 3rd party (unbundled) securities lending provider. (2) Mutual Funds and Commingled Funds: 60% of funds use the custodian provider for securities lending, and the other 40% prefer a 3rd party provider. Callan is in agreement that this study captures the current bundled and unbundled arrangement of securities lending from custody.

If the objective is to maximize revenue or alpha generation to enhance performance, unbundling securities lending from custody is a viable option. Certain public funds believe that unbundling securities lending custody focuses on "best in class" providers – core competency. A common thread to those plans who unbundle is the need to seek a performance boost for internally managed portfolios where performance based compensation is tied to a benchmark. Typically, clients who pursue this type of approach have dedicated personnel handling securities lending and with functional risk management tools to monitor the program.

Public funds who are risk averse or risk management is paramount, the approach has been to de-risk the program through a single provider. The sole securities lending agent is either through custody or a 3rd party provider depending on who can effectively de-risk the program regardless of revenue stream. The overarching criteria for selecting either a custody or 3rd party is risk management, The entity who can

provide the highest level of indemnification in the areas of borrower default, operational negligence, and collateral reinvestment risks is the preferred provider.

For a majority of public funds, securities lending is an "ancillary" function and an important source of funds to offset operations and administrative costs. The decision to unbundle hinges on this statement – "If a 3rd party securities lending agent cannot generate greater or equal revenue stream (within clearly defined risk parameters) than the custodian, and the 3rd party introduces undue operational/administrative oversight burden on staff, then unbundling becomes an unwarranted and expensive endeavor."

6. What is the risk/reward tradeoff of securities lending? How does this compare with other relatively "safe" investments?

There is no such thing as "safe" investments and this applies to securities lending. As noted in Question #1 above, risk management is paramount. The incremental return from securities lending should be generated from a risk-averse posture.

7. Please describe other risk beyond investment risk of the collateral pool.

Borrower Risk

(The risk that the borrower will not return the securities due to insolvency.)

- To mitigate this risk the lender requires that the borrower "over collateralize" the position.
- Unless specifically indemnified by the lending agent, the borrower suffers from any losses due to default.

Collateral Reinvestment Risk

(The risk that the investment of the cash collateral will not earn a sufficient return to cover the agreed upon rebate rate due to Interest Rate Risk, Liquidity Risk and Credit Risk.)

- The investor can stipulate the types of acceptable collateral and the instruments in which the collateral can be invested. For a risk averse program, an indemnified REPO program collateralized by US Treasury and Governments is prudent.

Operational Negligence

(The risk that an agent fails to mark to market collateralization levels, posting of corporate actions and income, including all economic benefits of ownership except for proxy voting.)

- Often covered by the E&O policy of the lending agent; standard indemnification covered by lending agent.

Trade Settlement Risk

(The risk that an investor sells a security that is out on loan and that the loaned security is not returned by the borrower and that a trade fails or the seller is charged with an overdraft fee.)

- Often covered by the terms and conditions proposed by lending agent, and often a standard indemnification offered by lending agent.
- Require contractual settlement and the parameters of recall of securities out on loan and the specific buy-in process.

Country and Currency Risks

(Regulatory, Political, Exchange Rate, Economic, Sovereign and Transfer Risks associated with country jurisdiction.)

- Vigilance is the only real solution.

8. Describe indemnification for the securities on loan, the collateral pool, losses from operational issues, and any other potential sources of loss.

See Question #7 above. Kindly refer to the Callan Research Paper "Ask the Expert: Securities Lending - Mechanics and Risks Revisited" for supplemental discussion.



ASK
THE
EXPERT

MARCH 2008

A Conversation with Callan's
Virgilio "Bo" Abesamis
Senior Vice President and
Manager of the Master Trust,
Global Custody and Securities
Lending Group

Interviewed by
Michael J. O'Leary, CFA
Executive Vice President and
Manager of Callan's Denver
Consulting Office

Securities Lending

Mechanics and Risks Revisited



Michael O'Leary (left) and Bo Abesamis

Securities lending has received considerable attention from the investment community. The vast majority of institutional investors lend securities either through stand-alone programs or, in many cases, through mutual funds or collective trusts. Many programs were impacted by the credit crunch, raising questions about the risks associated with what was generally thought to be a low risk program.

Recently, Michael O'Leary sat down with Bo Abesamis to discuss the principal players, the risks involved and client reactions to the current environment surrounding securities lending.

About Callan Associates

Founded in 1973, Callan Associates Inc. is one of the largest independently owned investment consulting firms in the country. Headquartered in San Francisco, Calif., the firm provides research, education, decision support and advice to a broad array of institutional investors through five distinct lines of business: Fund Sponsor Consulting, Independent Adviser Group, Institutional Consulting Group, Callan Investments Institute and the Trust Advisory Group. Callan employs more than 170 people and maintains four regional offices located in Denver, Chicago, Atlanta and Florham Park, N.J.

O'LEARY: Bo, let's start out with the basics. What is securities lending?

ABESAMIS: Securities lending is a transaction in which the owner of a security agrees to lend the security to a borrower according to negotiated terms. This temporary exchange of securities is between the lender (beneficial owner of securities) and the borrower, usually for other securities or the cash value equivalent (which can be a mixture of both), with an obligation to redeliver a like quantity of the same securities at a future date. Once a security is out-on-loan, the legal title to the security is transferred to the borrower and the loan is secured with collateral. However, the lender retains all economic benefits of ownership and is paid a fee.

SECURITIES LENDING BASIC PREMISE

WHY LEND?

Extra revenue (often to cover administrative costs and performance enhancements).

WHAT IS IT?

Owner of a security agrees to lend the security to a borrower according to negotiated terms and the owner is secured with collateral.

WHY BORROW?

To make delivery of securities to avoid fails, and money is not tied in the cash market.

DO YOU OWN WHAT YOU LEND?

No, but you are entitled to the economic benefits of ownership, except for proxy voting.

Anatomy of an Agency Lending Program



Who are the principal players and, on the borrowing side, who needs to borrow securities?

ABESAMIS: The principal players are the borrowers—broker/dealers and banks—and the institutional investors who lend.

Usually, a lending agent is the conduit to the securities lending transaction. Firms may need to temporarily borrow securities when they: (1) Sell securities they have purchased but have not been delivered; (2) Open a "short" position (i.e., sell securities they do not own), either voluntarily to establish a specific position or involuntarily as the result of an obligation as a market-maker to fill a customer buy order; (3) Need to deliver securities they have not yet purchased against an exercise of a derivatives contract (e.g., the exercise of a call option); (4) Want to raise specific collateral, perhaps for another securities lending transaction; or (5) Need to cover a failed transaction in a securities settlement system. Prime brokers who facilitate the borrowing needs of hedge funds account for the majority of the borrowing activity, which is estimated at around 60% of the marketplace.

SECURITIES LENDING AT A GLANCE

Many institutional investors routinely participate in securities lending programs, both directly and/or indirectly. Typically, institutional investors use their custodians to provide direct securities lending services. Institutional investors participate indirectly through a variety of collective investment vehicles (mutual funds, commingled trust funds, etc.) that have the authority to lend fund assets.

Securities lending involves the temporary loan of securities to approved counterparties or borrowers. The borrowers provide eligible collateral (generally cash), and the loans and collateral are marked to market daily. The lender retains all economic ownership rights except the right to vote proxies.

U.S. Government securities, domestic or international equity securities and corporate bonds can all be used in securities lending. Borrowers borrow to facilitate securities transactions (for example, to deliver on short sales or to provide acceptable collateral for futures or options transactions).

Transactions are structured so that they should not affect a manager's ability to sell the security on loan.

There are three primary risks associated with securities lending: operational risks, borrower/counterparty default risk and collateral reinvestment risk. The lending agent often indemnifies the lending fund against losses arising from operational errors and losses due to borrower default.

However, they do not generally indemnify for losses arising from the investment of collateral. The lending fund is responsible for returning the borrower's collateral and providing the agreed upon rebate rate on the collateral. Thus, if the lender earns a lower return on the collateral than the rebate rate, there will be an "investment loss" on the transaction. This risk is minimized by using very high quality, liquid instruments for collateral investment and then carefully managing potential asset liability duration differences. Naturally, highly unusual market conditions can create very challenging environments for lending programs.

In most cases, the lending agent receives a share of the spread (the difference between income earned on the collateral less the rebate rate promised). The proportion varies from client to client based on several factors, but generally 25% to 40% of the income earned goes to the lending agent. The lending agent typically absorbs the operational expenses associated with providing the service.

The institutional investor's net of expense income varies based on market conditions, the nature of the investor's portfolio (size and types of holdings) and the portion of the portfolio on loan. A large institutional portfolio can earn 15 to 17 basis points loaning U.S. Government securities, 17 to 20 basis points loaning U.S. equities and a greater spread loaning international stocks.

One more question pertaining to the players. I'm always amazed that many clients don't recognize that securities lending is generally done within mutual funds and, very frequently, within commingled investment vehicles offered by trust entities. Would you comment on that?

ABESAMIS: Several years ago, I informally studied the number of Callan clients that were participating in securities lending. At that time close to 85% of Callan clients participated in securities lending—about 75% through separate accounts and the remainder through commingled funds or collective trusts. So it is true, Mike, that an investor in an S&P 500 Index collective trust can be actually participating in securities lending often unbeknownst to them.

What do you see as the principal risks involved in a securities lending program from the institutional investor's perspective?

ABESAMIS: There are three main risks: operational risk, borrower/counterparty default risk and collateral reinvestment risk. As we know, cash collateral reinvestment risk was prevalent in the last several months of 2007.

How does the lender (the fund) mitigate operational and borrower default risk?

ABESAMIS: Any accomplished securities lending agent has strong operational controls and systems, and typically indemnifies the lending client against operational risks.

Does the same thing pertain to borrower default?

ABESAMIS: Yes. Borrower default risk indemnification is typically provided by the lending agent to the lender. Borrower default risk indemnification means that if a borrower fails to return the securities, or the borrower goes bankrupt and is unable to return the securities, then the lending agent—by virtue of the provisions of the indemnification clause—should make the client or the plan sponsor whole. So any time a borrower fails to deliver those securities back to the beneficial owner, the lending agent ensures the borrower's posted collateral is sufficient and, if not, covers any shortfall to make the client whole.

Can you briefly describe how the borrowing is collateralized?

ABESAMIS: Before they can borrow securities, the borrower has to post collateral to the lender. For example, for \$100 worth of domestic large cap securities to be lent out, the borrower must provide \$100 worth of collateral plus 2% margin in order to borrow the securities. The collateralization rate depends on the

RISKS

OPERATIONAL RISK – the risk that the lending agent did not administer the program as agreed. This includes the agent's failure to mark to market collateralization levels and to post corporate actions and income, including all economic benefits of ownership except for proxy voting.

BORROWER/COUNTERPARTY DEFAULT RISK – the risk that the borrower fails to return the securities due to insolvency or other reasons. Borrower default also leads to trade settlement risk, which is the risk that an investor sells a security on loan and that the loaned security is not returned by the borrower. Therefore the trade fails or the seller is charged with an overdraft fee.

COLLATERAL REINVESTMENT RISK – the risk of investment loss from the reinvestment of the cash collateral by the lending agent and/or beneficial owner. The real risk is that the investment of the cash collateral will not earn a sufficient return to cover the agreed upon rebate rate because of interest rate, liquidity and/or credit risks.

Before they can borrow securities, the borrower has to post collateral to the lender.

type of securities being lent. For domestic securities the typical collateralization rate is 102%, for international securities it is 105%.

There are two forms of collateral that can be posted to meet that 102% or 105%—cash collateral and non-cash collateral. Cash collateral is usually the U.S. dollar. Consistent with ERISA requirements, non-cash collateral normally takes the form of irrevocable letters of credit and/or U.S. Government bonds/Treasuries. For non-ERISA clients certain other non-cash securities are acceptable. But the main forms are U.S. dollar cash, irrevocable letters of credit and U.S. Government bonds/Treasuries.

With international securities, it is up to the client to determine if they want their cash held in the currency of the underlying security (or what we call same currency collateralization) or in a different currency (cross currency collateralization).

Is collateral marked to market daily to reflect changes in value of the security on loan?

ABESAMIS: Yes. This is a non-negotiable requirement. Failure to do so constitutes operational negligence by the lending agent.



Bo Abesamis

Further, if the loaned security increases in value, the borrower has to post additional collateral and, if it declines in value, the lending agent would be amenable to returning some portion of the collateral.

ABESAMIS: Yes, however, collateralization rates are typically initiated at the origination of the loan. Certain programs could mark daily at the designated level or they could mark at 100%. For example, the initial collateralization would be 102% for borrowed U.S. Treasuries, but for the subsequent mark after the loan is initiated, some of them would mark at 100%. That means that the lending agent will only ask for additional collateral once the market value of the collateral goes below 100%. In certain programs 100% is maintained at both initial and subsequent marks. This is often confusing and should be understood by clients participating in any form of securities lending transaction.

If collateral is the first line of protection to the lender or to the fund, what is the second line of protection?

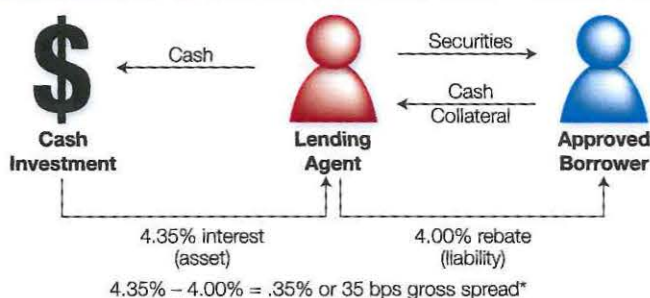
ABESAMIS: The second line of defense would be the indemnification provided by the lending agent.

Now, moving on to the third level of risk—investment risk—we begin by discussing the investment risk associated with cash collateral. The borrower provides cash equal to 102% or 105% of the value of the security that has been borrowed, and that cash is invested by the lending agent. The borrower will not let the lender invest the cash collateral and keep all the earnings. So this gets us into the rebate rate. Would you describe what it is?

ABESAMIS: The rebate rate is a negotiated rate that the lender must pay the borrower on the cash collateral. It is typically expressed as a rate linked to an index, such as the fed funds rate or LIBOR. For example, you'll hear the rebate rate is fed funds plus 25 (basis points). Therefore, before making any money, the lender needs to earn enough yield to cover the negotiated rebate rate agreed to between the lending agent and the borrower, including the principal value of the collateral (posted by the borrower). Any net earnings generated from the demand spread and the reinvestment spread are shared between the beneficial owner and the lending agent. By the way, if a security is in high demand, a borrower may forgo the rebate rate or even agree to a negative rebate rate. If this happens, the potential revenue of the loan increases significantly to the advantage of the client. For loans made against non-cash collateral, both lender and lending agent need not worry about the rebate rate. The borrower pays the lender and lending agent a premium (or fee) for posting non-cash collateral.

Any net earnings generated from the demand spread and the reinvestment spread are shared between the beneficial owner and the lending agent.

Cash Collateral Management – Gross Spread



* Gross spread is split between client and lending agent on a percentage basis.

This example shows how the gross spread is calculated as the difference between the interest rate generated through cash collateral management as agreed to by the lender and lending agent and the rebate rate negotiated between the borrower and lending agent.

It is imperative that the client, or any beneficial owner, understands how the cash collateral is to be reinvested.

By way of example, what happens if they earn 20 basis points more than the negotiated rebate rate?

ABESAMIS: The extra 20 basis points doesn't all go to the lender. The lending agent would normally have a revenue sharing arrangement with the lender or the beneficial owner. The revenue sharing arrangement (normally called a revenue split) can range from 50/50 to 90/10, where 90% goes to the lender and 10% goes to the lending agent. Typically, the lending agent has to absorb the program's expenses from its share of that gross spread.

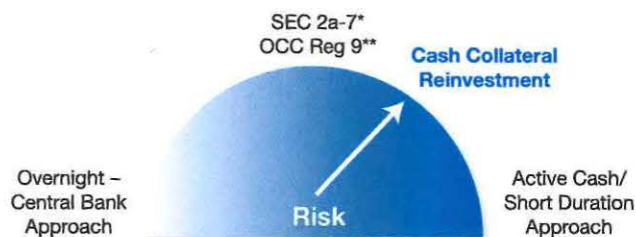
Now suppose that the lending agent investing the collateral invests in a security that defaults. Typically who bears that risk?

ABESAMIS: Collateral reinvestment risk is shouldered by the lender (the beneficial owner or the fund). Therefore, the lender has to cover both the rebate rate and the full principal value of the cash collateral posted by the borrower. Failure to do so results in collateral reinvestment risk. The lending agent typically *does not* indemnify clients for such a risk.

What is the principal investment risk in securities lending?

ABESAMIS: The credit and liquidity risks associated with the investment of the cash collateral. It is imperative that the client, or any beneficial owner, understands how the cash collateral is to be reinvested. There need to be stated policies and guidelines governing the reinvestment of the cash collateral agreed to between the client and the lending agent. Obviously, the lending agent must have the requisite skills to prudently manage the collateral portfolio.

Cash Collateral Reinvestment – Risk Speedometer



The chart illustrates that the average cash collateral reinvestment guidelines of securities lending falls between SEC Rule 2a-7/OCC Reg 9 STIF and active cash/short duration guidelines. Thus, there is a possibility that the securities lending cash collateral pool can sustain losses and not maintain \$1 net asset value.

* SEC RULE 2A-7: SEC Rule 2a-7 governs the eligible securities that money market funds may purchase, maintains an average dollar-weighted maturity of 90 days or less, and prohibits money market funds from purchasing securities that have an effective maturity longer than 13 months. The rule was designed to ensure that money market mutual funds preserve a \$1.00 NAV and don't "break the buck." [SEC = Securities and Exchange Commission]

** OCC REG 9: OCC Reg 9 led to the creation of STIF (short-term investment fund), which is a collective investment vehicle maintained by banks, and is similar to SEC Rule 2a-7. [OCC = Office of the Comptroller of the Currency]

TRUTHS & MISCONCEPTIONS

Misconception: *Anybody can lend.*

Truth: Not all plan sponsors and lending agents can lend securities. Asset size, investment guidelines and regulations can prohibit a plan sponsor from lending securities.

Misconception: *All securities can be lent.*

Truth: Not all securities are lendable. Liquidity and the derivatives market dictate what is lendable.

Misconception: *You still own what you lend.*

Truth: Given the nature of the transaction, the plan sponsor (lender) loses ownership (title), but retains the benefits of ownership (e.g., dividends, corporate actions, interest income, etc.) except for voting proxies.

Misconception: *Securities lending interferes with the decisions of money managers.*

Truth: A well structured program should not interfere with manager decisions as long as loans are recalled on the first indication of sale.

Misconception: *Securities lending is virtually risk free.*

Truth: Risk does not go away. Risk can be minimized if prudent guidelines are in place.

Misconception: *Securities lending generates a lot of money.*

Truth: Revenue generated by securities lending is subject to a number of factors, ranging from market forces to portfolio holdings. Securities lending should be viewed more as an activity that generates supplemental income than a substantial money-making enterprise. Net lending income, as a percentage of the lendable asset base, is very small. However, for a multi-billion dollar portfolio, securities lending can produce millions of dollars of incremental return.

Misconception: *Securities lending is a leveraged transaction.*

Truth: Technically speaking, securities lending effectuates the efficient use of leverage by market participants. However, since the beneficial owner is fully collateralized, leverage is therefore mitigated. Securities lending contributes to market efficiencies. Yet, indiscriminate, negligent and ignorant use of securities lending beyond its intended purpose can lead to market disruptions.

If the cash collateral reinvestment is not able to cover that rapid reset to the new fed funds rate at the higher level, that's when the possibility of a loss from duration mismatch can occur.

Excluding the mega funds, in most cases isn't cash collateral generally invested in collective investment vehicles designed expressly for securities lending programs?

ABESAMIS: Yes, the majority of lending agents invest cash collateral in a collective trust or a commingled fund vehicle dedicated to securities lending. Lending agents typically offer multiple types of cash pools for the reinvestment of cash collateral. The degree of each pool's risk must be carefully considered. While most are conservatively oriented, some assume greater credit, liquidity and/or duration risk. Even if a lending agent has a single very high quality cash pool, it doesn't really eliminate all of the investment risk. The perfect storm we encountered in the last several months of 2007 was a sobering experience.

What are the other sources of investment risk?

ABESAMIS: Within cash collateral reinvestment risk, there is what we call the duration mismatch risk between the duration of the loan relative to the duration or maturity of the cash collateral investment. The duration of the loan, because it resets daily, is one day, but the duration of the investment can be one day to six months or more depending on how the cash collateral is reinvested. So it doesn't take much to see that if the duration of the loan is one day and the duration of the investment averages 30 days, it would lead to a duration mismatch, creating an additional source of risk for the program.

The duration mismatch risk is heightened in a rising interest rate environment and/or if the yield curve is inverted. Recalling the earlier example, the duration of the loan is pegged to the fed funds rate, so the borrower would expect the rebate rate to be fed funds plus 25. So let's say we start at a fed funds rate of 5% plus



Michael O'Leary

25 and, in an interest rate environment that's going up, we're now at 6% plus 25. If the cash collateral reinvestment is not able to cover that rapid reset to the new fed funds rate at the higher level, that's when the possibility of a loss from duration mismatch can occur.

However, in practice this seldom occurs.

ABESAMIS: Correct. The asset/liability mismatch is generally not a major risk unless the client is using an unusually long duration or illiquid collateral pool. One would expect that, by extending the duration, one would squeeze out incremental returns but also increase the risk of short-term losses owing to rate volatility.

The lending agent is paid a percent of the gross spread as compensation while the client bears the risk of loss. Doesn't that relationship create an inherent potential conflict?

ABESAMIS: In reality, the lending agent is incentivized to generate spreads in order to earn their portion of the revenue. There's an inherent potential conflict if the lending agent does not align with the client's interest. It is imperative that both the lending agent and the lender agree on the risk/reward trade-off. If a lending agent understands the inherent risk appetite of a client, then the incentive should not be an issue. It has been my experience that a client's willingness to accept all forms of investment risk may change with market conditions.

The difference between the agreed upon rebate rate and the investment rate of the collateral varies significantly by type of security on loan, with Treasuries and agencies being in the low to mid-teens (pre-split), domestic equities being maybe just a tad higher and international stocks being more than twice that of domestic equities. Is that a reasonable order of magnitude?

ABESAMIS: Yes. Over the three years ending December 2006, the median spread net of rebate was 16 basis points for U.S. Treasuries and agencies. The median spreads net of rebate for domestic large cap equity and international equity were 23 basis points and 63 basis points, respectively.

Are the splits for mutual funds or collective trusts as generous from the lender's perspective as they seem to be in the institutional separate account world?

ABESAMIS: Typically, the revenue sharing arrangement with collective funds or mutual fund complexes is in the 50/50 to 60/40 range. In the separate account tax-exempt arena, institutional investors who are able to lend their securities have a revenue sharing arrangement that ranges from 60/40 to 90/10, where the aver-

The commingled vehicle allows even small accounts to have some of the benefits of participating in a securities lending program that these investors would not have on a stand-alone basis.

Up until this point, clients have not really factored securities lending into their risk budgeting exercise.

age is between 70/30 and 75/25. Nonetheless, the commingled vehicle allows even small accounts to have some of the benefits of participating in a securities lending program that these investors would not have on a stand-alone basis.

How big does a client have to be for them to have their own customized collateral investment vehicle and not participate in a collective pool?

ABESAMIS: Ideally a client should have average out-on-loan balances of at least \$100 million in order to have its own separate collateral investment account and not participate in a collective pool. But a much larger average daily balance—\$500 million or higher—would be more reasonable.

In the difficult current credit market environment, an ability to understand the risks you are taking is something that's very valuable to clients. Is it typical for lending agents to provide a complete transparency to the collateral pools so that a client can actually see what's in the collateral pool on a real-time basis or a next-day basis?

ABESAMIS: When clients insist, they should be able to see how the cash collateral in the pool is invested on a next-day basis at a minimum. They should be able to have what we call a "peek through" for the program. Now, it's typical to have agents provide hard copies of the cash collateral or a summary of the program on a month-end basis. But clients have the ability to demand a report from their lending agent on a next-day basis and to see how that cash is invested. There are certain programs in the industry where lending agents provide a complete real-time peek through.

In that case, clients who have their portfolios online are given access to the collateral pool from an accounting valuation perspective.

ABESAMIS: Exactly. But that is not typical because a lot of the programs are amortized when they reflect the valuation. So you could have a peek through to the securities at the point in time valuation, but it doesn't necessarily mean that it is the market value at that point in time.

Give us a measure of clients' comfort level—what do we see today? Many seem to be questioning whether securities lending is worth the risk.

ABESAMIS: By virtue of the fact that a lending agent can have huge blocks of securities out-on-loan and is charged to reinvest large amounts of cash collateral on any given day, the lending agent can be the single largest investment manager of a client. Up until this point, clients have not really factored securities lending into their risk budgeting exercise. However, when something goes wrong in a

program that is expected to generate incremental revenue at very low risk, it is just normal to question its value. As a result of the current environment and losses incurred, clients' comfort levels are changing and some are indeed questioning the ongoing risk/reward trade-off of their securities lending programs. There is no free lunch with securities lending. I do believe that a program focused on risk management is far superior to a revenue-driven program.

As we look back on 20 plus years of clients actually participating in securities lending programs, have there been losses? What's the incidence and the magnitude of them? And are we currently in an environment where we will see losses?

ABESAMIS: Over the last 20 plus years that Callan has been monitoring and advising clients on their securities lending programs, we have seldom seen plans realize any losses. There have been very few losses arising from actual collateral investment defaults. Back in 1994, some plans quickly terminated their programs and suffered small losses associated with the forced sale of collateral investments at inopportune times.

I haven't seen losses due to operational negligence, as programs out there have really followed the guidelines that were set by the industry and by regulatory bodies.

There were instances of borrower default, but overall borrower default has not really been problematic. It's the events with cash collateral that we have experienced in 2007 and now has overflowed to 2008—probably to a certain extent a credit and liquidity crisis—that have caused losses. When liquidity and credit markets are stressed, programs may be confronted with potential losses, particularly if forced to liquidate collateral investments quickly.

I encourage fund sponsors to avoid a knee jerk reaction should they experience losses. First and foremost, clients should sit down with their consultant and with their lending agent to understand the program. How does it look given the current credit and liquidity crisis? Can a less aggressive set of collateral investment guidelines be adopted? Those options should be addressed with the lending agent. If changes are adopted, they should ideally be made to new loans such that current collateral investments are not subject to forced sales in an illiquid environment. Finally, if clients terminate their lending programs, change custodians or even fire managers with securities out-on-loan, it is critical that the current lending program be unwound in an orderly manner.

Thank you very much, Bo.

If clients terminate their lending programs, change custodians or even fire managers with securities out-on-loan, it is critical that the current lending program be unwound in an orderly manner.

Glossary

BORROWER/COUNTERPARTY DEFAULT RISK – The failure by a borrower to return securities on demand or upon recall. The default can arise from financial difficulty or bankruptcy.

COLLATERAL – Security for a loan in the form of assets with monetary value. The creditor holds either the asset itself or title to it until the loan is repaid.

COLLATERAL REINVESTMENT RISK – The risk associated with the reinvestment loss in the cash securities in which the lending agent and/or beneficial owner choose to reinvest the cash collateral. The real risk is that the investment of the cash collateral will not earn a sufficient return to cover the agreed upon rebate rate because of interest rate, liquidity and/or credit risks.

DURATION MISMATCH RISK – Risk known to occur when the interest rate sensitivity of the asset (cash collateral reinvestment) is longer or shorter than the interest rate sensitivity of the liabilities (loan).

FED FUNDS RATE – The rate of interest charged for an overnight loan from one bank to another of excess reserves, that is, cash and deposits in excess of the reserves it is required to have on hand. Because the interest rate for such loans depends largely on supply and demand, it is regarded as a very important barometer of monetary conditions at any given time.

GROSS SPREAD – The difference between the yield or return generated by the cash collateral and the negotiated rebate paid on a securities loan (or, in the case of loans vs. non-cash collateral, the premium). The gross spread is the sum of the demand spread and the collateral reinvestment spread.

INDEMNIFICATION – An agreement to compensate for damage or loss.

LENDING AGENT – An entity that undertakes a securities loan and negotiates the terms with borrowers on behalf of the owner of the securities that are out-on-loan.

MARGIN – The amount or percentage by which the collateral value exceeds the value of the securities that are on loan.

MARKING TO MARKET – The daily process of adjusting the value of a portfolio to reflect daily changes in the market prices of the assets held in the portfolio.

MATCHED BOOK – Within the context of a securities lending transaction, the duration of the liability of the loan is synchronized and matched to the duration of the cash collateral reinvestment.

OPEN LOAN – A securities loan with no fixed maturity date.

OPERATIONAL RISKS – The risk that the lending agent did not administer the program as agreed. This includes the failure of the agent to mark to market collateralization levels, and to post corporate actions and income including all economic benefits of ownership except for proxy voting.

PROXY – A written form that is given by shareholders to record their vote or to authorize someone else to vote in their place at a shareholder's meeting. Shareholders or investment managers typically receive proxy notification specific to a pending vote.

REBATE RATE – The negotiated interest rate that a securities lender pays the borrower on cash collateral. The negotiated interest rate or rebate rate is determined by the scarcity value of a security or demand for a specific security in the marketplace.

RECALL – The ability to receive a security without fail that is out-on-loan to complete a sale transaction or to exercise a proxy vote.

TERM LOAN – A security loan with a fixed maturity date.

TRADE SETTLEMENT RISK – The risk that an investor sells a security that is out-on-loan and that the loaned security is not returned by the borrower, and that a trade fails or the seller is charged with an overdraft fee.

Biographies



Virgilio "Bo" Abesamis III

Senior Vice President and Manager of the Master Trust, Global Custody and Securities Lending Group

Bo joined Callan Associates in 1987. Bo is a shareholder of the firm. Initially, Bo worked in the Capital Markets Research Group with responsibilities involving asset/liability modeling, manager structure, benchmark and database reviews, style analysis and research. Bo previously managed the Specialty Performance Measurement Group at Callan Associates with an emphasis on analytics involving non-traditional asset classes, namely international, alternative investments and real estate. He also assisted in the development of Callan's International Consulting Services Group and Defined Contribution Consulting Services Group. Bo earned a B.S. degree in Accounting and Finance from Ateneo de Manila, Philippines, and an M.B.A. with a double major in Finance and International Business from the University of San Francisco.



Michael J. O'Leary, Jr., CFA

Executive Vice President and Manager of the Denver Consulting Office

Michael joined Callan in 1984 in the firm's Chicago office as a senior consultant. He established the firm's Denver office in 1990. Michael is a shareholder of the firm. Prior to joining Callan, Michael worked for 13 years for major Trust companies in Chicago and Hartford, Connecticut. Michael works directly with a number of the firm's major public and private accounts by providing a complete range of investment consulting services. He has extensive personal experience in asset allocation analysis, manager structure analysis, manager selection, performance evaluation, securities lending, and defined contribution plan design and evaluation. He speaks frequently at client conferences and to professional groups. Michael earned a bachelor's degree from Fordham University.

For more information, please contact your Callan Consultant or Bo Abesamis at 415.974.5060.



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Suite 950
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1.303.861.1900

New Jersey

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Suite 230
Florham Park, NJ 07932
1.800.274.5878
1.973.593.8050

www.callan.com

From: [Leidinger, Bill](#)
To: [Condon, Bill](#)
Cc: "[Abesamis, Bo](#)"; [Rebecca Gunnlaugsson](#)
Subject: RE: Securities Lending Recommendation
Date: Tuesday, May 22, 2012 4:38:37 PM

OK...That's why I shot the issue to you.....I'm happy if you are happy...so long as the confidentiality is maintained.....Thanks....Bill

From: Condon, Bill
Sent: Tuesday, May 22, 2012 4:32 PM
To: Leidinger, Bill
Subject: RE: Securities Lending Recommendation

Bill, I am not sure what the problem w/ # 5 is. That seems like info that the RSIC needs. I thought Rebecca's memo would be confidential (w/in the procurement advisory team now) but that we would look for a way to share needed information w/ the RSIC (for example, they sign NDAs and meet in executive session). If I am correct, then I think Bo can be as specific as needed when responding to Rebecca.

From: Leidinger, Bill
Sent: Tuesday, May 22, 2012 4:03 PM
To: Rebecca Gunnlaugsson
Cc: Condon, Bill
Subject: RE: Securities Lending Recommendation

Bill.....FYI.....a challenge you will love! Thanks....Bill

From: Rebecca Gunnlaugsson [<mailto:RGunnlaugsson@ic.sc.gov>]
Sent: Tuesday, May 22, 2012 3:55 PM
To: Leidinger, Bill
Subject: RE: Securities Lending Recommendation

Thanks, Bill! And, if you and Bill Condon and figure out a way to get #5 into the due diligence memo to the Commissioners, let me know. Thank you again!

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Tuesday, May 22, 2012 3:41 PM
To: 'Abesamis, Bo'; Swilley-Burke, Gwelda
Cc: Rebecca Gunnlaugsson; Douglas W. Lybrand
Subject: FW: Securities Lending Recommendation

Bo and Gwelda, please see Rebecca's note below. Would you please help her out by providing your insight and experience, and that of other states, with respect to her questions but please keep it as non-specific (i.e. no. 5 below) as possible since it relates to procurement related info.....Thanks.....Bill

From: Rebecca Gunnlaugsson [<mailto:RGunnlaugsson@ic.sc.gov>]

Sent: Tuesday, May 22, 2012 3:31 PM
To: Leidinger, Bill
Subject: Securities Lending Recommendation

Bill,

Now that I am back in the office, I realize that none of our experts on securities lending know any of the details of the proposals reviewed by the evaluation panel. And, I can't share it with them. Would you be willing to forward this along to Bo to get his thoughts and recommendations on the securities lending programs to be used to develop the due diligence memo for the Commissioners approval? In particular, can he address the following:

1. Under what conditions and what investment guidelines should RSIC engage in a securities lending program?
2. What is the anticipated revenue from a securities lending program, given the current portfolio of the Trust Fund? What does this translate to from a return on investment or yield perspective?
3. What options does the RSIC have to increase revenue from securities lending (i.e.- converting co-mingled investments to managed accounts)? What are the pros and cons of such options?
4. What qualifications of a 3rd party securities lending agent should be required?
5. What are the benefits of choosing Deutsche Bank over a bundled custody/sec lending solution with SS or BNYMellon? How will the existing losses in the collateral pool be handled if we change providers?
6. What is the risk/reward tradeoff of securities lending? How does this compare with other relatively "safe" investments?
7. Please describe other risk beyond investment risk of the collateral pool.
8. Describe indemnification for the securities on loan, the collateral pool, losses from operational issues, and any other potential sources of loss.

Thanks,
Rebecca

From: [Leidinger, Bill](#)
To: ["Abesamis, Bo"; Swilley-Burke, Gwelda](#)
Cc: [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Tahiliani, Shakun](#); [Condon, Bill](#)
Subject: Additional negotiations re: custody and securities lending
Date: Tuesday, May 22, 2012 4:32:19 PM

Bo and Gwelda, the Treasurer has OK'd your negotiating further as we discussed this AM. Press On! Please keep me posted.

Thanks much....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

From: [Leidinger, Bill](#)
To: [Rebecca Gunnlaugsson](#)
Cc: [Condon, Bill](#)
Subject: RE: Securities Lending Recommendation
Date: Tuesday, May 22, 2012 4:03:39 PM

Bill.....FYI.....a challenge you will love! Thanks....Bill

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To: Leidinger, Bill
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Rebecca

From: [Leidinger, Bill](#)
To: ["Abesamis, Bo"](#); [Swilley-Burke, Gwelda](#)
Cc: [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#)
Subject: FW: Securities Lending Recommendation
Date: Tuesday, May 22, 2012 3:40:50 PM

Bo and Gwelda, please see Rebecca's note below. Would you please help her out by providing your insight and experience, and that of other states, with respect to her questions but please keep it as non-specific (i.e. no. 5 below) as possible since it relates to procurement related info.....Thanks.....Bill

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Sent: Tuesday, May 22, 2012 3:31 PM
To: Leidinger, Bill
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To: [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Tahiliani, Shakun](#); [Condon, Bill](#); "Abesamis, Bo"; [Swilley-Burke, Gwelda](#); [Douglas W. Lybrand](#)
Subject: FW: DRAFT - CUSTODY AND ANCILLARY SERVICES FEES
Date: Monday, May 21, 2012 8:25:23 AM
Attachments: [South Carolina - DRAFT Fee Compare 5-17-2012.pdf](#)
[South Carolina - DRAFT Fee Compare 5-17-2012.xlsx](#)
Importance: High

Folks, Bo's updated Summary of Custody and Ancillary services Fees.....see you tomorrow at 9AM.....looking forward to our discussion.....Bill

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Thursday, May 17, 2012 1:00 PM
To: Leidinger, Bill
Cc: Swilley-Burke, Gwelda
Subject: DRAFT - CUSTODY AND ANCILLARY SERVICES FEES
Importance: High

Bill,

As requested, attached please find Callan's Fee and Cost Calculation Spreadsheet. We will use this to guide us in our discussion on Tuesday. I also posted the 2 calculations Retirement and General Acct/LGIP in different worksheets in the spreadsheet.

RETIRMENT SYSTEMS - FEES AND COSTS [DRAFT]

Core and Ancillary Services	BNY Mellon	State Street
Core Custody		
Account Based Fees (Admin, Acctg, etc)	\$0.00	\$131,000.00
Asset Based Fees (Custody)	\$115,527.00	\$808,298.00
Transaction Based (Buy, Sell, etc)	\$132,498.00	\$288,344.50
Global Custody Support & Market Admin		
Related Support except Global Tax Agent	\$0.00	\$0.00
On-Line Access	\$0.00	\$0.00
Contractual Settlement and Auto Credit	\$0.00	\$0.00
Transition/Conversion	\$0.00	Pass Thru
Penalty Costs		
Third Party FX Support	\$0.00	\$0.00
Third Party Seclending Support	\$75,000.00	\$75,000.00
Out of Pocket Expenses		
Wires	\$0.00	\$0.00
Courier Serives, Telex etc.	\$0.00	Pass Thru
Stamp Duty, Registration, etc.	Pass Thru	Pass Thru
Corporate Actions		
Voluntary	\$0.00	\$0.00

	Involuntary	\$0.00	\$0.00
Proxy Notifications			
	Notifications	\$0.00	\$0.00
	Online Access by ProxyEdge Software	Pass Thru	Pass Thru
Class Action Support/Filing of Proof of Claim		\$0.00	\$0.00
Compliance Monitoring Tool			
	Intermediate	\$0.00	\$392,600.00
Independent Derivatives Valuation			
	Pricing	\$54,000.00	\$60,000.00
	Collateral Management	TBD	TBD
Performance Measurement			
	Historical Upload	\$0.00	\$0.00
	Monthly Performance	\$200,000.00	\$201,125.00
	Daily Performance (FOR ILLUSTRATIVE PURPOSES ONLY]	Memo Post = \$275,000	Memo Post = \$465,750
	Inv Characteristics and Benchmark Comp	\$0.00	\$0.00
	Universe Comparison - Custody Bank Peer Universe of Clients	\$0.00	\$50,000.00
	Universe Comparison - TUCS Universe	\$0.00	\$74,000.00
	Attribution	\$0.00	\$63,250.00
Advanced Risk Analytics			
	Look Thru, VaR, Scenario, Stress Testing	\$350,000.00	\$302,000.00
Daily Interface with 3rd Party Providers - Data Feeds			
	Level of Data Feeds or Support	TBD	TBD
Corporate Governance Tool Support			
	In-House Platform	Not Available	\$0.00
Alternative Investment Support			
	Private Equity	\$125,000.00	\$230,000.00
	Hedge Fund Transparency	\$150,000.00	\$0.00
	Hedge Fund Administration	TBD	\$0.00
TOTAL COST		\$1,202,025.00	\$2,675,617.50
Data Warehousing and Portfolio Accounting		BNY Mellon	State Street
	Data Hub	\$320,000.00	TBD
	Inv. Accounting	\$386,000.00	TBD
	ASP Solution (Hosted Server)	\$630,000.00	TBD

Note* Yellow Highlight are Estimated Costs done for Comparative Purposes.

GENERAL ACCOUNT AND LGIP FEES AND COSTS [DRAFT]

Core and Ancillary Services		BNY Mellon	State Street
Core Custody			
	Account Based Fees (Admin, Acctg, etc)	\$0.00	\$25,500.00
	Asset Based Fees (Custody)	\$148,249.00	\$297,971.00
	Transaction Based (Buy, Sell, etc)	\$11,028.00	\$48,451.00
On-Line Access		\$0.00	\$0.00
Contractual Settlement and Auto Credit		\$0.00	\$0.00
Transition/Conversion		\$0.00	Pass Thru
Penalty Costs			
	Third Party FX Support	\$0.00	\$0.00
	Third Party Seclending Support	\$75,000.00	\$75,000.00
Out of Pocket Expenses		\$0.00	Pass Thru
Corporate Actions (if required)		\$0.00	\$0.00
Proxy Notifications (if required)			
	Notifications	\$0.00	\$0.00
	Online Access by ProxyEdge Software	Pass Thru	Pass Thru
Class Action Support (if required)		\$0.00	\$0.00
Compliance Monitoring Tool			
	Intermediate	\$0.00	\$35,200.00
Independent Derivatives Valuation		TBD	TBD
Performance Measurement		\$25,000.00	\$49,500.00
	Historical Upload	Included	Included
	Monthly Performance	Included	Included
	Inv Characteristics and Benchmark Comp	Included	Included
	Universe Comparison - Custody Bank Peer Universe of Clients	Included	Included
	Attribution	Included	Included
Advanced Risk Analytics			
	Look Thru, VaR, Scenario, Stress Testing	\$20,000.00	\$76,000.00
Daily Interface with 3rd Party Providers - Data Feeds			
	Level of Data Feeds or Support	TBD	TBD
Corporate Governance Tool Support		Not Available	\$0.00
Transfer Agency Services		\$75,000.00	\$75,000.00
TOTAL COST		\$354,277.00	\$682,622.00
Data Warehousing and Portfolio Accounting		BNY Mellon	State Street

	Data Hub	TBD	TBD
	Inv. Accounting	TBD	TBD
	ASP Solution (Hosted Server)	TBD	TBD

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

101 California Street
Suite 3500
San Francisco, CA 94111
P. 415.274.3074
F. 415.291.4016

www.callan.com

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RETIREMENT SYSTEMS - FEES AND COSTS [DRAFT]

Core and Ancillary Services		BNY Mellon	State Street
Core Custody			
	Account Based Fees (Admin, Acctg, etc)	\$0.00	\$131,000.00
	Asset Based Fees (Custody)	\$115,527.00	\$808,298.00
	Transaction Based (Buy, Sell, etc)	\$132,498.00	\$288,344.50
Global Custody Support & Market Admin			
	Related Support except Global Tax Agent	\$0.00	\$0.00
On-Line Access			
	Contractual Settlement and Auto Credit	\$0.00	\$0.00
Transition/Conversion			
	Penalty Costs	\$0.00	Pass Thru
Penalty Costs			
	Third Party FX Support	\$0.00	\$0.00
	Third Party Seclending Support	\$75,000.00	\$75,000.00
Out of Pocket Expenses			
	Wires	\$0.00	\$0.00
	Courier Serives, Telex etc.	\$0.00	Pass Thru
	Stamp Duty, Registration, etc.	Pass Thru	Pass Thru
Corporate Actions			
	Voluntary	\$0.00	\$0.00
	Involuntary	\$0.00	\$0.00
Proxy Notifications			
	Notifications	\$0.00	\$0.00
	Online Access by ProxyEdge Software	Pass Thru	Pass Thru
Class Action Support/Filing of Proof of Claim			
	Compliance Monitoring Tool	\$0.00	\$0.00
	Intermediate	\$0.00	\$392,600.00
Independent Derivatives Valuation			
	Pricing	\$54,000.00	\$60,000.00
	Collateral Management	TBD	TBD
Performance Measurement			
	Historical Upload	\$0.00	\$0.00
	Monthly Performance	\$200,000.00	\$201,125.00
	Daily Performance (FOR ILLUSTRATIVE PURPOSES ONLY]	Memo Post = \$275,000	Memo Post = \$465,750
	Inv Characteristics and Benchmark Comp	\$0.00	\$0.00
	Universe Comparison - Custody Bank Peer Universe of Clients	\$0.00	\$50,000.00
	Universe Comparison - TUCS Universe	\$0.00	\$74,000.00
	Attribution	\$0.00	\$63,250.00
Advanced Risk Analytics			
	Look Thru, VaR, Scenario, Stress Testing	\$350,000.00	\$302,000.00
Daily Interface with 3rd Party Providers - Data Feeds			
	Level of Data Feeds or Support	TBD	TBD
Corporate Governance Tool Support			
	In-House Platform	Not Available	\$0.00

Alternative Investment Support			
	Private Equity	\$125,000.00	\$230,000.00
	Hedge Fund Transparency	\$150,000.00	\$0.00
	Hedge Fund Administration	TBD	\$0.00
TOTAL COST		\$1,202,025.00	\$2,675,617.50
Data Warehousing and Portfolio Accounting		BNY Mellon	State Street
	Data Hub	\$320,000.00	TBD
	Inv. Accounting	\$386,000.00	TBD
	ASP Solution (Hosted Server)	\$630,000.00	TBD

Note* Yellow Highlight are Estimated Costs done for Comparative Purposes.

GENERAL ACCOUNT AND LGIP FEES AND COSTS [DRAFT]

Core and Ancillary Services	BNY Mellon	State Street
Core Custody		
Account Based Fees (Admin, Acctg, etc)	\$0.00	\$25,500.00
Asset Based Fees (Custody)	\$148,249.00	\$297,971.00
Transaction Based (Buy, Sell, etc)	\$11,028.00	\$48,451.00
On-Line Access	\$0.00	\$0.00
Contractual Settlement and Auto Credit	\$0.00	\$0.00
Transition/Conversion	\$0.00	Pass Thru
Penalty Costs		
Third Party FX Support	\$0.00	\$0.00
Third Party Seclending Support	\$75,000.00	\$75,000.00
Out of Pocket Expenses	\$0.00	Pass Thru
Corporate Actions (if required)	\$0.00	\$0.00
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Notifications	\$0.00	\$0.00
Online Access by ProxyEdge Software	Pass Thru	Pass Thru
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Compliance Monitoring Tool		
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Independent Derivatives Valuation	TBD	TBD
Performance Measurement		
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	BNY Mellon	State Street
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Penalty Costs			
	Third Party FX Support	\$0.00	\$0.00
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TOTAL COST		\$354,277.00	\$682,622.00
Data Warehousing and Portfolio Accounting		BNY Mellon	State Street
	Data Hub	TBD	TBD
	Inv. Accounting	TBD	TBD
	ASP Solution (Hosted Server)	TBD	TBD

Note* Yellow Highlights are Estimated Costs done for Comparative Purposes.

From: [Abesamis, Bo](#)
To: [Leidinger, Bill](#); catherine.wargo@bnymellon.com; [Swilley-Burke, Gwelda](#); [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Tahiliani, Shakun](#); [Condon, Bill](#)
Subject: RE: BNY Mellon Transfer Agency Demo
Date: Friday, May 18, 2012 5:50:57 PM

Bill and All,

I will not be able to participate since I will be in transit from San Francisco to Columbia that day.

Thanks. BO

From: Leidinger, Bill [mailto:Bill.Leidinger@sto.sc.gov]
Sent: Friday, May 18, 2012 12:31 PM
To: catherine.wargo@bnymellon.com; Abesamis, Bo; Swilley-Burke, Gwelda; Lybrand, Douglas; Rebecca Gunnlaugsson; Tammy Nichols; Faith Wright; Tahiliani, Shakun; Condon, Bill
Subject: RE: BNY Mellon Transfer Agency Demo

FYI.....You certainly are invited to call in and participate if your schedule permits.....Bill

From: catherine.wargo@bnymellon.com [mailto:catherine.wargo@bnymellon.com]
Sent: Friday, May 18, 2012 9:04 AM
To: Leidinger, Bill
Subject: BNY Mellon Transfer Agency Demo

Good Morning Bill,

Attached is the information and instructions for the Transfer Agency demonstration on Monday, May 21st 3:00 - 4:30 ET. Please let me know if you would like me to invite Bo and Gwelda from Callan and I can forward them the information as well.

Thank you. Have a nice weekend.

Catherine

DATE: Monday, May 21, 2012
TIME: 3:00 pm, Eastern Daylight Time (New York, GMT-04:00)
MEETING NUMBER: 768 129 439
PASSWORD: 0521ACdemo
TELECONFERENCE: Call-in # 1-866-692-3158 PC 6728576
Please click the link below to see more information, or to join the meeting.

Here's what to do:

1. At the meeting's starting time, either click the following link or copy and paste it into your Web browser:

<https://bnymellon.webex.com/bnymellon/j.php?ED=167063447&UID=1099515262&PW=NNDA3NWYyOTZI&RT=MIMxMQ%3D%3D>

2. Enter your name, your email address, and the meeting password (if required), and then click Join.

3. If the meeting includes a teleconference, follow the instructions that automatically appear on your screen.

That's it! You're in the web meeting!

WebEx will automatically setup Meeting Manager for Windows the first time you join a meeting. To save time, you can setup prior to the meeting by clicking this link:
<https://bnymellon.webex.com/bnymellon/meetingcenter/mcsetup.php>

For Help or Support:

Go to <https://bnymellon.webex.com/bnymellon/mc> click Assistance, then Click Help or click Support.

To add this meeting to your calendar program (for example Microsoft Outlook), click this link:

<https://bnymellon.webex.com/bnymellon/j.php?ED=167063447&UID=1099515262&ICS=MI&LD=1&RD=2&ST=1&SHA2=LGTSYUydb7Jgrf-1AjUkfCAv5FkwuWEcQYk2EoxsTZc=&RT=MIMxMQ%3D%3D>

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From: [Leidinger, Bill](#)
To: catherine.wargo@bnymellon.com; "Abesamis, Bo"; [Swilley-Burke, Gwelda](#); [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Tahiliani, Shakun](#); [Condon, Bill](#)
Subject: RE: BNY Mellon Transfer Agency Demo
Date: Friday, May 18, 2012 3:31:50 PM

FYI.....You certainly are invited to call in and participate if your schedule permits.....Bill

From: catherine.wargo@bnymellon.com [mailto:catherine.wargo@bnymellon.com]
Sent: Friday, May 18, 2012 9:04 AM
To: Leidinger, Bill
Subject: BNY Mellon Transfer Agency Demo

Good Morning Bill,

Attached is the information and instructions for the Transfer Agency demonstration on Monday, May 21st 3:00 - 4:30 ET. Please let me know if you would like me to invite Bo and Gwelda from Callan and I can forward them the information as well.

Thank you. Have a nice weekend.

Catherine

DATE: Monday, May 21, 2012
TIME: 3:00 pm, Eastern Daylight Time (New York, GMT-04:00)
MEETING NUMBER: 768 129 439
PASSWORD: 0521ACdemo
TELECONFERENCE: Call-in # 1-866-692-3158 PC 6728576
Please click the link below to see more information, or to join the meeting.

Here's what to do:

1. At the meeting's starting time, either click the following link or copy and paste it into your Web browser:
<https://bnymellon.webex.com/bnymellon/j.php?ED=167063447&UID=1099515262&PW=NNDA3NWYyOTZl&RT=MIMxMQ%3D%3D>
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For Help or Support:

Go to <https://bnymellon.webex.com/bnymellon/mc> click Assistance, then Click Help or click Support.

To add this meeting to your calendar program (for example Microsoft Outlook), click this link:

<https://bnymellon.webex.com/bnymellon/j.php?ED=167063447&UID=1099515262&ICS=MI&LD=1&RD=2&ST=1&SHA2=LGTSYUydb7Jgrf-1AjUkfCAv5FkwuWEcQYk2EoxsTZc=&RT=MIMxMQ%3D%3D>

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From: [Leidinger, Bill](#)
To: [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Tahiliani, Shakun](#); [Condon, Bill](#); ["Abesamis, Bo"](#); [Swilley-Burke, Gwelda](#); [Douglas W. Lybrand](#)
Subject: Tuesday May 22 mtg of Custody Selection Advisory Panel with Bo and Gwelda
Date: Wednesday, May 16, 2012 9:04:53 AM

Folks, I ask that you come to our meeting prepared to:

- review with Bo and Gwelda what I believe they will have prepared as the final comparative evaluation regarding basic custody, ancillary services and costs
- answer the question before the house: Which bank do you recommend for securities lending and which bank for custody?
- raise any other questions or comments you believe appropriate

See you Tuesday Thanks....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

From: [Protasewich, Richard G](#)
To: [Bissell, Ann](#); [Paton, R Scott](#); [Schafer, Mark E](#); [Tyrrell, Lisa H](#); [Brauer, Paul G](#); abesamis@callan.com; swilley-burke@callan.com; [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Hershel Harper](#); [Leidinger, Bill](#)
Subject: South Carolina / State Street Information Technology Discussion
Attachments: [InterWiseEvent.vcs](#)

You are invited to attend an AT&T Connect iMeeting .

To connect to the Web Conference:

=====
Click here: <https://connect15.uc.att.com/statestreet/meet/?ExEventID=88257533>

TO CONNECT WITH YOUR *TELEPHONE ONLY* (no computer):

=====

1. Choose one of the following numbers to dial:

* Toll-Free Number (in USA): 888-772-8526

* Caller-Paid number: 602-333-2031

* Blackberry (Toll-Free Number): 888-772-8526x8257533#

* A number in your country or in a country close to you (may be toll free): <https://www.teleconference.att.com/servlet/glbAccess?process=1&accessNumber=8887728526&accessCode=8257533>

2. When prompted, enter the meeting access code: 8257533#

Powered by AT&T Connect.

From: [Leidinger, Bill](#)
To: [Protasewich, Richard G](#); [abesamis@callan.com](#); [swilley-burke@callan.com](#); [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Hershel Harper](#)
Cc: [Schafer, Mark E](#); [Paton, R Scott](#)
Subject: RE: South Carolina Follow-up
Date: Tuesday, May 15, 2012 10:38:36 AM

2 or 3.....Please schedule and those that are interested and can participate will.....Thanks....bill

From: Protasewich, Richard G [<mailto:rgprotasewich@statestreet.com>]
Sent: Tuesday, May 15, 2012 10:32 AM
To: Leidinger, Bill; [abesamis@callan.com](#); [swilley-burke@callan.com](#); Lybrand, Douglas; Rebecca Gunnlaugsson; Tammy Nichols; Faith Wright; Condon, Bill; Tahiliani, Shakun; Harper, Hershel
Cc: Schafer, Mark E; Paton, R Scott
Subject: RE: South Carolina Follow-up

Would a time next Monday or Tuesday work for the Team?

Rich

Richard G. Protasewich, Vice President
State Street Global Services | Institutional Investors Services | One Lincoln Street, Boston, MA 02111
P 617-664-3788 | F 617-786-2079 | M 704-560-5560 | rgprotasewich@statestreet.com
www.statestreetglobalservices.com

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From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Tuesday, May 15, 2012 10:28 AM
To: Protasewich, Richard G; [abesamis@callan.com](#); [swilley-burke@callan.com](#); Lybrand, Douglas; Rebecca Gunnlaugsson; Tammy Nichols; Faith Wright; Condon, Bill; Tahiliani, Shakun; Harper, Hershel
Cc: Schafer, Mark E; Paton, R Scott
Subject: RE: South Carolina Follow-up

I am sorry but Thursday and Friday of the week are not doable for us.....
Thanks....Bill

From: Protasewich, Richard G [<mailto:rgprotasewich@statestreet.com>]
Sent: Tuesday, May 15, 2012 10:23 AM
To: [abesamis@callan.com](#); [swilley-burke@callan.com](#); Leidinger, Bill; Lybrand, Douglas; Rebecca Gunnlaugsson; Tammy Nichols; Faith Wright; Condon, Bill; Tahiliani, Shakun; Harper, Hershel
Cc: Schafer, Mark E; Paton, R Scott
Subject: FW: South Carolina Follow-up

South Carolina Evaluation Team, Bo and Gwelda:

Attached below are the follow-up items arising from your visit to Boston. On behalf of State Street, thank you for your continued consideration and interest. Please contact me with any questions and

we look forward to arranging further discussions regarding Information Technology and InfraHedge.

I would like to propose a conference on Thursday, May 17th at 2pm to discuss Information Technology Infrastructure and future developments. Please let me know if that time works for the group and I will send out a meeting invite with call in details.

I look forward to any other feedback or information that we can provide to assist your evaluation process.

Thanks again,

Rich

Richard G. Protasewich, Vice President

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P 617-664-3788 | F 617-786-2079 | M 704-560-5560 | rprotasewich@statestreet.com

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From: Protasewich, Richard G
Sent: Monday, May 07, 2012 12:13 AM
To: abesamis@callan.com; 'swilley-burke@callan.com'; bill.leidinger@sto.sc.gov
Cc: Schafer, Mark E
Subject: South Carolina Follow-up

Bo, Gwelda and Bill:

It was our pleasure to host the team from the State of South Carolina last week in Boston to review our proposed investment servicing solution. I believe our time was well spent and that we shared compelling reasons for the South Carolina to choose State Street as its next global custodian. Throughout the day, many items were requested and discussed by various stakeholders as follow-up. Outlined below is a list of those items:

Boilerplate Custody and Securities Finance Authorization Agreement

Redacted post conversion Audit

Business Process Review - Beacon Consulting Offer Description and Project Plan

Conversion Call to answer Bill Condon's specific questions – No longer needed per Bill Condon

IT Data Information Flow Diagram outlining single platform

Information Technology Call – tentatively scheduled for May 17th at 2pm based on availability of the SC Team

Floating Rate Data Elements

Do you have a report that shows the variable rate and the date that is changed?

Answer: Yes, the priced position interactive view shows the current rate and the next change date for the rate. I've attached a report that shows these fields. The "Rate Change Date" field is when the rate will change next.

InfraHedge Call – We recommend conducted this review/discussion in person at the Team's convenience

Biography Book of proposed SC Team client facing team

Client Team Structure, Roles and responsibilities – Diagram

Entity Exposure Monitor Information / Demo

Securities Finance – Differentiators and Risk Reporting Samples

Investment Compliance Average alerts and a depiction of the reduction of the number of alerts due to the effectiveness of our service.

State Street's Investment compliance services and our Compliance Dashboard Workflow and Trend Analysis Reporting enables significant control and transparency for our clients. The attached reports demonstrate the effectiveness of enhanced compliance program. Where a rule breach occurs regularly, our Compliance Analysts review the conditions of the breach(s) and share our "best practices" with the client. The adoption of these "best practices", enrichment of data characteristics and the evolution of the tool have a positive impact of the results (as demonstrated in the attached graph).

Identification of "active" vs. "passive" breach best practice ensures the priority issues are being investigated/reported

Recognizing and incorporating Risk data into the Compliance testing program expands the coverage & governance of the Compliance program

Shift the workflow; our analysts engage direct with investment managers performing reconciliation prior

Ashleigh Hollins

Subject: South Carolina / State Street Information Technology Discussion
Location: <https://connect15.uc.att.com/statestreet/>

Start: Tue 5/22/2012 3:00 PM
End: Tue 5/22/2012 4:00 PM

Recurrence: (none)

Meeting Status: Meeting organizer

Organizer: Ashleigh Hollins

Categories: Online Meeting

to notifying client of the results

Create a holistic compliance solution by utilizing 3rd party data integration – look through enhancing the clarity of rules

Investment Compliance Monitoring Proposed Conversion Timeline

Trade Cost Analysis information

Fee negotiation – to be conducted at the direction of Callan and the SC Evaluation Team

I have already collected a majority of this information and will wait until it is complete to send to you and Bill Leidinger as Procurement Officer, so that it may be distributed to the full evaluation team early this week. Meanwhile, please let me know if I missed any items. I recommend arranging the conference calls to last no more than 30 minutes for the areas highlighted in yellow. My team is available and flexible this week to meet the schedule of the stakeholders.

Any other feedback is welcomed. Thank you again for considering State Street and I look forward speaking with you this week.

Best Regards,

Rich

Richard G. Protasewich, Vice President

State Street Global Services | Institutional Investors Services | One Lincoln Street, Boston, MA 02111

P 617-664-3788 | F 617-786-2079 | M 704-560-5560 | rgprotasewich@statestreet.com

www.statestreetglobalservices.com

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From: [Protasewich, Richard G](#)
To: [Leidinger, Bill](#); abesamis@callan.com; swilley-burke@callan.com; [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Hershel Harper](#)
Cc: [Schafer, Mark E](#); [Paton, R Scott](#)
Subject: RE: South Carolina Follow-up
Date: Tuesday, May 15, 2012 10:32:19 AM

Would a time next Monday or Tuesday work for the Team?

Rich

Richard G. Protasewich, Vice President

State Street Global Services | Institutional Investors Services | One Lincoln Street, Boston, MA 02111
P 617-664-3788 | F 617-786-2079 | M 704-560-5560 | rgprotasewich@statestreet.com
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From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Tuesday, May 15, 2012 10:28 AM
To: Protasewich, Richard G; abesamis@callan.com; swilley-burke@callan.com; Lybrand, Douglas; Rebecca Gunnlaugsson; Tammy Nichols; Faith Wright; Condon, Bill; Tahiliani, Shakun; Harper, Hershel
Cc: Schafer, Mark E; Paton, R Scott
Subject: RE: South Carolina Follow-up

I am sorry but Thursday and Friday of the week are not doable for us.....
Thanks....Bill

From: Protasewich, Richard G [<mailto:rgprotasewich@statestreet.com>]
Sent: Tuesday, May 15, 2012 10:23 AM
To: abesamis@callan.com; swilley-burke@callan.com; Leidinger, Bill; Lybrand, Douglas; Rebecca Gunnlaugsson; Tammy Nichols; Faith Wright; Condon, Bill; Tahiliani, Shakun; Harper, Hershel
Cc: Schafer, Mark E; Paton, R Scott
Subject: FW: South Carolina Follow-up

South Carolina Evaluation Team, Bo and Gwelda:

Attached below are the follow-up items arising from your visit to Boston. On behalf of State Street, thank you for your continued consideration and interest. Please contact me with any questions and we look forward to arranging further discussions regarding Information Technology and InfraHedge.

I would like to propose a conference on Thursday, May 17th at 2pm to discuss Information Technology Infrastructure and future developments. Please let me know if that time works for the group and I will send out a meeting invite with call in details.

I look forward to any other feedback or information that we can provide to assist your evaluation process.

Thanks again,

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From: Protasewich, Richard G
Sent: Monday, May 07, 2012 12:13 AM
To: abesamis@callan.com; 'swilley-burke@callan.com'; bill.leidinger@sto.sc.gov
Cc: Schafer, Mark E
Subject: South Carolina Follow-up

Bo, Gwelda and Bill:

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Redacted post conversion Audit

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Conversion Call to answer Bill Condon's specific questions – **No longer needed per Bill Condon**

IT Data Information Flow Diagram outlining single platform

th

Information Technology Call – tentatively scheduled for May 17 at 2pm based on availability of the SC Team

Floating Rate Data Elements

Do you have a report that shows the variable rate and the date that is changed?

Answer: Yes, the priced position interactive view shows the current rate and the next change date for the rate. I've attached a report that shows these fields. The "Rate Change Date" field is when the rate will change next.

InfraHedge Call – We recommend conducted this review/discussion in person at the Team's convenience

Biography Book of proposed SC Team client facing team

Client Team Structure, Roles and responsibilities – Diagram

Entity Exposure Monitor Information / Demo

Securities Finance – Differentiators and Risk Reporting Samples

Investment Compliance Average alerts and a depiction of the reduction of the number of alerts due to the effectiveness of our service.

State Street's Investment compliance services and our Compliance Dashboard Workflow and Trend Analysis Reporting enables significant control and transparency for our clients. The attached reports demonstrate the effectiveness of enhanced compliance program. Where a rule breach occurs regularly, our Compliance Analysts review the conditions of the breach(s) and share our "best practices" with the client. The adoption of these "best practices", enrichment of data characteristics and the evolution of the tool have a positive impact of the results (as demonstrated in the attached graph).

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To: [Protasewich, Richard G](#); abesamis@callan.com; swilley-burke@callan.com; [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Hershel Harper](#)
Cc: [Schafer, Mark E](#); [Paton, R Scott](#)
Subject: RE: South Carolina Follow-up
Date: Tuesday, May 15, 2012 10:29:01 AM

I am sorry but Thursday and Friday of the week are not doable for us.....
Thanks....Bill

From: Protasewich, Richard G [mailto:rgprotasewich@statestreet.com]
Sent: Tuesday, May 15, 2012 10:23 AM
To: abesamis@callan.com; swilley-burke@callan.com; [Leidinger, Bill](#); [Lybrand, Douglas](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Harper, Hershel](#)
Cc: [Schafer, Mark E](#); [Paton, R Scott](#)
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From: [Leidinger, Bill](mailto:Bill.Leidinger@sto.sc.gov)
To: catherine.wargo@bnymellon.com
Cc: [Abesamis, Bo](mailto:Abesamis.Bo@callan.com); [Condon, Bill](mailto:Bill.Condon@sto.sc.gov); claire.sonnenberg@bnymellon.com; [Douglas W. Lybrand](mailto:Douglas.W.Lybrand@ic.sc.gov); [Faith Wright](mailto:Faith.Wright@retirement.sc.gov); [Hershel Harper](mailto:Hershel.Harper@ic.sc.gov); [Rebecca Gunnlaugsson](mailto:Rebecca.Gunnlaugsson@ic.sc.gov); [Tahiliani, Shakun](mailto:Tahiliani.Shakun@sto.sc.gov); susan.swigor@bnymellon.com; swilley-burke@callan.com; [Tammy Nichols](mailto:Tammy.Nichols@retirement.sc.gov); vince.sands@bnymellon.com
Subject: RE: BNY Mellon Follow-up
Date: Friday, May 11, 2012 12:17:11 PM

Please coordinate **all** procurement activities through me.....Thanks and have a great weekend.....Bill

From: catherine.wargo@bnymellon.com [mailto:catherine.wargo@bnymellon.com]
Sent: Friday, May 11, 2012 12:04 PM
To: Leidinger, Bill
Cc: [Abesamis, Bo](mailto:Abesamis.Bo@callan.com); [Condon, Bill](mailto:Bill.Condon@sto.sc.gov); claire.sonnenberg@bnymellon.com; [Lybrand, Douglas](mailto:Lybrand.Douglas@ic.sc.gov); fwright@retirement.sc.gov; [Harper, Hershel](mailto:Harper.Hershel@ic.sc.gov); rgunnlaugsson@ic.sc.gov; [Tahiliani, Shakun](mailto:Tahiliani.Shakun@sto.sc.gov); susan.swigor@bnymellon.com; swilley-burke@callan.com; [Tammy Nichols](mailto:Tammy.Nichols@retirement.sc.gov); vince.sands@bnymellon.com
Subject: RE: BNY Mellon Follow-up

Hi Bill,

One of the follow-up items is a webex demonstration of the Transfer Agency system. We would like to ensure we comply with all procurement regulations and in that regard would like to reconfirm whether it is okay to reach out directly to Shakun or whether the demo should be coordinated through Callan or another designated party.

Thank you,

Catherine

From: "Leidinger, Bill" <Bill.Leidinger@sto.sc.gov>
To: "catherine.wargo@bnymellon.com" <catherine.wargo@bnymellon.com>, "[Condon, Bill](mailto:Bill.Condon@sto.sc.gov)" <Bill.Condon@sto.sc.gov>, "[Tahiliani, Shakun](mailto:Tahiliani.Shakun@sto.sc.gov)" <Shakun.Tahiliani@sto.sc.gov>, "[Harper, Hershel](mailto:hharper@ic.sc.gov)" <hharper@ic.sc.gov>, "[Lybrand, Douglas](mailto:Lybrand.Douglas@ic.sc.gov)" <dlybrand@ic.sc.gov>, "rgunnlaugsson@ic.sc.gov" <rgunnlaugsson@ic.sc.gov>, "fwright@retirement.sc.gov" <fwright@retirement.sc.gov>, Tammy Nichols <Tnichols@retirement.sc.gov>
Cc: "[Abesamis, Bo](mailto:Abesamis.Bo@callan.com)" <Abesamis.Bo@callan.com>, "swilley-burke@callan.com" <swilley-burke@callan.com>, "vince.sands@bnymellon.com" <vince.sands@bnymellon.com>, "susan.swigor@bnymellon.com" <susan.swigor@bnymellon.com>, "claire.sonnenberg@bnymellon.com" <claire.sonnenberg@bnymellon.com>
Date: 05/11/2012 08:51 AM
Subject: RE: BNY Mellon Follow-up

Thank you, Catherine.

Folks, please remember that all this material is to be kept confidential by everyone who received this email....it is procurement related.....Thanks.....bill

From: catherine.wargo@bnymellon.com [mailto:catherine.wargo@bnymellon.com]
Sent: Thursday, May 10, 2012 10:43 AM

To: Leidinger, Bill; Condon, Bill; Tahiliani, Shakun; Harper, Hershel; Lybrand, Douglas;
rgunnlaugsson@ic.sc.gov; fwright@retirement.sc.gov; Tammy Nichols
Cc: Abesamis, Bo; swilley-burke@callan.com; vince.sands@bnymellon.com;
susan.swigor@bnymellon.com; claire.sonnenberg@bnymellon.com
Subject: BNY Mellon Follow-up

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Thank you,

Catherine

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From: catherine.wargo@bnymellon.com
To: Leidinger, Bill
Cc: Abesamis, Bo; Condon, Bill; claire.sonnenberg@bnymellon.com; Douglas W. Lybrand; Faith Wright; Hershel Harper; Rebecca Gunnlaugsson; Tahiliani, Shakun; susan.swigor@bnymellon.com; swilley-burke@callan.com; Tammy Nichols; vince.sands@bnymellon.com
Subject: RE: BNY Mellon Follow-up
Date: Friday, May 11, 2012 12:04:38 PM

Hi Bill,

One of the follow-up items is a webex demonstration of the Transfer Agency system. We would like to ensure we comply with all procurement regulations and in that regard would like to reconfirm whether it is okay to reach out directly to Shakun or whether the demo should be coordinated through Callan or another designated party.

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To: "catherine.wargo@bnymellon.com" <catherine.wargo@bnymellon.com>, "Condon, Bill" <Bill.Condon@sto.sc.gov>, "Tahiliani, Shakun" <Shakun.Tahiliani@sto.sc.gov>, "Harper, Hershel" <hharper@ic.sc.gov>, "Lybrand, Douglas" <dlybrand@ic.sc.gov>, "rgunnlaugsson@ic.sc.gov" <rgunnlaugsson@ic.sc.gov>, "fwright@retirement.sc.gov" <fwright@retirement.sc.gov>, Tammy Nichols <tnichols@retirement.sc.gov>
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Date: 05/11/2012 08:51 AM
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To: Leidinger, Bill; Condon, Bill; Tahiliani, Shakun; Harper, Hershel; Lybrand, Douglas; rgunnlaugsson@ic.sc.gov; fwright@retirement.sc.gov; Tammy Nichols
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To: catherine.wargo@bnymellon.com; [Condon, Bill](#); [Tahiliani, Shakun](#); [Hershel Harper](#); [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#); [Tammy Nichols](#)
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Subject: RE: BNY Mellon Follow-up
Date: Friday, May 11, 2012 8:51:59 AM

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To: [Leidinger, Bill](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Harper, Hershel](#); [Lybrand, Douglas](#); rgunnlaugsson@ic.sc.gov; fwright@retirement.sc.gov; [Tammy Nichols](#)
Cc: [Abesamis, Bo](#); swilley-burke@callan.com; vince.sands@bnymellon.com; susan.swigor@bnymellon.com; claire.sonnenberg@bnymellon.com
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To: [Protasewich, Richard G](#)
Cc: [Schafer, Mark E](#); [Tyrrell, Lisa H](#); [Paton, R Scott](#); [Callahan, Laura A](#); [O'Rourke, Keith A](#); abesamis@callan.com; swilley-burke@callan.com; [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Condon, Bill](#); [Tahiliani, Shakun](#)
Subject: RE: South Carolina Follow-up
Date: Wednesday, May 09, 2012 2:02:00 PM

Folks, Bill Condon has indicated he does not believe this call is necessary.....
Let's cancel.....Thanks.....Bill

From: Protasewich, Richard G [mailto:rgprotasewich@statestreet.com]
Sent: Wednesday, May 09, 2012 1:52 PM
To: Leidinger, Bill
Cc: Schafer, Mark E; Tyrrell, Lisa H; Paton, R Scott; Callahan, Laura A; O'Rourke, Keith A; abesamis@callan.com; swilley-burke@callan.com; Lybrand, Douglas; Rebecca Gunnlaugsson; Tammy Nichols; Faith Wright; Condon, Bill; Tahiliani, Shakun
Subject: RE: South Carolina Follow-up

Bill:

I just sent the meeting invite with the call in information to you and the SC Team. Please send any specific questions beforehand and we can be sure to have any material that will help our discussion.

Have a great day off tomorrow.

Best Regards,

Rich

Richard G. Protasewich, Vice President

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P 617-664-3788 | F 617-786-2079 | M 704-560-5560 | rgprotasewich@statestreet.com
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From: Leidinger, Bill [mailto:Bill.Leidinger@sto.sc.gov]
Sent: Wednesday, May 09, 2012 1:42 PM
To: Leidinger, Bill; Protasewich, Richard G
Cc: Schafer, Mark E; Tyrrell, Lisa H; Paton, R Scott; Callahan, Laura A; O'Rourke, Keith A; abesamis@callan.com; swilley-burke@callan.com; Lybrand, Douglas; Rebecca Gunnlaugsson; Tammy Nichols; Faith Wright; Condon, Bill; Tahiliani, Shakun
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Sent: Monday, May 07, 2012 1:12 PM

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Subject: RE: South Carolina Follow-up

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To: abesamis@callan.com; swilley-burke@callan.com; Leidinger, Bill

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Subject: South Carolina Follow-up

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Subject: RE: South Carolina Follow-up
Date: Wednesday, May 09, 2012 1:52:22 PM

Bill:

I just sent the meeting invite with the call in information to you and the SC Team. Please send any specific questions beforehand and we can be sure to have any material that will help our discussion.

Have a great day off tomorrow.

Best Regards,

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- Redacted post conversion Audit
- Business Process Review - Beacon Consulting Offer Description and Project Plan
- Conversion Call to answer Bill Condon's specific questions
- IT Data Information Flow Diagram outlining single platform
- Information Technology Call
- Floating Rate Data Elements

- **InfraHedge Call**

- Biography Book of full proposed SC Team
- Client Team Structure, Roles and responsibilities – Diagram
- Entity Exposure Monitor Information / Demo
- Securities Finance – Differentiators and Risk Reporting Samples
- Investment Compliance Average alerts and a depiction of the reduction of the number of alerts due to the effectiveness of our service.
- Trade Cost Analysis information
- Fee negotiation

I have already collected a majority of this information and will wait until it is complete to send to you and Bill Leidinger as Procurement Officer, so that it may be distributed to the full evaluation team early this week. Meanwhile, please let me know if I missed any items. I recommend arranging the conference calls to last no more than 30 minutes for the areas highlighted in yellow. My team is available and flexible this week to meet the schedule of the stakeholders.

Any other feedback is welcomed. Thank you again for considering State Street and I look forward speaking with you this week.

Best Regards,

Rich

Richard G. Protasewich, Vice President

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From: [Leidinger, Bill](#)
To: [Hershel Harper](#); [Adam Jordan](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#)
Cc: [Loftis, Curtis](#); [Condon, Bill](#)
Subject: Custody RFP
Date: Tuesday, May 08, 2012 11:50:13 AM

Folks, good to meet this AM and discuss informing the Commissioners at Wampee re: the status of the custody RFP.

For the record, I have no problem with us advising the Commission in general, non-specific terms of the process we have employed in this procurement, the current status of the procurement, what we believe the timeline ahead will be and issues that may be explored/questions that may be asked by the Advisory Selection Panel as it goes forward to finish its work and be in a position to make a specific recommendation(s) to the Treasurer. I will be pleased to help develop the presentation as well as participate in the presentation.

I will remind you again that we can not reveal at Wampee who the selected finalist banks are, content of and contrasts between finalist proposals or any other information of a specific nature sufficient to identify the banks or the contents of their proposals.

When I returned to the office I reviewed our conversation with Bill Condon and I became aware that I may have misspoken during our meeting. Since this is the Treasurer's procurement and ultimately the Treasurer's contract to sign, there may not be an opportunity for the Commission to "approve" or "disapprove" the contract. Rather, the IC staff members who are on the Selection Advisory Panel are expected to advise the full Selection Advisory Panel of the wants and needs of the Investment Commission. Once the contract is finalized and signed by the Treasurer, the Investment Commission will be able to select the ancillary services it wants that are provided by the selected custodian following whatever process it chooses.

If Rebecca and Doug feel that a certain vendor or certain vendor's ancillary services or tools are critical or most important to the Investment Commission, they should make that very clear to the Selection Advisory Panel as we go forward. They may even want to ask the Commissioners what they think is most important to the Commission, but they would have to do so without disclosing confidential procurement information.

I apologize for my error.

Thanks.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

From: [Leidinger, Bill](#)
To: [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Condon, Bill](#); [Tahiliani, Shakun](#)
Cc: [Abesamis, Bo](#); [Swilley-Burke, Gwelda](#)
Subject: Bo's Thoughts re:Custody Decision Variables - May 22 (Meeting) of Advisory Selection Panel
Date: Monday, May 07, 2012 12:07:36 PM
Importance: High

Folks, here are Bo's thoughts and suggestions regarding the May 22 meeting of the Selection Advisory Panel. Please do your homework and come prepared to offer your recommendations on the 22nd.

Thanks.....Bill

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Sunday, May 06, 2012 10:39 PM
To: Leidinger, Bill
Cc: Swilley-Burke, Gwelda
Subject: Custody Decision Variables - May 22 (Meeting)
Importance: High

Bill,

Kindly have the whole group available on May 22 (9:00 am to 2:00 pm) for a meeting to discuss the decision variables and go through the must haves – debrief of the on-sites and products/services.

The most important decision is to bundle or unbundle securities lending with custody. Is what Deutsche Bank Americas offering compelling enough (in level of expertise, risk management and revenue generation) to warrant unbundling securities lending from custody? This is necessary because on the implications on custody and ancillary services fees from either BNY Mellon or State Street.

The next phase is to prioritize and ascertain specific products and services to be delivered by the custody bank. This phase would involve a discussion by the evaluation group (prioritizing, "must have" service, etc.). Based on what I have assessed so far, 5 Variables need to be taken into consideration:

- (1) Custody – This is a core requirement and necessary for all stakeholders.
- (2) Accounting – This is a core requirement and necessary for all stakeholders, specifically Retirement Systems for CAFRs and GASB Reporting.
- (3) Look Through, Private Equity and Hedge Fund Transparency – This is becoming to be a much needed service given the intensive allocation to alternative asset classes. Without a doubt, the Investment Commission, Retirement System and STO would want to have some level of access to these tools. This toolkit may be one way for the State Treasurer to track all investments whether custodied (traditional asset classes) or non-custodied assets (alternative investments – LPs, Commingled Funds, etc.).
- (4) Performance Measurement, Analytics and Risk Management Tools – This is critical to the Investment Commission, specifically advance-type analytics. Shakun needs basic performance, while the Retirement System does not really get involved in this area. Some of these tools may be needed by the STO with respect to no-in-bank assets.
- (5) Data Warehousing, Transfer Agency and Related Services – This is the last item that we need to discuss. Shakun's group would need to have some access to transfer agency platform. Depending on level of need, Investment Commission may need data warehousing for consolidated and aggregation of investments for independent tracking purposes. Another area within this 5th Variable is Investment Accounting to replace QED – this needs to be evaluated

further.

We will discuss all of the above on May 22. It will be very helpful if the representatives from each entity would be in agreement with respect to that entity's needs and wants. Everyone will have an opportunity to discuss whatever other matters may be on their minds.

We have asked both BNY Mellon and State Street to submit some fee clarity to the services last April, and we will use that to map out the potential costs for all of the above. Once we bring our heads together, we will fine tune the costs and seek further clarity and/or "best and final" offer. Again, the bundling and unbundling of securities lending would have an impact on relationship pricing, or the revenue generated from a 3rd party seclending agent would more than cover the costs for the above services.

Thanks.

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

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From: [Leidinger, Bill](#)
To: [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#)
Cc: [Condon, Bill](#); [Tahiliani, Shakun](#)
Subject: Attached Opinion to Hon. Curtis Loftis dated April 20, 2012
Date: Thursday, May 03, 2012 4:29:01 PM
Attachments: [loftis.c.m.jr.os-9395.4-20-12-co-fiduciary's.duties.pdf](#)

Folks, I happened to have a sidebar conversation with Tammy while we were “on the road” during which I mentioned the attached opinion. I thought it would be a good idea to share it with all members of the Selection Advisory Panel.

It perhaps will assist you in better appreciating some of the questions the STO has raised as well as point out that it applies to the benefits and responsibilities of information sharing among all the entities (Investment Commission, Retirement Systems and STO) who have fiduciary responsibilities.

Bill Blume and Hershel Harper received a copy of the opinion earlier.

Thanks.....Bill



ALAN WILSON
ATTORNEY GENERAL

April 20, 2012

The Honorable Curtis M. Loftis, Jr.
South Carolina State Treasurer
P. O. Box 11778
Columbia, South Carolina 29211

Dear Treasurer Loftis,

You seek our opinion “regarding a co-fiduciary’s duty to provide information to another co-fiduciary and a co-fiduciary’s duty to request from another co-fiduciary information that he deems necessary to perform his duties.” By way of background, you state the following:

The five public pension plans operated by the State of South Carolina (“SCRS”) have assets that approximate \$25 billion and a huge unfunded liability that places a burden on the State of South Carolina, the participants and beneficiaries of the five public pension plans, and the taxpayers of South Carolina. The assets of the SCRS are not funds of the State but are held in trust as provided in Section 9-16-20. S.C. Code Ann. § 9-1-1310(C). Under South Carolina law, the Budget and Control Board (“B&CB”) is the trustee of the SCRC, S.C. Code Ann. § 9-1-1310, and has legal title to the assets of the SCRS, Op. Att’y Gen’l, p. 14 (Nov. 16, 2011). The State Treasurer is the custodian of the assets in the SCRS. S.C. Code Ann. § 9-1-1320. The six-member Retirement System Investment Commission (“RSIC”) has the responsibility to invest the assets of the SCRS. See S.C. Code Ann. § 9-16-20(A).

The State Treasurer has a unique role regarding the SCRS. First, the State Treasurer serves as custodian of the funds in the SCRS. S.C. Code Ann. § 9-1-1320. In this role, he serves as an “other fiduciary” with respect to the SCRS pursuant to S.C. Code Ann. § 9-16-40. Op. Att’y Gen, p. 12 (Nov. 16, 2011). Second, the State Treasurer serves ex-officio as a member of the six-member RSIC. S.C. Code Ann. § 9-16-315(A)(2). The RSIC is responsible for investing the assets of the SCRS, hiring staff, and establishing investment objectives. See S.C. Code Ann. §§ 9-16-50, 9-16-315(G), 9-16-330(A). As a member of the RSIC, the State Treasurer is also a fiduciary. S.C. Code Ann. § 9-16-10(4)(c). Finally, the State Treasurer is a member of the B&CB, S.C. Code Ann. § 1-11-10, which has legal title to the assets of the SCRS and serves as trustee of the SCRS.

The State Treasurer serves as a fiduciary or a trustee in each of his roles regarding the SCRS. Failure to perform his fiduciary duties could be detrimental to the SCRS, its participants and beneficiaries, and State’s taxpayers and could result in personal liability for the State Treasurer, S.C. Code Ann. § 9-16-70(A). He therefore has the need for

timely and complete information to perform his duties. Accordingly, the specific issues for which the State Treasurer is seeking your opinion include the following:

1. Whether the RSIC and its staff have a duty to provide information to the State Treasurer regarding each of the State Treasurer's roles in the SCRS.
2. Whether the State Treasurer has a duty to request from the RSIC and its staff information and to request to examine all relevant records of the co-fiduciary that the State Treasurer deems necessary to fulfill his trustee and other fiduciary responsibilities regarding the SCRS.
3. If the answer to issue number 2 is yes, whether the RSIC and its staff have a duty to timely provide to the State Treasurer the requested information and to timely access to the State Treasurer to examine relevant records of the RSIC.
4. Whether the scope of information that the RSIC and its staff must provide to the State Treasurer is limited in any fashion.

As background, the information that the RSIC and its staff may need to provide to the State Treasurer or that the State Treasurer may need to fulfill his fiduciary duties may include, but is not limited to, the following: investments made by the RSIC or its staff; additional information on investments recommended to the RSIC by its staff, third-party investment managers used; contracts entered into with third-party managers and so called strategic partners; information about outside custodians of SCRS' funds; investment management fees paid and other costs incurred by the RSIC; soft-dollar benefits received from outside persons by members of the RSIC or its Staff, and documentation of initial and ongoing due diligence procedures performed on investment managers by the RSIC, its staff, and others on their behalf.

Law / Analysis

In an Opinion, dated November 16, 2011, we addressed at considerable length the interaction of various statutes “and the scope of the powers which have been vested in the State Treasurer with regard to the [South Carolina Retirement System Investment] Commission and Investment of Retirement System funds or assets.” This Opinion answers the questions you have raised in your letter concerning the duty of Retirement System co-trustees to cooperate with each other and specifically, in that regard, to provide requested information to each other. In the 2011 Opinion, we concluded that “[p]ursuant to Act No. 153 of 2005, the General Assembly has established the structure for the administration of the State Retirement System, which constitutes a statutory trust.” We further stated as follows:

In our opinion, the Retirement System Investment Commission is given *exclusive authority* to “invest and manage” Retirement System assets in accordance with Art. X, § 16 of the state Constitution and the statutory guidelines which the Legislature has set forth. No other agency or entity is now authorized by law to invest these funds, Act No. 153 having transferred all investment authority to the Commission. Thus, in this regard,

we concur in your view that the Investment Commission's powers and responsibilities are "very broadly framed."

Such does not mean, however, that the other entities involved in the Retirement System - the Budget and Control Board, as trustee, and the State Treasurer, as custodian, do not themselves have important responsibilities in this regard. The Investment Commission's authority is the "investing and managing assets" of the Retirement System. See, § 9-16-50. [describes how the Commission shall perform its investing and managing function]. We note also that the Budget and Control Board remains the "trustee" of the Retirement System, holding the "legal title" to such assets on behalf of and in trust for the beneficiaries of the trust. *Hamiter, supra*. The five Retirement Systems are placed under the administration of the Budget and Control Board. See, §§ 9-1-20; 9-8-20; 9-9-20; 9-11-20. See also §§ 9-1-210; 9-8-30(1); 9-9-30(1); 9-11-30(1). *Hamiter, Id*. The State Treasurer remains the "custodian" of the Retirement System assets, and acts as a bailee of those funds, possessing the ministerial duty to disburse such funds upon proper warrant or other directive authorized by law.

Each of these agencies - the Retirement System Investment Commission, the Budget and Control Board and the State Treasurer possesses a fiduciary duty to the statutory trust. Each must have the protection and preservation of that trust uppermost in mind and actions. See § 9-16-40(3) [a "trustee, commission member or other fiduciary shall discharge duties with respect to a retirement system with the care, skill and caution under the circumstances then prevailing"]. As the West Virginia Court stated in *Dadisman, supra*, involving a similar statutory scheme, the entity performing the investment function possesses a fiduciary relation with the trust and thus "has the highest fiduciary duty to see to it" that the retirement funds are invested in secure investments. In that instance, the Court intervened when the investment authority of the Investment Board had been abused by investment in speculative ventures. Here, the Budget and Control Board, as trustee, has been placed "in a fiduciary relationship" with the trust and its participants. *Id*. As trustee, the Board possesses all common law responsibilities as trustee, in addition to its statutory duties. While the Board no longer possesses the authority to invest, the statutes require that the Board holds the assets of the retirement system in a group trust. That group trust is created so that collective investment may be made. Thus, as a co-trustee, the Budget and Control Board must independently exercise care to protect the trust, including acting accordingly if it deems investments are not being carried out in the best interests of the trust. *Dadisman, Id*.

Similarly, even though the Treasurer, as custodian, acts in a ministerial role, he does so as a fiduciary. We deem the State Treasurer to be an "other fiduciary" pursuant to § 9-16-90(3). Thus, the Treasurer may not disburse funds which have no basis in law. In addition, the Treasurer is not only the custodian of the assets, but also a member of the Budget and Control Board, the trustee of the funds, as well as a member of the Retirement System Investment Commission.

Accordingly, in view of the fact that each of the three agencies possess the highest of fiduciary duties owed to the Retirement System trust, it is essential that each keep the other fully informed and that each cooperate fully with their fellow fiduciaries. The important fiduciary duties of each were designed by the Legislature as a check and balance. It is indeed the Retirement System Investment Commission which has been given the exclusive investment function by the Legislature. However, the other fiduciaries - the Budget and Control Board, as trustee, and the Treasurer, as custodian - also owe an independent fiduciary duty to protect the trust and to insure that the trust is fully preserved. Your letter indicates that the Commission "works closely with the State Treasurer, as well as the Retirement System, in monitoring and maintaining adequate cash balances to meet the needs of the Retirement System." This close cooperation and sharing of all available information should continue and even be improved upon, if possible. Each fiduciary should recognize that it is the trust, i.e. the Retirement System assets, which the law has charged them to protect. As the Florida Court stated in Ball, supra, "co-trustees owe to each other, as well as to the beneficiaries ... the duty and obligation to so conduct themselves as to foster a spirit of mutual trust, confidence and cooperation to the extent possible."

(emphasis added).

The 2011 Opinion also quoted the following language from *Restatement 3d on Trusts* § 81 regarding the duty of co-trustees, particularly as to the duty of co-trustees to share information with each other:

[t]hus, trust provisions may and often should allocate roles and responsibilities among the trustees, or relieve one or more of the trustees of duties to participate in particular aspects of the trust's administration. A settlor may even designate, or provide for the appointment of a "special trustee" to handle only one or more specified functions or types of decisions (e.g. the exercise of tax-sensitive powers or distributions, when the general trustee or trustees are beneficiaries of those powers), with the special trustee having no authority in or responsibility for other aspects of the trust administration. The settlor's limiting of a trustee's functions or allocation of functions among the trustees usually, either explicitly or as a matter of interpretation, has the effect of relieving the trustee(s) to whom a function is not allocated of any affirmative duty to remain informed or to participate in deliberations about matters within that function. Similarly, exculpatory provisions (§ 96) may be designed to apply selectively.

Even in matters for which a trustee is relieved of responsibility, however, if the trustee knows that a co-trustee is committing or attempting to commit a breach of trust, the trustee has a duty to take reasonable steps to prevent the fiduciary misconduct *Furthermore, absent clear provision in the trust to the contrary, even in the absence of any duty to intervene or grounds of suspicion, a trustee is entitled to request and receive reasonable information regarding an aspect of trust administration in which the trustee is not required to participate.*

(emphasis added).

Another leading treatise, Bogert, *The Law of Trusts and Trustees*, § 584, confirms the foregoing conclusions contained in the 2011 Opinion. In Bogert, it is stated quite clearly that “[t]rustees also are under a duty to furnish information relevant to the administration of the trust to co-trustees. The duty ensures that each Trustee can fully participate in the administration of the trust, carry out the trust purposes and terms, avoid possible liability for breach of trust, and prevent or redress a breach of trust by a co-trustee.” (citing *Benedict v. Amaducci*, 1993 WL 87937 (S.D.N.Y. 1993; *Equitable Trust Co. v. Schwebel*, 32 F.Supp. 241 (E.D. Pa. 1940), affd. 117 F.2d 738 (3d Cir. 1941); *Henley v. Birmingham Trust Nat. Bank*, 322 So.2d 688 (Ala. 1975); *Pa. Co. v. Wilmington Trust Co.*, 186 A.2d 751 (Del. 1962), affd., 200 A.2d 441 (Del. 1964).

Previous opinions of this Office are in accord. We have emphasized, by way of analogy, that a custodian of public funds is held to the highest standards of a trustee. In *Op. S.C. Atty. Gen.*, June 2, 2003 (2003 WL 21471508), we stated:

“typically, a public officer responsible for the handling and collection of public funds is considered a trustee, a bailee, or an insurer with all applicable duties and responsibilities of such funds or property” See *Op. Atty. Gen.*, dated March 3, 1997. Such public funds

... are considered trust funds, and he [the public officer] is responsible to the same degree as the trustee of a private fund. It is the policy of the law to hold an official custodian of public funds to strict accountability, and he must exercise ordinary diligence to keep informed of the conditions of funds subject to his disposal. 67 C.J.S., *Officers*. § 211.

Id., When presented with similar questions our Supreme Court has expressed general agreement with the principle stated above. For example, in *Sumter Co. v. Hurst*, 189 S.C. 316, 319, 1 S.E.2d 242 (1939), the Court held that “when a public officer receives money for the public use, he is a trustee to received such monies and to pay them to the public official or function for whom or which they were intended.”

(emphasis added). Thus, we have found that a custodian of funds must “exercise ordinary diligence to keep informed of the conditions of funds subject to his disposal.” *Id.*

Conclusion

We are of the opinion that the November 16, 2011 Opinion answers the majority of your questions, and that Opinion is herein reaffirmed. As we concluded therein, each of the agencies involved in the operation of the State Retirement Systems – the Retirement System Investment Commission, the Budget and Control Board and the State Treasurer – “possesses a fiduciary duty to the statutory trust.” Thus, our further conclusion was that “in view of the fact that each of the three agencies possess[es] the highest of fiduciary duties owed to the Retirement System trust, it is essential that each keep the other fully informed and that each cooperate fully with their fellow fiduciaries.” Quoting from the Florida


The Honorable Curtis M. Loftis, Jr.
Page 6
April 20, 2012

decision in *Ball v. Mills*, 376 So.2d 1174, 1182 (Fla. App. 1979), we stated that “co-trustees owe to each other, as well as to the beneficiaries ... the duty and obligation to so conduct themselves as to foster a spirit of mutual trust, confidence and cooperation to the extent possible.” Further quoting from *Restatement 3d on Trusts* § 81, we stated that “... even in the absence of any duty to intervene or grounds for suspicion, a trustee is entitled to request and receive reasonable information regarding an aspect of trust administration in which the trustee is not required to participate.”

With respect to your final question as to whether there are any limitations upon the scope of information which must be provided by one co-trustee to another (such as the RSIC to the Treasurer), we have been unable in our research to find such a limitation. We note that the *Restatement 3d* (§ 81) speaks of the duty of a co-trustee to provide “reasonable information.” Bogert states that “[a] co-trustee is entitled to full information from his fellow trustee” Bogert, *supra* at § 962, n. 48. Our June 2, 2003 opinion, referenced above, emphasizes that a custodian “must exercise ordinary diligence to keep informed of the conditions of funds subject to disposal.”

Thus, as we advised in the November 16, 2011 Opinion, a “close cooperation [between the co-trustees] and sharing of *all available information* should continue, and even be improved upon, if possible.” Because each of the co-trustees owes the highest fiduciary duty to protect the Retirement trust funds, the rule must be: when in doubt, provide the information to fellow trustees.

Sincerely,


Signature Redacted

Robert D. Cook
Deputy Attorney General

RDC/an

From: [Swilley-Burke, Gwelda](#)
To: Bill.Leidinger@sto.sc.gov; [Abesamis, Bo](#)
Cc: [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#); [Tammy Nichols](#); Bill.Condon@sto.sc.gov; Shakun.Tahiliani@sto.sc.gov
Subject: Re: Next Week
Date: Friday, April 27, 2012 6:56:18 PM

Everyone,

The cell phone number to reach me on is 678-640-4393. See you next week.

Gwelda

From: Leidinger, Bill [mailto:Bill.Leidinger@sto.sc.gov]
Sent: Friday, April 27, 2012 01:24 PM
To: Abesamis, Bo; Swilley-Burke, Gwelda
Cc: Lybrand, Douglas <dlybrand@ic.sc.gov>; Rebecca Gunnlaugsson <RGunnlaugsson@ic.sc.gov>; Faith Wright <FWright@retirement.sc.gov>; Tammy Nichols <tnichols@retirement.sc.gov>; Condon, Bill <Bill.Condon@sto.sc.gov>; Tahiliani, Shakun <Shakun.Tahiliani@sto.sc.gov>
Subject: Next Week

Folks, do you have the address for Monday's meeting with Deutsche?
Thanks.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

From: Swilley-Burke, Gwelda
To: Bill.Leidinger@sto.sc.gov; Abesamis, Bo
Cc: Douglas W. Lybrand; Rebecca Gunnlaugsson; Faith Wright; Tammy Nichols; Bill.Condon@sto.sc.gov; Shakun.Tahiliani@sto.sc.gov
Subject: Re: Next Week
Date: Friday, April 27, 2012 4:27:51 PM

60 Wall Street
26th Floor
New York, NY 10005
Joe Santorro (212) 250-4492.

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Friday, April 27, 2012 01:24 PM
To: Abesamis, Bo; Swilley-Burke, Gwelda
Cc: Lybrand, Douglas <dlybrand@ic.sc.gov>; Rebecca Gunnlaugsson <RGunnlaugsson@ic.sc.gov>; Faith Wright <FWright@retirement.sc.gov>; Tammy Nichols <tnichols@retirement.sc.gov>; Condon, Bill <Bill.Condon@sto.sc.gov>; Tahiliani, Shakun <Shakun.Tahiliani@sto.sc.gov>
Subject: Next Week

Folks, do you have the address for Monday's meeting with Deutsche?
Thanks.....Bill

William Leidinger
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From: [Leidinger, Bill](#)
To: [Abesamis, Bo](#); [Swilley-Burke, Gwelda](#)
Cc: [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#); [Tammy Nichols](#); [Condon, Bill](#); [Tahiliani, Shakun](#)
Subject: Next Week
Date: Friday, April 27, 2012 4:25:03 PM

Folks, do you have the address for Monday's meeting with Deutsche?
Thanks.....Bill

William Leidinger
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From: [Leidinger, Bill](#)
To: [Abesamis, Bo](#)
Cc: [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Swilley-Burke, Gwelda](#)
Subject: RE: Custody and Securities Lending On-sites
Date: Friday, April 27, 2012 10:33:58 AM

Bo, I certainly understand and I hope all goes well for you and your family. My wife and I have experienced the same on 2 occasions and I know well how you and your family feel. Bill

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Friday, April 27, 2012 10:23 AM
To: Leidinger, Bill
Cc: Lybrand, Douglas; Rebecca Gunnlaugsson; Tammy Nichols; Faith Wright; Condon, Bill; Tahiliani, Shakun; Swilley-Burke, Gwelda
Subject: Custody and Securities Lending On-sites
Importance: High

Bill and All,

I had to send you this email because I will not be able to make it next week in NYC and Boston. My house got burglarized yesterday and had to deal with the headaches. Thank God my wife, Cheryl, and kids were not around the house when it happened. Everybody is totally shaken and upset. So sorry that I have to do this, but please do understand.

Gwelda is going to the on-sites and she will lead the team. As I told Gwelda the on-sites are really SC's time to ask the most important questions and for you to assess that the organizations are up to the task. You have to keep in mind is the people are solid, have your best interest in mind, and that their deliverables are up to the task to meet your exacting needs.

BO

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

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From: [Abesamis, Bo](#)
To: [Leidinger, Bill](#)
Cc: [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Swilley-Burke, Gwelda](#)
Subject: Custody and Securities Lending On-sites
Date: Friday, April 27, 2012 10:23:32 AM
Importance: High

Bill and All,

I had to send you this email because I will not be able to make it next week in NYC and Boston. My house got burglarized yesterday and had to deal with the headaches. Thank God my wife, Cheryl, and kids were not around the house when it happened. Everybody is totally shaken and upset. So sorry that I have to do this, but please do understand.

Gwelda is going to the on-sites and she will lead the team. As I told Gwelda the on-sites are really SC's time to ask the most important questions and for you to assess that the organizations are up to the task. You have to keep in mind is the people are solid, have your best interest in mind, and that their deliverables are up to the task to meet your exacting needs.

BO

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

101 California Street
Suite 3500
San Francisco, CA 94111
P. 415.274.3074
F. 415.291.4016

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From: [Leidinger, Bill](#)
To: [Abesamis, Bo](#)
Cc: [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Tammy Nichols](#); [Faith Wright](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Swilley-Burke, Gwelda](#)
Subject: RE: IMPORTANT --- Update on On-sites Next Week 4/30/2012 to 5/2/2012
Date: Wednesday, April 25, 2012 1:53:04 PM

Thanks, Bo.....see you then.....Bill

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Wednesday, April 25, 2012 1:50 PM
To: Leidinger, Bill
Cc: Lybrand, Douglas; Rebecca Gunnlaugsson; Tammy Nichols; Faith Wright; Condon, Bill; Tahiliani, Shakun; Abesamis, Bo; Swilley-Burke, Gwelda
Subject: IMPORTANT --- Update on On-sites Next Week 4/30/2012 to 5/2/2012
Importance: High

Bill and All,

Please **PRINT** this email and bring it with you for the on-sites. Most importantly, my cell phone is (925) 639-5577.

April 30, 2012

11:00 am to 11:30 am

Deutsche Bank (Securities Lending)

60 Wall Street

26th Floor

New York, NY 10005

Contact: Joe Santorro (212) 250-4492 or Christine Zsilavetz (212) 250-7272.

Comment: Please be sure to check in with the security desk and they will call Joe Santorro. Since we are near the NYSE at Wall Street, be aware of your surroundings. Please do not panic if you are stopped by law enforcement why you are hauling luggage. Pretty much all of Wall Street are for pedestrian traffic only.

1:30 pm

Penn Station – Acela to Boston (3:04 pm)

Comment: I arranged for a van to bring us from Deutsche Bank to Penn Station. Given the luggage and the number of people, I thought that taking the subway to Penn Station would be a painful exercise.

6:40 pm

Arrival at South Station Boston.

Comment: Honestly, we can walk from South Station to Omni Parker House Hotel at School Street. It is about 6 blocks away. Please be sure to wear comfortable shoes.

Dinner – We can discuss options.

May 1, 2012

8:00 am

Meet at the lobby of Omni Parker House

Comment: We will walk to State Street which is about 4 blocks from the Parker House. We need the lead time since we need to check in with security since we are entering a bank.

8:30 am – 2:30 pm

State Street Bank & Trust (State Street Financial Center)

1 Lincoln Street

Boston, MA 02111

Contacts: Rich Protasewich (704) 560-5560 or Mark Schafer (857) 294-8756

Comment: Please check in at the security desk and have official ID handy. At the end of the on-site of State Street, you have time to relax before dinner, I know that dragging you all without a breather is cruel and unusual punishment.

Dinner: We can discuss options.

May 2, 2012

7:30 am

Comment: Let us meet at the lobby of the Omni Parker House. I arranged a van service to bring us to Everett – BNY Mellon. Please be sure to check-out by 7:15 am and bring your luggage with you, because we will go from Everett to Logan Airport after the meeting.

8:00 am to 2:00 pm

BNY Mellon

135 Santilli Highway

Everett, MA 02149

Contacts: Susan Swigor (617) 382-2399 or (617) 306-4654 cell and Claire Sonnenberg (617) 722-7853 or (617) 416-6271

Comment: We need to check in with security. Please note that after the meeting at around 2:00 pm, I made arrangement for a van service to bring us to Logan Airport.

2:00 pm

End of Meetings – To the Airport we go.

THANKS.

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Date: Wednesday, April 25, 2012 1:49:41 PM
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Cc: [Loftis, Curtis](#); [William Blume](#); [Hershel Harper](#)
Subject: On-Site Due Diligence Next Week
Date: Tuesday, April 24, 2012 1:25:27 PM

Folks, as our on-site due diligence trip next week draws closer, I ask that you give specific thought to the services that you believe will best benefit your agency and all of us collectively. I don't want us to sit passively and listen to sales pitches or accept "fluff" regarding offered services, capacity, benefits, value, ease of use, clarity, transparency, and other values to be received.

This is an excellent opportunity to talk together with these firms in a meaningful and straightforward way and with the folks who we will be looking to help us get our work done in the future in the best way. Let's not be shy about inquiring/asking about anything that is on our individual or collective minds. Feel free to challenge or push them for information/clarification as you believe to be in your or our best interests. Don't be shy about asking them to show you report formats or asking for a live demonstration of what they allege.

This will be an enlightening and rewarding time for us together.

Thanks.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

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Subject: RE: State of South Carolina - Fee Clarification Spreadsheet CONFIDENTIAL PROCUREMENT RELATED
Date: Tuesday, April 17, 2012 1:06:13 PM

Thank you, Bo.....Bill

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Tuesday, April 17, 2012 1:00 PM
To: Leidinger, Bill
Cc: Lybrand, Douglas; Rebecca Gunnlaugsson; Tammy Nichols; Faith Wright; Condon, Bill; Tahiliani, Shakun; Swilley-Burke, Gwelda
Subject: Re: State of South Carolina - Fee Clarification Spreadsheet CONFIDENTIAL PROCUREMENT RELATED

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Sent: Tuesday, April 17, 2012 9:47 AM
To: Leidinger, Bill
Subject: FW: State of South Carolina - Fee Clarification Spreadsheet
Importance: High

FYI – REVISED FEE PROPOSAL FROM BNY MELLON.

WE CAN DISCUSS THEIR PROPOSAL AS PART OF THE ON-SITES, WHICH IS SLATED AT THE END OF THE MEETING.

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Sent: Monday, April 16, 2012 12:52 PM
To: Abesamis, Bo
Cc: claire.sonnenberg@bnymellon.com; laurin.moore@bnymellon.com; vince.sands@bnymellon.com
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Bo,

It was very nice speaking with you and as discussed, attached please find the fee worksheet for the South Carolina State Treasurer's Office, along with a cover letter.

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Date: 04/02/2012 05:05 PM
Subject: State of South Carolina - Fee Clarification Spreadsheet

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<image001.gif>

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Subject: FW: State of South Carolina - Fee Clarification Spreadsheet CONFIDENTIAL PROCUREMENT RELATED
Date: Tuesday, April 17, 2012 10:23:14 AM
Attachments: [041612 Letter.pdf](#)
[SC - Retirement and Genera lAccout LGIP Fee Grid 041612.XLSX](#)
Importance: High

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Susan D. Swigor, Managing Director • The Bank of New York Mellon
US Asset Servicing • Tel 617.382.2399 • Mobile 617.306.4654 • susan.swigor@bnymellon.com

From: "Abesamis, Bo" <abesamis@callan.com>

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Date: 04/02/2012 05:05 PM
Subject: State of South Carolina - Fee Clarification Spreadsheet

Susan and Vince,

As directed by the South Carolina State Treasurer's Office, kindly review the attached Excel Workbook with 2 Spreadsheets (SC – Retirement and GeneralAccountLGIP.xlsx = SC Retirement System and General Account/LGIP worksheets within the workbook). Please submit your response to the Fee Calculations as requested by the deadline of April 17, 2012.

Thank you for the time and effort you would expend on this additional request for fee clarification.

Callan

Bo Abesamis | Executive Vice President
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[attachment "SC - Retirement and GeneralAccountLGIP.XLSX" deleted by Susan D Swigor/CorpUS/BNYMellon]

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BNY MELLON
ASSET SERVICING

Susan Swigor
Managing Director
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April 16, 2012

Mr. Virgilio Abesamis
Executive Vice President
Callan
101 California Street
San Francisco, CA 94111

Dear Bo,

Thank you for requesting fee clarifications for the South Carolina State Treasurer's Office proposal. Attached please find the Excel workbook, detailing the information requested. Please note the following in conjunction with your review of the workbook:

- As discussed, the requirement to maintain a minimum cash balance has been removed. An assumption inherent in our fee proposal, however, is that any cash balances maintained will be invested in a BNY Mellon cash vehicle.
- Flat fees have been included for many of the services requested.
- Although an unbundled fee has been provided for Custody and Accounting, we would be pleased to discuss a flat fee for these services.
- Our fee proposal contemplates the current asset mix of the South Carolina State Treasurer's Office. Any significant modifications, including additional global accounts would need to be discussed further.
- As discussed, one fee proposal is being submitted, regardless of participation in the Securities Lending program.

We welcome your comments and insight and will be prepared to discuss our fee proposal during the *Fee Discussion* section of the agenda on May 2. We are, however, very happy to discuss any of the details or assumptions of our fee proposal at any time which is convenient for you.

Best regards,

Signature Redacted

State of South Carolina - Retirement Systems

	Volume	Fees	Pro-Forma Cost
Account Fees			
Number of Plans	5		Included in custody and transaction fees below
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			Included in custody and transaction fees below
Custody Fees			
	Market Values	Fees	Pro-Forma Cost
Domestic Equities			
Separate Accounts	\$2,120,554,029.40	0.000015	\$31,808
Commingled/Line Items	0		-
International Equities			
Separate Accounts	0		-
Commingled/Line Items	\$1,240,730,614.24		-
Domestic Fixed Income			
Separate Accounts	\$1,844,223,833.37	0.000015	\$27,663

	Volume	Fees	Pro-Forma Cost
Commingled/Line Items	0		-
Global Fixed-Income			
Separate Accounts	\$2,086,118,121.44	0.000015	\$31,292
Commingled/Line Items	\$3,124,395,969.92		-
Real Estate			
Direct/Separate Accounts	0		-
Commingled/Line Items	\$133,323,297.30		-
Private Equity			
Direct/Separate Accounts	0		-
Commingled/Line Items	\$1,050,435,850.00		-
Derivatives/Overlay			
Direct/Separate Accounts	\$1,418,499,978.10	0.000015	\$21,277
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		-
Commingled/Line Items	\$6,240,590,569.23		-
Commodities			
Direct/Separate Accounts	0		-
Commingled/Line Items	0		-
Strategic Partnerships			
Direct/Separate Accounts	0		-
Commingled/Line Items	\$6,280,953,860.07		-
Cash Accounts			
Direct/Separate Accounts	0		-
Commingled/Line Items	\$626,215,553.83		-
Transition Accounts			
Direct/Separate Accounts	\$60,362,992.54	0.000015	\$905
			-
For International Securities	Corresponding Market Values in US\$ as of June 30, 2011		
Australia	\$8,089,803.90	0.000015	\$121
Austria			-
Belgium			-
Bahamas			-
Belgium			-
Bermuda			-
Brazil	\$646,456.99	0.000015	\$10
British Virgin Islands			-
Canada	\$43,304,810.89	0.000015	\$650
Cayman Islands			-
China			-
Colombia			-
Cote d'Ivoire			-
Cyprus			-
Czech Republic			-
Denmark			-
European Union			-
Finland			-
France	\$54,960,992.09	0.000015	\$824
Germany	\$2,676,807.32	0.000015	\$40
Greece			-
Hong Kong	\$594,876.17	0.000015	\$9

	Volume	Fees	Pro-Forma Cost
Hungary			-
India			-
Indonesia			-
Ireland			-
Israel			-
Italy	\$281,763.85	0.000015	\$4
Japan	\$14,219,261.58	0.000015	\$213
Liberia			-
Luxembourg			-
Malaysia			-
Marshall Islands			-
Mexico			-
Netherlands			-
New Zealand	\$313,660.55	0.000015	\$5
Norway			-
Panama			-
Peru			-
Philippines			-
Poland			-
Portugal			-
Puerto Rico			-
Russian Federation			-
Singapore			-
South Africa			-
South Korea			-
Spain	\$1,176,137.34	0.000015	\$18
Sweden	\$510,569.65	0.000015	\$8
Switzerland			-
Taiwan			-
Thailand			-
Turkey			-
UK	\$45,275,191.28	0.000015	\$679
Subtotal			\$115,527
Transactions	Annual Volume	Fees	Pro-Forma Cost
Domestic Depository Trades (DTC/Fed Book)	22,206	\$4	\$88,824
Domestic Non-Depository Trades	3,038	\$4	\$12,152
Physicals	1	\$4	\$4
Principal Payments	2,333		
Maturities	121		
Dividend/Income Receipts	5,413		
Tax Reclaims	0		
Wires	589		
Capital Calls	60		
Options/Futures	1,054	\$4	\$4,216
Swaps	1,034	\$4	\$4,136
3 rd Party FX	654	\$35	\$22,890
Custody FX Trades	48		
Proxy Notification	777		

	Volume	Fees	Pro-Forma Cost
Corporate Actions (Splits, Voluntary/Involuntary)	456		
Class Action Filings	55		
Other International Transactions --			
Australia	1	\$4	\$4
Austria			
Belgium			
Bahamas			
Bermuda			
Brazil			
British Virgin Islands			
Canada	26	\$4	\$104
Cayman Islands			
China			
Colombia			
Cote d'Ivoire			
Cyprus			
Czech Republic			
Denmark			
Egypt			
European Union (Euroclear)	42	\$4	\$168
Finland			
France			
Germany			
Greece			
Hong Kong			
Hungary			
India			
Indonesia			
Ireland			
Israel			
Italy			
Japan			
Korea			
Liberia			
Luxembourg			
Malaysia			
Marshall Islands			
Mexico			
Netherlands			
New Zealand			
Norway			
Panama			
Peru			
Philippines			
Poland			
Portugal			
Puerto Rico			
Russian Federation			
Singapore			
South Africa			
South Korea			

	Volume	Fees	Pro-Forma Cost
Spain			
Sweden			
Switzerland			
Taiwan			
Thailand			
Turkey			
UK			
Subtotal			\$132,498
Others: (Enumerate)	Annual Volume	Fees	Pro-Forma Cost
Global Custody – Support			
Power of Attorney			Included in above fee
Global Tax Agent			TBD
Country Registration			Included in above fee
Tax-Exempt Filing			Included in above fee
Market Guide			Included in above fee
Subtotal			Included and TBD
On-line/Internet Access and Reporting			
User Interface			Included in above fee
Subscription			Included in above fee
Assets/Holding			Included in above fee
Cash			Included in above fee
Transactions			Included in above fee
Standard reports			Included in above fee
GASB Support - Reporting			Included in above fee
Customized reporting			TBD
Executive/Board reporting			TBD
Income Inquiry Reports			Included in above fee
Corporate Actions Reporting			Included in above fee
Terminal charge			Included in above fee
Communication software			Included in above fee
CPU connect time			Included in above fee
Others: (specify)			
Subtotal			Included and TBD
Contractual Settlement and Auto Credit			
Domestic			Included in above fee
International			Included in above fee
ADRs			Included in above fee
Subtotal			Included

	Volume	Fees	Pro-Forma Cost
Transition & Conversion			No transition or conversion required
Reregistration			
Scrip Fees			
Etc.			
Subtotal			0
Penalty Costs			
Third Party FX	654	See fee above	
Third Party Secending	0	\$75,000 per lender	
Etc.			
Subtotal			
Out of Pocket			
Wire Transfer			Included in above fee
Courier Service			Included in above fee
Telex Charges			Included in above fee
Computer processing			Included in above fee
Staff Training			Included in above fee
Stamp Duty			Pass-through
Reregistration			Pass-through
Others:			
Subtotal			Included and pass-through
Corporate Actions			Included in above fee
Voluntary/Mandatory			
Involuntary			
Subtotal			Included in above fee
Proxy Notification Support			
Proxy Notifications	777		Included in above fee
Reporting			
On-line Access			
3rd Party Online (ProxyEdge or ISS)	777	Fees to be provided by Broadridge	Fees to be provided by Broadridge
Others			
Subtotal			Included and Broadridge
Class Action			
Filing	55		Included in above fee
Reporting			Included in above fee
On-line Access			Included in above fee
Legal Filings Support with 3rd Party		Fees to be provided by Broadridge	Fees to be provided by Broadridge
Others:			

Volume

Fees

Pro-Forma Cost

	Volume	Fees	Pro-Forma Cost
Subtotal			Included and Broadridge
Investment Guideline Compliance			
<i>BASIC COMPLIANCE - see below accounts</i>			A fully outsourced compliance service has been included in the flat performance fee below.
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			A fully outsourced compliance service has been included in the flat performance fee below.
<i>INTERMEDIATE COMPLIANCE FULL OUTSOURCE- see below accounts</i>			Included in flat performance fee below
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		

	Volume	Fees	Pro-Forma Cost
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			Included in flat performance fee below
Independent Derivatives Processing and Valuation			
Pricing - Futures	100	270	\$27,000
Pricing - Options	50	270	\$13,500
Pricing - Swaps	50	270	\$13,500
Processing			
Collateral Management			
Reporting			
Subtotal			54,000
Performance Measurement			\$200,000 flat annual fee
Historical Upload			Historical upload not required
Cost for Historical Performance - 5 Years of Upload of Returns and Flows		N/A	
Others			

	Volume	Fees	Pro-Forma Cost
Subtotal			Historical upload not required
Monthly Return Calcs - including Gross & Net of Fees, Lagged & Unlagged, Time Weighted and IRR Calcs			Included in flat annual performance fee above
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			Included in flat annual fee performance fee above
Daily Return Calcs - including Gross & Net of Fees, Lagged & Unlagged, Time Weighted and IRR Calcs		\$75,000	\$75,000
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		

Volume

Fees

Pro-Forma Cost

	Volume	Fees	Pro-Forma Cost
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal		\$75,000	\$75,000
Investment Portfolio Characteristics and Risk Adjusted Returns - Benchmarks			Included in flat annual performance fee above
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		

	Volume	Fees	Pro-Forma Cost
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			Included in flat annual performance fee above
Universe Comparison - <u>Custody Bank</u>			
Peer Universes			Included in flat annual performance fee above.
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		

	Volume	Fees	Pro-Forma Cost
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			Included in flat annual performance fee above
Universe Comparison - <u>TUCS Universe</u>			The BNYM Universe is included in the flat annual performance fee above. The fees below are included for illustrative purposes and not included in the total.
Number of Plans	5		
Domestic Equities			
Separate Accounts	7	1200	
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3	1200	
Domestic Fixed Income			
Separate Accounts	7	1200	
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2	1200	
Commingled/Line Items	6	1200	
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6	1200	
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27	1200	

	Volume	Fees	Pro-Forma Cost
Derivatives/Overlay			
Direct/Separate Accounts	2	1200	
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9	1200	
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27	1200	
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13	1200	
Transition Accounts			
Direct/Separate Accounts	2	1200	
Commingled/Line Items	27	1200	
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13	1200	
Transition Accounts			
Direct/Separate Accounts	2	1200	
Subtotal			The BNYM Universe is included in the flat annual performance fee above. The fees above for TUCS are included for illustrative purposes only and not included in the total.
Attribution - Investment Portfolio Factor Analysis			Included in flat annual performance fee above
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		

	Volume	Fees	Pro-Forma Cost
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			Included in flat annual performance fee above
Advanced Risk Analytics			\$140,000
Look Through/Drill Down			
VaR Testing			
Stress Testing			
Scenario Testing			
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		

	Volume	Fees	Pro-Forma Cost
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			\$140,000
Data Interface with 3rd Party Providers			
Fund Consultants		Included	Included
Actuary		Included	Included
External Auditors		Included	Included
Externtal Inv. Accounting Platforms (i.e. Eagle, QED, PAM, etc.)		Included	Included
Nottingham		TBD	TBD
Class Action Agent		TBD	TBD
Tax Reclaim Agent		TBD	TBD
Proxy Voting Agent		TBD	TBD
Others:			
Subtotal			Included and TBD
Corporate Governance Tools			
Governmentrics		N/A	
Risk Metrics Governance Module		N/A	
Custody In-house Platform		N/A	
Specify –			
Subtotal			N/A
Alternative Investment Support			\$125,000
Private Equity - Support (like Private I, Private Informant, Document Management, Capital Call Mgmt and Reconciliation Support)			
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		

	Volume	Fees	Pro-Forma Cost
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Subtotal			\$125,000
Hedge Fund Transparency			\$150,000
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Hedge Fund Administration Services		TBD	TBD
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Subtotal			\$150,000 and TBD
Data Warehousing and Investment Portfolio Accounting for SC Purposes			The below figures represent hosted solutions
Investment Data Hub			\$320,000/yr + \$9,800 per each billion AUM in excess of \$25 billion
Investment Accounting (if separate from Investment Data Warehousing Hub)			\$386,000/yr + \$12,000 per each billion AUM in excess of \$25 billion
ASP Solution (Hosting Solution with Software Operations Maintenance and Disastery Recovery)			Bundled Data Hub and Investment Accounting: \$630,000/yr + \$19,000 per each billion AUM in excess of \$25 billion
Subtotal			The figures above represent hosted solutions
Other Costs			
Daily Valuation		\$125,000	\$125,000
Subtotal			\$125,000

	Volume	Fees	Pro-Forma Cost
TOTAL ESTIMATED COSTS			\$1,117,025 (excluding hosted Data Hub and Investment Accounting Fee of \$630,000)*

- * \$248,025 Custody and Accounting
- \$200,000 Performance Measurement
- \$ 54,000 Independent Derivative Processing/Valuation
- \$ 75,000 Daily Return Calculations
- \$140,000 Advanced Risk Analytics
- \$125,000 Alternative Investment Support
- \$150,000 Hedge Fund Transparency
- \$125,000 Daily Valuation
- \$1,117,025 Total

SC Treasurer's Office General Account and LGIP

	Volume	Fees	Pro-Forma Cost
Account Fees			
GENERAL ACCOUNT			Included in custody and transaction fees below
Number of Funds	11		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
LGIP			
Number of Funds	1		
Domestic Fixed Income			
Separate Accounts	1		
Commingled/Line Items			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items			
Subtotal			Included in custody and transaction fees below
Custody Fees			
	Market Values	Fees	Pro-Forma Cost
GENERAL ACCOUNT			
Domestic Fixed Income			
Separate Accounts	\$7,203,194,725.84	0.000015	\$108,048
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	\$49,095,798.00		
LGIP			
Domestic Fixed Income			
Separate Accounts	\$2,680,080,581.35	0.000015	\$40,201
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items			
Subtotal			\$148,249
Transactions			
	Annual Volume	Fees	Pro-Forma Cost
GENERAL ACCOUNT			

	Volume	Fees	Pro-Forma Cost
Domestic Depository Trades (DTC/Fed Book)	1,846	4	\$7,384
Domestic Non-Depository Trades	197	4	\$788
Physicals			
Principal Payments	3,101		
Maturities	403		
Dividend/Income Receipts	1,819		
Tax Reclaims			
Wires	1,303		
Capital Calls			
Options/Futures			
Swaps			
Proxy Notification			
Corporate Actions (Splits, Voluntary/Involuntary)	37		
LGIP			
Domestic Depository Trades (DTC/Fed Book)	461	4	\$1,844
Domestic Non-Depository Trades	253	4	\$1,012
Physicals			
Principal Payments			
Maturities	379		
Dividend/Income Receipts	617		
Tax Reclaims			
Wires	149		
Capital Calls			
Options/Futures			
Swaps			
Proxy Notification			
Corporate Actions (Splits, Voluntary/Involuntary)	1		
Subtotal			\$11,028
Others: (Enumerate)	Annual Volume	Fees	Pro-Forma Cost
On-line or Internet Access			
User Interface			Included in above fee
Subscription			Included in above fee
Assets/Holding			Included in above fee
Cash			Included in above fee
Transactions			Included in above fee
Standard reports			Included in above fee
GASB Support			Included in above fee
Customized reporting			TBD
Executive/Board reporting			TBD
Income Inquiry Reports			Included in above fee
Corporate Actions Reporting			Included in above fee
Terminal charge			Included in above fee
Communication software			Included in above fee
CPU connect time			Included in above fee
Others: (specify)			

Volume

Fees

Pro-Forma Cost

	Volume	Fees	Pro-Forma Cost
Subtotal			Included and TBD
Contractual Settlement and Auto Credit			
Domestic			Included in above fee
International			Included in above fee
ADRs			Included in above fee
Subtotal			Included
Transition & Conversion			No transition or conversion required
Reregistration			
Scrip Fees			
Etc.			
Subtotal			0
Penalty Costs			
Third Party FX			\$35
Third Party SecLending			\$75,000 per lending agent
Etc.			
Subtotal			N/A and \$75,000 per lending agent
Out of Pocket			Included in above fee
Wire Transfer			
Courier Service			
Telex Charges			
Computer processing			
Staff Training			
Stamp Duty			
Reregistration			
Others:			
Subtotal			Included in above fee
Corporate Actions			Included in above fee
Voluntary/Mandatory			
Involuntary			
Subtotal			Included in above fee
Proxy Notification			Included in above fee
Reporting			
On-line Access			
Others			
Subtotal			Included in above fee
Class Action			
Filings			Included in above fee
On-line Access			Included in above fee
Legal Filings			If 3rd party utilized, fees to be provided by 3rd party
Reporting			Included in above fee
Others			

	Volume	Fees	Pro-Forma Cost
Subtotal			Included and potential 3rd party fees
Investment Guideline Compliance			
<i>BASIC COMPLIANCE - see below accounts</i>			A fully outsourced compliance service has been included in the flat performance fee below.
Funds	12		
Domestic Fixed Income			
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Subtotal			A fully outsourced compliance service has been included in the flat performance fee below.
<i>INTERMEDIATE COMPLIANCE FULL OUTSOURCE- see below accounts</i>			Included in flat annual performance fee below
Funds	12		
Domestic Fixed Income			
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Subtotal			Included in flat annual performance fee below
Independent Derivatives Processing and Valuation			N/A
Reporting			
Pricing			
Processing			
Collateral Management			
Subtotal			N/A
Performance Measurement			\$25,000
Historical Upload			Historical upload not required
Cost for Historical Performance - 5 Years of Upload of Returns and Flows			
Others			

Volume

Fees

Pro-Forma Cost

Subtotal			Historical upload not required
Monthly Return Calcs - including Gross & Net of Fees			Included in flat annual performance fee above
Funds	12		
Domestic Fixed Income			
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Internally Managed			
Subtotal			Included in flat annual performance fee above
Investment Portfolio Characteristics and Risk Adjusted Returns - Benchmarks			Included in flat annual performance fee above
Funds	12		
Domestic Fixed Income			
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Internally Managed			
Subtotal			Included in flat annual performance fee above
Universe Comparison			Included in flat annual performance fee above
Funds	12		
Domestic Fixed Income			
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Internally Managed			
Subtotal			Included in flat annual performance fee above
Attribution			Included in flat annual performance fee above
Funds	12		
Domestic Fixed Income			

Volume

Fees

Pro-Forma Cost

	Volume	Fees	Pro-Forma Cost
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Internally Managed			
Subtotal			Included in flat annual performance fee above
Advanced Risk Analytics			\$20,000
Look Through/Drill Down			
VaR Testing			
Stress Testing			
Scenario Testing			
Domestic Fixed Income			
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Internally Managed			
Subtotal			\$20,000
Data Interface with 3rd Party Providers			
Fund Consultants			Included
Actuary			Included
External Auditors			Included
SAP G/L			Included
QED II			Included
Class Action Agent			TBD
Tax Reclaim Agent			TBD
Proxy Voting Agent			TBD
Others:			
Subtotal			Included and TBD
Corporate Governance Tools			
Governmentrics			N/A
Risk Metrics Governance Module			N/A
Custody In-house Platform			N/A
Specify –			
Subtotal			N/A
Data Warehousing and Investment Portfolio Accounting for SC Purposes			The below figures represent hosted solutions

	Volume	Fees	Pro-Forma Cost
Investment Data Hub			\$320,000/yr. + \$9,800 per each billion AUM in excess of \$25 billion
Investment Accounting (if separate from Investment Data Warehousing Hub)			\$386,000/yr. + \$12,000 per each billion AUM in excess of \$25 billion
ASP Solution (Hosting Solution with Software Operations Maintenance and Disastery Recovery)			Bundled Data Hub and Investment Accounting: \$630,000/yr. + \$19,000 per each billion AUM in excess of \$25 billion
Subtotal			The above figures represent hosted solutions
Transfer Agency Services			\$75,000
Shareholder Reporting			
Shareholder Tracking			
<i>All Call Center Done by SC</i>			
Subtotal			\$75,000
Other Costs			
(enumerate)			
Subtotal			
TOTAL ESTIMATED COSTS			\$279,277 (excluding hosted Data Hub and Investment Accounting fee of \$630,000)*

* \$159,277 Custody and Accounting
\$ 25,000 Performance Measurement
\$ 20,000 Advanced Risk Analytics
\$ 75,000 Transfer Agency Services
\$279,277 Total

From: [Leidinger, Bill](#)
To: [Abesamis, Bo](#)
Cc: [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Tammy Nichols](#); [Faith Wright](#); [Swilley-Burke, Gwelda](#)
Subject: FW: Draft Agenda for On-Sites
Date: Wednesday, April 11, 2012 9:44:20 AM

Bo, this is the only response I have received from the Advisory Selection Panel members regarding your suggested agenda for the up-coming on-site visits.

I agree with Doug that we sure don't want a repeat of the presentations that we have already received. No "dog and pony shows".....we want the visits be rich in discussion and demonstration of basic service offerings as well as "add on" services and the additional costs of the latter. We want the right people there from the banks who can confidently and knowingly answer our questions. Please tell the banks to be very well prepared for our visits and assure them that we will be focused and are expecting a great deal from them during our time together.

Thanks much.....Bill

From: Douglas W. Lybrand [mailto:DLybrand@ic.sc.gov]
Sent: Friday, April 06, 2012 2:28 PM
To: Leidinger, Bill
Subject: RE: Draft Agenda for On-Sites

Hi Bill,

I would be interested to learn to what extent the custodians can keep us informed on proxy voting.

I would also be interest in the reporting capabilities surrounding Class Action suits. When are suits filed? What is the extent of our participation? Did we file in time? Did we get paid? When, how much?

It seems to me that Bo has duplicated many issues supposedly covered in the written responses and in-house presentations. I hope we can avoid going over the same thing multiple times and focus on those issues best discerned in their offices.

Given the shortage of time overall, some demos would seem to be a waste of time, like those we have already seen. Some demos I've seen have lasted hours. There are some who may want to see Burgiss more, however (me too). I am also interested in hedge fund transparency and administrative services. Gary Li and I will see another demo on Investor Analytics (BNYM's risk application) in-house next week. Perhaps we could arrange something similar with State Street.

I would also be interested in a better understanding of how Eagle data services (BNYM) could play a role in our operations. Perhaps Eagle could briefly demonstrate/illustrate how other clients use/could use their services. Especially in conjunction with other proposed services.

Also some custody services are so... fundamental. Is it really necessary to demonstrate how the two best in the country perform these duties. A "life of the trade" is admittedly a useful framework, but can we keep it at a high level?

Also let us try and focus on the differences in the (BNYM) offices (Boston or Pittsburg) that could service our private equity, hedge fund and other alternative investments.

These are my thoughts. I hope this is what you are looking for.

Hey Bill, should we start making transportation and lodging arrangements or is someone going to coordinate major parts of that for us? Please advise as we have to jump through hoops on our side. Thanks.

Doug

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Tuesday, April 03, 2012 5:12 PM
To: Abesamis, Bo
Cc: Tammy Nichols; Hershel Harper; Tahiliani, Shakun; Douglas W. Lybrand; Raven, Dinah; McDermott, Mike; Rebecca Gunnlaugsson; Faith Wright; Swilley-Burke, Gwelda; William Blume
Subject: RE: Draft Agenda for On-Sites

Folks, as we discussed with Bo today, please review and add anything you believe should be added from the perspective of your entity and return to me. I will compile in a master edited document which contains all of edits and send to you and Bo.....Please try to have your edits to me by close of business next Tuesday.....Thanks.....Bill

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Tuesday, April 03, 2012 4:48 PM
To: Leidinger, Bill
Cc: Tammy Nichols; Harper, Hershel; Tahiliani, Shakun; Lybrand, Douglas; Raven, Dinah; McDermott, Mike; Rebecca Gunnlaugsson; fwright@retirement.sc.gov; Swilley-Burke, Gwelda; wblume@retirement.sc.gov
Subject: Draft Agenda for On-Sites

Bill,

As requested, please see attached draft of the Agenda for the On-sites. Kindly review.

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

101 California Street
Suite 3500
San Francisco, CA 94111
P. 415.274.3074
F. 415.291.4016

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From: [Abesamis, Bo](#)
To: [AMY WRIGHT Amy.Wright@sto.sc.gov](mailto:AMY.WRIGHT.Amy.Wright@sto.sc.gov)
Cc: [Leidinger, Bill](#); [Tammy Nichols](#); [Hershel Harper](#); [Tahiliani, Shakun](#); [Douglas W. Lybrand](#); [Raven, Dinah](#); [McDermott, Mike](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#); [Swilley-Burke, Gwelda](#); [William Blume](#)
Subject: RE: Custody and SEC Lending Meetings
Date: Tuesday, April 10, 2012 12:55:01 AM

Amy and All:

Sorry for not getting back to you. I am on vacation all this week, but checking on emails. I provided information to some member of the group but here it is again.....

Please note that for Boston, the cheapest rate or one with good public fund rate is the Omni Parker House at School Street. This would be the best location. This is within walking distance of State Street. I would recommend that everybody stay in Boston. The BNY Mellon facility is located in Everett, Massachusetts which is a suburb of Boston. I will arrange for a van to bring us to BNY Mellon. Other hotels to consider are Hyatt Boston Financial at Avenue de Lafayette which is next door to State Street or the Hilton but a ways off.

Deutsche Bank (Securities Lending)
60 Wall Street, 26th Floor
New York, NY 10005-2858

State Street Bank
State Street Financial Center
1 Lincoln Street
Boston, MA 02111

BNY Mellon
135 Santilli Highway
Everett, MA 02149

From: Wright, Amy [mailto:amy.wright@sto.sc.gov]
Sent: Monday, April 09, 2012 8:41 AM
To: Abesamis, Bo
Subject: Custody and SEC Lending Meetings

Mr. Abesamis – Can you send me the street addresses for the three meetings April 30 – May 2 with Deutsche, State Street, and BNY Mellon?

Thanks,
Amy

Signature Redacted

Executive Assistant to the State Treasurer
South Carolina Office of State Treasurer
803-734-2016
803-734-2690 (Fax)
amy.wright@sto.sc.gov

From: [Leidinger, Bill](#)
To: [Tahiliani, Shakun](#); [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Hershel Harper](#); [Douglas W. Lybrand](#); [Condon, Bill](#)
Cc: [AMY WRIGHT Amy.Wright@sto.sc.gov](mailto:AMY.WRIGHT@sto.sc.gov)
Subject: RE: Boston
Date: Monday, April 09, 2012 8:32:15 AM

OK by me.....Bill

From: Tahiliani, Shakun
Sent: Friday, April 06, 2012 4:21 PM
To: Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Harper, Hershel; Lybrand, Douglas; Condon, Bill; Leidinger, Bill
Subject: FW: Boston

fyi

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Friday, April 06, 2012 1:46 PM
To: Tahiliani, Shakun; Swilley-Burke, Gwelda
Subject: RE: Boston

Shakun,

The best hotel is the Omni Parker House at School Street. They accept government rates and the most reasonable.

BO

From: [Tahiliani, Shakun](#)
To: [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Hershel Harper](#); [Douglas W. Lybrand](#); [Condon, Bill](#); [Leidinger, Bill](#)
Subject: FW: Boston
Date: Friday, April 06, 2012 4:21:07 PM

fyi

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Friday, April 06, 2012 1:46 PM
To: Tahiliani, Shakun; Swilley-Burke, Gwelda
Subject: RE: Boston

Shakun,

The best hotel is the Omni Parker House at School Street. They accept government rates and the most reasonable.

BO

From: [Douglas W. Lybrand](#)
To: [AMY WRIGHT Amy.Wright@sto.sc.gov](mailto:AMY.WRIGHT@sto.sc.gov)
Cc: [Rebecca Gunnlaugsson](#)
Subject: Custodian On-site visits
Date: Friday, April 06, 2012 2:52:55 PM

Hi Amy, Doug Lybrand here. Bill told me you were coordinating the travel and lodging arrangements for the folks from the STO for the on-site visits to NYC and Boston. I was wondering if you would mind sharing some of your efforts to help me (and Rebecca) make similar arrangements? Do you have the addresses of the offices we plan to visit. Have you selected a hotel near the Boston offices that meet the cost limitations? Have you identified convenient flights to fit within our proposed schedule. Are you/we planning on taking a train or a plane from NYC to Boston? If by train is that Amtrak? I would appreciate any input you could share with me as I need to get started ASAP. Thanks.

Douglas Lybrand
Sr. Risk Management Officer
SCRS Investment Commission
803-737-7582 Work
803-201-4542 Mobile
DLybrand@ic.sc.gov

From: [Abesamis, Bo](#)
To: Bill.Leidinger@sto.sc.gov
Cc: [Tammy Nichols](#); [Hershel Harper](#); [Tahillani, Shakun](#); [Douglas W. Lybrand](#); [Raven, Dinah](#); [McDermott, Mike](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#); [Swilley-Burke, Gwelda](#); [William Blume](#)
Subject: Custody and Seclending On-sites
Date: Wednesday, April 04, 2012 3:36:26 PM
Importance: High

Bill and All,

Please note that Deutsche, State Street and BNY Mellon confirmed that they are all available the week of April 30, 2012 for the on-sites.

Deutsche (Monday 11:00 ish to 1:30 pm) in Manhattan, NYC
State Street (Tuesday 8:30 am to 2:30 pm) in Boston
BNY Mellon (Wednesday 8:30 am to 2:30 pm) in Boston

Thanks.

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

101 California Street
Suite 3500
San Francisco, CA 94111
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F. 415.291.4016

www.callan.com

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From: [Leidinger, Bill](#)
To: [Abesamis, Bo](#)
Cc: [Tammy Nichols](#); [Hershel Harper](#); [Tahiliani, Shakun](#); [Douglas W. Lybrand](#); [Raven, Dinah](#); [McDermott, Mike](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#); [Swilley-Burke, Gwelda](#); [William Blume](#)
Subject: RE: Draft Agenda for On-Sites
Date: Tuesday, April 03, 2012 5:12:44 PM

Folks, as we discussed with Bo today, please review and add anything you believe should be added from the perspective of your entity and return to me. I will compile in a master edited document which contains all of edits and send to you and Bo.....Please try to have your edits to me by close of business next Tuesday.....Thanks.....Bill

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Tuesday, April 03, 2012 4:48 PM
To: Leidinger, Bill
Cc: Tammy Nichols; Harper, Hershel; Tahiliani, Shakun; Lybrand, Douglas; Raven, Dinah; McDermott, Mike; Rebecca Gunnlaugsson; fwright@retirement.sc.gov; Swilley-Burke, Gwelda; wblume@retirement.sc.gov
Subject: Draft Agenda for On-Sites

Bill,

As requested, please see attached draft of the Agenda for the On-sites. Kindly review.

Callan

Bo Abesamis | Executive Vice President
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From: [Abesamis, Bo](#)
To: Bill.Leidinger@sto.sc.gov
Cc: [Tammy Nichols](#); [Hershel Harper](#); [Tahiliani, Shakun](#); [Douglas W. Lybrand](#); [Raven, Dinah](#); [McDermott, Mike](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#); [Swilley-Burke, Gwelda](#); [William Blume](#)
Subject: Draft Agenda for On-Sites
Date: Tuesday, April 03, 2012 4:48:06 PM
Attachments: [SC Draft Agenda - Onsites.docx](#)

Bill,

As requested, please see attached draft of the Agenda for the On-sites. Kindly review.

Callan

Bo Abesamis | Executive Vice President
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AGENDA (Draft)

STATE OF SOUTH CAROLINA ON-SITES

Tentatively Schedule April 30 – May 3

Custody and Securities Lending On-sites

Organization and Experience

- Organizational Update (Management Structure and Financial Health)
- Keys to Success, Competitive Advantage in a Tough Market Environment
- Litigation Issues and Challenges of Regulatory Environment

Client Servicing

- Service Model – Why different than the Competition?
- Client Service Team and Credentials (Meet the Team)
- Client Relations Assessment and Evaluation Mechanism
- Transition Conversion Discussion

Tour of Facilities (focus on life of trade, accounting and reconciliation discipline)

Accounting and Custody

- Custody Capabilities for All Asset Classes (Distinct Advantage)
- Custody Issues – Derivatives and International Tax Agents
- Corporate Actions, Class Actions Support
- Accounting and Reporting – Reconciliation Process (Life of a Trade)
- GASB and Regulatory Reporting Support
- Corporate Governance Support
- FX Discussion on Transparency
- Cash Management Sweep and Liquidity Tracking Discussion (Options)

Alternative Investment Support

- Provide a Discussion of a “Client” Power User of your capabilities
- Service Model and Integrated Service Solution for Alts
- Private Equity (Extent of Capabilities and Support)
- Burgiss/PrivateEdge - Private I, Informant, Document Management
- Capital Call Management
- Hedge Funds Transparency
- Hedge Fund Administration Services

On-Line Technology and Applications

- Full Run Through of Capabilities
- Live Demo of Applications
- Data Mining and Information Access
-

Performance Measurement and Analytics

- Show Reconciliation Process to ascertain accuracy of calculated returns
- Compliance Monitoring (Why do you have a better mousetrap?)
- Performance Measurement (Calcs, Universe Comparison, Attribution)
- Risk Analytics (VaR, Stress Testing, Scenario Analysis)

Transfer Agency

- Business Model and Client Experience
- Demo a Public Fund Client that utilize your TA services
- Shareholding Tracking and Support
- Shareholder Reporting
- Distinct Support for Treasury Management or Cash Managers

Others

- Other notable services or products that we should consider

Securities Lending

- Organizational Issues and Personnel Update
- Program Structure and Process
- New Products or Distinct Capabilities and Thinking in the area of SecLending
- Intrinsic vs. General Collateral Lending
- Risk Mitigation and Indemnity
- Cash vs. Non-Cash Collateral
- Revenue Management (Disclosure and Hidden Fees)
- Conversion Considerations

Fee Discussion

- Flat and Unit Costs (Fee Calculation Worksheet)
- Clarifications – Implicit and Explicit Fees
- Transparency and Full Disclosure of all Costs

Securities Lending Only On-sites

- Organizational Issues and Personnel Update
- Program Structure and Process
- New Products or Distinct Capabilities and Thinking in the area of SecLending
- Intrinsic vs General Collateral Lending
- Risk Mitigation and Indemnity
- Cash vs. Non-Cash Collateral
- Revenue Management (Disclosure and Hidden Fees)
- Conversion Considerations

Tour of Facilities (focus on life of lending and extracting value from securities out on loan)

From: [Leidinger, Bill](#)
To: [Abesamis, Bo](#)
Cc: [Tammy Nichols](#); [Hershel Harper](#); [Tahiliani, Shakun](#); [Douglas W. Lybrand](#); [Raven, Dinah](#); [McDermott, Mike](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#); [Swilley-Burke, Gwelda](#); [William Blume](#)
Subject: RE: Update - Custody Review
Date: Tuesday, April 03, 2012 9:49:37 AM

Thanks, Bo.....We all look forward to their responses.....Talk with you today at 2PM our time.....Thanks.....Bill todayBill

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Tuesday, April 03, 2012 9:46 AM
To: Leidinger, Bill
Cc: Tammy Nichols; Harper, Hershel; Tahiliani, Shakun; Lybrand, Douglas; Raven, Dinah; McDermott, Mike; Rebecca Gunnlaugsson; fwright@retirement.sc.gov; Swilley-Burke, Gwelda; wblume@retirement.sc.gov
Subject: Update - Custody Review

Bill,

Good Morning! Wanted to pass along that I did reach out to both BNY Mellon and State Street to clarify their fees and all the pricing components that everybody brought to my attention last week. (See attached spreadsheet which is in a workbook format with two worksheets – SC Retirement System and Treasurer’s General Account/LGIP.) BNY Mellon and State Street will respond by April 17. I also did raise with Vince Sands that the \$1.5 billion cash balance fee contingency that they put forth in their Cost Proposal was unacceptable and they understood my point.

I am giving both organizations a little more than a week to formulate a competitive response.

Callan

Bo Abesamis | Executive Vice President
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From: [Abesamis, Bo](#)
To: Bill.Leidinger@sto.sc.gov
Cc: [Tammy Nichols](#); [Hershel Harper](#); [Tahiliani, Shakun](#); [Douglas W. Lybrand](#); [Raven, Dinah](#); [McDermott, Mike](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#); [Swilley-Burke, Gwelda](#); [William Blume](#)
Subject: Update - Custody Review
Date: Tuesday, April 03, 2012 9:45:49 AM
Attachments: [SC - Retirement and GeneralAccountLGIP.xlsx](#)

Bill,

Good Morning! Wanted to pass along that I did reach out to both BNY Mellon and State Street to clarify their fees and all the pricing components that everybody brought to my attention last week. (See attached spreadsheet which is in a workbook format with two worksheets – SC Retirement System and Treasurer’s General Account/LGIP.) BNY Mellon and State Street will respond by April 17. I also did raise with Vince Sands that the \$1.5 billion cash balance fee contingency that they put forth in their Cost Proposal was unacceptable and they understood my point.

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State of South Carolina - Retirement Systems

Account Fees	# of Accounts	Fees	Pro-Forma Cost
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			
Custody Fees	Market Values	Fees	Pro-Forma Cost
Domestic Equities			
Separate Accounts	\$2,120,554,029.40		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	\$1,240,730,614.24		
Domestic Fixed Income			
Separate Accounts	\$1,844,223,833.37		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	\$2,086,118,121.44		
Commingled/Line Items	\$3,124,395,969.92		

Real Estate			
Direct/Separate Accounts		0	
Commingled/Line Items		\$133,323,297.30	
Private Equity			
Direct/Separate Accounts		0	
Commingled/Line Items		\$1,050,435,850.00	
Derivatives/Overlay			
Direct/Separate Accounts		\$1,418,499,978.10	
Hedge Funds/Absolute Returns			
Direct/Separate Accounts		0	
Commingled/Line Items		\$6,240,590,569.23	
Commodities			
Direct/Separate Accounts		0	
Commingled/Line Items		0	
Strategic Partnerships			
Direct/Separate Accounts		0	
Commingled/Line Items		\$6,280,953,860.07	
Cash Accounts			
Direct/Separate Accounts		0	
Commingled/Line Items		\$626,215,553.83	
Transition Accounts			
Direct/Separate Accounts		\$60,362,992.54	
For International Securities		Corresponding Market Values in US\$ as of June 30, 2011	
Australia		\$8,089,803.90	
Austria			
Belgium			
Bahamas			
Belgium			
Bermuda			
Brazil		\$646,456.99	
British Virgin Islands			
Canada		\$43,304,810.89	
Cayman Islands			
China			
Colombia			
Cote d'Ivoire			
Cyprus			
Czech Republic			
Denmark			
European Union			
Finland			
France		\$54,960,992.09	
Germany		\$2,676,807.32	
Greece			
Hong Kong		\$594,876.17	
Hungary			
India			
Indonesia			
Ireland			
Israel			
Italy		\$281,763.85	

Japan	\$14,219,261.58		
Liberia			
Luxembourg			
Malaysia			
Marshall Islands			
Mexico			
Netherlands			
New Zealand	\$313,660.55		
Norway			
Panama			
Peru			
Philippines			
Poland			
Portugal			
Puerto Rico			
Russian Federation			
Singapore			
South Africa			
South Korea			
Spain	\$1,176,137.34		
Sweden	\$510,569.65		
Switzerland			
Taiwan			
Thailand			
Turkey			
UK	\$45,275,191.28		
Subtotal			
Transactions	Annual Volume	Fees	Pro-Forma Cost
Domestic Depository Trades (DTC/Fed Book)	22,206		
Domestic Non-Depository Trades	3,038		
Physicals	1		
Principal Payments	2,333		
Maturities	121		
Dividend/Income Receipts	5,413		
Tax Reclaims	0		
Wires	589		
Capital Calls	60		
Options/Futures	1,054		
Swaps	1,034		
3 rd Party FX	654		
Custody FX Trades	48		
Proxy Notification	777		
Corporate Actions (Splits, Voluntary/Involuntary)	456		
Class Action Filings	55		
Other International Transactions --			
Australia	1		
Austria			
Belgium			
Bahamas			

Bermuda			
Brazil			
British Virgin Islands			
Canada	26		
Cayman Islands			
China			
Colombia			
Cote d'Ivoire			
Cyprus			
Czech Republic			
Denmark			
Egypt			
European Union (Euroclear)	42		
Finland			
France			
Germany			
Greece			
Hong Kong			
Hungary			
India			
Indonesia			
Ireland			
Israel			
Italy			
Japan			
Korea			
Liberia			
Luxembourg			
Malaysia			
Marshall Islands			
Mexico			
Netherlands			
New Zealand			
Norway			
Panama			
Peru			
Philippines			
Poland			
Portugal			
Puerto Rico			
Russian Federation			
Singapore			
South Africa			
South Korea			
Spain			
Sweden			
Switzerland			
Taiwan			
Thailand			
Turkey			
UK			
Subtotal			

Others: (Enumerate)	Annual Volume	Fees	Pro-Forma Cost
Global Custody – Support			
Power of Attorney			
Global Tax Agent			
Country Registration			
Tax-Exempt Filing			
Market Guide			
Subtotal			
On-line/Internet Access and Reporting			
User Interface			
Subscription			
Assets/Holding			
Cash			
Transactions			
Standard reports			
GASB Support - Reporting			
Customized reporting			
Executive/Board reporting			
Income Inquiry Reports			
Corporate Actions Reporting			
Terminal charge			
Communication software			
CPU connect time			
Others: (specify)			
Subtotal			
Contractual Settlement and Auto Credit			
Domestic			
International			
ADRs			
Subtotal			
Transition & Conversion			
Reregistration			
Scrip Fees			
Etc.			
Subtotal			
Penalty Costs			
Third Party FX	654		
Third Party Seclending	0		
Etc.			
Subtotal			

Out of Pocket			
Wire Transfer			
Courier Service			
Telex Charges			
Computer processing			
Staff Training			
Stamp Duty			
Reregistration			
Others:			
Subtotal			
Corporate Actions			
Voluntary/Mandatory			
Involuntary			
Subtotal			
Proxy Notification Support			
Proxy Notifications Reporting	777		
On-line Access			
3rd Party Online (ProxyEdge or ISS)	777		
Others			
Subtotal			
Class Action			
Filing	55		
Reporting			
On-line Access			
Legal Filings Support with 3rd Party			
Others:			
Subtotal			
Investment Guideline Compliance			
<i>BASIC COMPLIANCE - see below</i>			
accounts			
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		

Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			
INTERMEDIATE COMPLIANCE FULL OUTSOURCE- see below accounts			
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts	0		
Commingled/Line Items	27		

Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			
Independent Derivatives Processing and Valuation			
Pricing - Futures	100		
Pricing - Options	50		
Pricing - Swaps	50		
Processing			
Collateral Management			
Reporting			
Subtotal			
Performance Measurement			
Historical Upload			
Cost for Historical Performance - 5 Years of Upload of Returns and Flows			
Others			
Subtotal			
Monthly Return Calcs - including Gross & Net of Fees, Lagged & Unlagged, Time Weighted and IRR Calcs			
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		

Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			
<u>Daily Return Calcs</u> - including Gross & Net of Fees, Lagged & Unlagged, Time Weighted and IRR Calcs			
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Commingled/Line Items	27		

Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			
Investment Portfolio Characteristics and Risk Adjusted Returns - Benchmarks			
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			

Universe Comparison - Custody Bank Peer Universes			
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			
Universe Comparison - TUCS Universe			
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		

Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Subtotal			
Attribution - Investment Portfolio Factor Analysis			
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		

Private Equity			
Direct/Separate Accounts		0	
Commingled/Line Items		27	
Derivatives/Overlay			
Direct/Separate Accounts		2	
Hedge Funds/Absolute Returns			
Direct/Separate Accounts		0	
Commingled/Line Items		9	
Commodities			
Direct/Separate Accounts		0	
Commingled/Line Items		0	
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items		27	
Cash Accounts			
Direct/Separate Accounts		0	
Commingled/Line Items		13	
Transition Accounts			
Direct/Separate Accounts		2	
Commingled/Line Items		27	
Cash Accounts			
Direct/Separate Accounts		0	
Commingled/Line Items		13	
Transition Accounts			
Direct/Separate Accounts		2	
Subtotal			
Advanced Risk Analytics			
Look Through/Drill Down			
VaR Testing			
Stress Testing			
Scenario Testing			
Number of Plans		5	
Domestic Equities			
Separate Accounts		7	
Commingled/Line Items		0	
International Equities			
Separate Accounts		0	
Commingled/Line Items		3	
Domestic Fixed Income			
Separate Accounts		7	
Commingled/Line Items		0	
Global Fixed-Income			
Separate Accounts		2	
Commingled/Line Items		6	
Real Estate			
Direct/Separate Accounts		0	
Commingled/Line Items		6	
Private Equity			
Direct/Separate Accounts		0	
Commingled/Line Items		27	
Derivatives/Overlay			
Direct/Separate Accounts		2	

Hedge Funds/Absolute Returns			
Direct/Separate Accounts		0	
Commingled/Line Items		9	
Commodities			
Direct/Separate Accounts		0	
Commingled/Line Items		0	
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items		27	
Cash Accounts			
Direct/Separate Accounts		0	
Commingled/Line Items		13	
Transition Accounts			
Direct/Separate Accounts		2	
Commingled/Line Items		27	
Cash Accounts			
Direct/Separate Accounts		0	
Commingled/Line Items		13	
Transition Accounts			
Direct/Separate Accounts		2	
Subtotal			
Data Interface with 3rd Party Providers			
Fund Consultants			
Actuary			
External Auditors			
External Inv. Accounting Platforms (i.e. Eagle, QED, PAM, etc.)			
Nottingham			
Class Action Agent			
Tax Reclaim Agent			
Proxy Voting Agent			
Others:			
Subtotal			
Corporate Governance Tools			
Governmetrics			
Risk Metrics Governance Module			
Custody In-house Platform			
Specify –			
Subtotal			
Alternative Investment Support			
Private Equity - Support (like Private I, Private Informant, Document Management, Capital Call Mgmt and Reconciliation Support)			
Real Estate			
Direct/Separate Accounts		0	
Commingled/Line Items		6	

Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Subtotal			
Hedge Fund Transparency			
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Hedge Fund Administration Services			
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Subtotal			
Data Warehousing and Investment Portfolio Accounting for SC Purposes			
Investment Data Hub			
Investment Accounting (if separate from Investment Data Warehousing Hub)			
ASP Solution (Hosting Solution with Software Operations Maintenance and Disastery Recovery)			
Subtotal			
Other Costs			
(enumerate)			
Subtotal			
TOTAL ESTIMATED COSTS			

SC Treasurer's Office General Account and LGIP

Account Fees	# of Accounts	Fees	Pro-Forma Cost
GENERAL ACCOUNT			
Number of Funds	11		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
LGIP			
Number of Funds	1		
Domestic Fixed Income			
Separate Accounts	1		
Commingled/Line Items			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items			
Subtotal			
Custody Fees	Market Values	Fees	Pro-Forma Cost
GENERAL ACCOUNT			
Domestic Fixed Income			
Separate Accounts	\$7,203,194,725.84		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	\$49,095,798.00		
LGIP			
Domestic Fixed Income			
Separate Accounts	\$2,680,080,581.35		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items			
Subtotal			
Transactions	Annual Volume	Fees	Pro-Forma Cost
GENERAL ACCOUNT			
Domestic Depository Trades (DTC/Fed Book)	1,846		
Domestic Non-Depository Trades	197		
Physicals			
Principal Payments	3,101		

Maturities	403		
Dividend/Income Receipts	1,819		
Tax Reclaims			
Wires	1,303		
Capital Calls			
Options/Futures			
Swaps			
Proxy Notification			
Corporate Actions (Splits, Voluntary/Involuntary)	37		
LGIP			
Domestic Depository Trades (DTC/Fed Book)	461		
Domestic Non-Depository Trades	253		
Physicals			
Principal Payments			
Maturities	379		
Dividend/Income Receipts	617		
Tax Reclaims			
Wires	149		
Capital Calls			
Options/Futures			
Swaps			
Proxy Notification			
Corporate Actions (Splits, Voluntary/Involuntary)	1		
Subtotal			
Others: (Enumerate)	Annual Volume	Fees	Pro-Forma Cost
On-line or Internet Access			
User Interface			
Subscription			
Assets/Holding			
Cash			
Transactions			
Standard reports			
GASB Support			
Customized reporting			
Executive/Board reporting			
Income Inquiry Reports			
Corporate Actions Reporting			
Terminal charge			
Communication software			
CPU connect time			
Others: (specify)			
Subtotal			
Contractual Settlement and Auto Credit			
Domestic			
International			

ADRs			
Subtotal			
Transition & Conversion			
Reregistration			
Scrip Fees			
Etc.			
Subtotal			
Penalty Costs			
Third Party FX			
Third Party SecLending			
Etc.			
Subtotal			
Out of Pocket			
Wire Transfer			
Courier Service			
Telex Charges			
Computer processing			
Staff Training			
Stamp Duty			
Reregistration			
Others:			
Subtotal			
Corporate Actions			
Voluntary/Mandatory			
Involuntary			
Subtotal			
Proxy Notification			
Reporting			
On-line Access			
Others			
Subtotal			
Class Action			
Filings			
On-line Access			
Legal Filings			
Reporting			
Others			
Subtotal			
Investment Guideline Compliance			
<i>BASIC COMPLIANCE - see below</i>			
<i>accounts</i>			
Funds		12	
Domestic Fixed Income			
Separate Accounts		8	
Commingled/Line Items			
Internally Managed			
Cash Accounts			

Direct/Separate Accounts			
Commingled/Line Items	4		
Subtotal			
INTERMEDIATE COMPLIANCE FULL OUTSOURCE- see below accounts			
Funds	12		
Domestic Fixed Income			
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Subtotal			
Independent Derivatives Processing and Valuation			
Reporting			
Pricing			
Processing			
Collateral Management			
Subtotal			
Performance Measurement			
Historical Upload			
Cost for Historical Performance - 5 Years of Upload of Returns and Flows			
Others			
Subtotal			
Monthly Return Calcs - including Gross & Net of Fees			
Funds	12		
Domestic Fixed Income			
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Internally Managed			
Subtotal			
Investment Portfolio Characteristics and Risk Adjusted Returns - Benchmarks			
Funds	12		
Domestic Fixed Income			
Separate Accounts	8		

Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Internally Managed			
Subtotal			
Universe Comparison			
Funds	12		
Domestic Fixed Income			
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Internally Managed			
Subtotal			
Attribution			
Funds	12		
Domestic Fixed Income			
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Internally Managed			
Subtotal			
Advanced Risk Analytics			
Look Through/Drill Down			
VaR Testing			
Stress Testing			
Scenario Testing			
Domestic Fixed Income			
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Internally Managed			
Subtotal			
Data Interface with 3rd Party Providers			
Fund Consultants			

Actuary			
External Auditors			
SAP G/L			
QED II			
Class Action Agent			
Tax Reclaim Agent			
Proxy Voting Agent			
Others:			
Subtotal			
Corporate Governance Tools			
Governmetrics			
Risk Metrics Governance Module			
Custody In-house Platform			
Specify –			
Subtotal			
Data Warehousing and Investment Portfolio Accounting for SC Purposes			
Investment Data Hub			
Investment Accounting (if separate from Investment Data Warehousing Hub)			
ASP Solution (Hosting Solution with Software Operations Maintenance and Disastery Recovery)			
Subtotal			
Transfer Agency Services			
Shareholder Reporting			
Shareholder Tracking			
<i>All Call Center Done by SC</i>			
Subtotal			
Other Costs			
(enumerate)			
Subtotal			
TOTAL ESTIMATED COSTS			

From: [Leidinger, Bill](#)
To: [Leidinger, Bill](#); [Tammy Nichols](#); [Hershel Harper](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [Douglas W. Lybrand](#); [Raven, Dinah](#); [McDermott, Mike](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#); [abesamis@callan.com](#); [swilley-burke@callan.com](#); [Loftis, Curtis](#); [William Blume](#)
Subject: RE: Meeting with BO to Discuss Next Steps CALL IN NUMBER AND INSTRUCTIONS
Date: Monday, April 02, 2012 4:42:48 PM

CALL IN NUMBER AND INSTRUCTIONS FOR TOMORROW'S 2PM CONFERENCE CALL

Date/Time: April 03, 2012 at 02:00 PM America/New_York
Length: 60 (minutes)
Frequency: once

Meeting ID: 608968

Phone Number: 8038969993

Number of ports: 15

USE OF THE TELECONFERENCING BRIDGE DURING AN EMERGENCY EVENT

During an emergency event such as a natural disaster, pandemic influenza, violent incident, terrorist act or even during a preparedness training exercise, the South Carolina Budget and Control Board reserves the right to maintain and regulate all ports on the teleconferencing bridge for an undetermined period of time or until the emergency concludes. For the duration of the emergency event, there is the possibility that your conference call could be rescheduled or canceled. The goal of these actions is to protect the lives and properties of the residents of the State of South Carolina.

DIRECTIONS FOR JOINING A MEETING

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3. To attend a meeting, please press "1".
4. The conference bridge will state the following: "enter the meeting id number followed by the # key."
5. Enter the "meeting id number" followed by the # key.
6. The conference bridge will state the following: "you are about to attend the meeting with the ID number (xxxxx).
7. If the "meeting id number" is correct, please press "1"; otherwise press the * key.
8. The conference bridge will state the following: "at the tone please speak your name or location."
9. When finished, please press the # key.
10. You will hear an audible tone, notifying you that you have successfully entered the meeting.

CALLING CARD PROCEDURES

CALLING INTO THE CONFERENCE BRIDGE

1. Dial calling card telephone number 1-800-294-2322.
2. Enter your calling card access number (located on the back of the calling card).
3. Join the conference call by dialing the audio bridge telephone number (803-896-9993).
4. Enter the access code that has been assigned to your conference call (six digit code).
5. If you are the first person to join the conference call you will not hear an audible tone, do not hang up.
6. Please identify yourself when you join the conference call.

ADDING PARTICIPANTS TO A CONFERENCE CALL

1. Dial calling card telephone number 1-800-294-2322.
2. Enter your calling card access number (located on the back of the calling card).
3. Dial telephone number of participant.
4. Once participant is on the line, press the transfer button and dial the conference number (803-896- 9993) and follow the prompts. Press the transfer button again.
5. Repeat the instructions above until all the participants are connected to the call.

TIPS FOR THE MOST SUCCESSFUL CALLING CONDITIONS

- To stop the music press the * key.
- Move the speakerphone as close as possible to the speaker so it will pick up less background noise.
- Mute the phone if your site is not actively participating in the meeting. Turn the mute function off when someone has a question or comment.
- Save side conversations for after the meeting. Even if they are work related they distract from the speaker and other participants.
- Don't tap pens or shuffle papers. These noises sound louder at remote locations than in your meeting room.
- If it won't make the room too uncomfortable, turn off fans and air conditioning as they sound louder through a speakerphone.
- Shut meeting room doors to keep out background noise from your workplace.
- Only one person at a time should speak.
- Limit the use of a secondary conference phone altogether when practical.
- Use LAN lines rather than mobile phones.
- Please identify yourself when you join the conference call.

You can check the status of this maintenance and in addition hear about any other network outage or disruption

in service by calling (803) 734-INFO (4636).

If you have any questions or comments relating to this notification, please contact Information Technology Services and Support at (803) 896-0001, or reply to this email.

Thank you,

-----Original Appointment-----

From: Leidinger, Bill

Sent: Monday, April 02, 2012 4:38 PM

To: Leidinger, Bill; Tammy Nichols; Harper, Hershel; Tahiliani, Shakun; Condon, Bill; Lybrand, Douglas; Raven, Dinah; McDermott, Mike; Rebecca Gunnlaugsson; fwright@retirement.sc.gov; abesamis@callan.com; swilley-burke@callan.com; Loftis, Curtis; wblume@retirement.sc.gov

Subject: Meeting with BO to Discuss Next Steps

When: Tuesday, April 03, 2012 2:00 PM-3:00 PM (GMT-05:00) Eastern Time (US & Canada).

Where: STO 120

Folks, I know this is extremely short notice but I am suggesting we meet tomorrow (Tuesday) at 2PM in the Treasurer's Office to discuss the matters below. Bo will call in.

Bo will be unavailable the latter portion of this week and all of the following week but since he has this time available tomorrow, I think we should make the effort to avail ourselves of the opportunity rather than wait.

Amy is setting up a conference call- in number for Bo and anyone who would prefer to call in rather than attend in person. We will have 15 lines available for call- in but I do suggest that you attend in person if you can....face to face is better! I will send the call-in number and instructions to you in the next few minutes if I receive it but certainly by early tomorrow AM.

Thanks for your understanding and cooperation.....Bill

From: [Leidinger, Bill](#)
To: [Leidinger, Bill](#); [Tammy Nichols](#); [Hershel Harper](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [Douglas W. Lybrand](#); [Raven, Dinah](#); [McDermott, Mike](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#)
Cc: abesamis@callan.com; swilley-burke@callan.com; [Loftis, Curtis](#); [William Blume](#)
Subject: RE: Suggested Next Steps - Meeting Tomorrow at 2PM
Date: Monday, April 02, 2012 4:35:30 PM

Folks, I know this is extremely short notice but I am suggesting we meet tomorrow (Tuesday) at 2PM in the Treasurer's Office to discuss the matters below. Bo will call in.

Bo will be unavailable the latter portion of this week and all of the following week but since he has this time available tomorrow, I think we should make the effort to avail ourselves of the opportunity rather than wait.

Amy is setting up a conference call- in number for Bo and anyone who would prefer to call in rather than attend in person. We will have 15 lines available for call- in but I do suggest that you attend in person if you can....face to face is better! I will send the call-in number and instructions to you in the next few minutes if I receive it but certainly by early tomorrow AM.

Thanks for your understanding and cooperation.....Bill

From: Leidinger, Bill
Sent: Monday, April 02, 2012 3:32 PM
To: Tammy Nichols; Harper, Hershel; Tahiliani, Shakun; Condon, Bill; Lybrand, Douglas; Raven, Dinah; McDermott, Mike; 'Rebecca Gunnlaugsson'; fwright@retirement.sc.gov
Cc: abesamis@callan.com; swilley-burke@callan.com; wblume@retirement.sc.gov
Subject: Suggested Next Steps

Folks, now that we have finished our reference calls, I suggest we get together in the next few days, compare notes, ID any matters we want to follow up on, discuss conversion process, date and schedule, and "To Be" partners (either BoNY New York to BoNY Boston, BoNY New York to BoNY Boston and Deutsche, BoNY New York to State Street, BoNY New York to State Street and Deutsche or BoNY New York and Deutsche, or any other viable combination I may have overlooked) and discuss/decide site visits.

Bo, I don't know if you would prefer to attend in person or by telephone but you can be assured we want you fully involved in these discussions. One question we have for you already: Is BoNY Boston taking on so many new clients that we should have concerns about their ability to provide us with first class service, if we select them, both initially and on an ongoing basis?

Bo, let me know your availability and preference for how you want to participate in the above referenced meeting. I will then schedule the meeting.

Thanks everyone.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

From: [Abesamis, Bo](#)
To: [Leidinger, Bill](#); [Tammy Nichols](#); [Hershel Harper](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [Douglas W. Lybrand](#); [Raven, Dinah](#); [McDermott, Mike](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#)
Cc: [Swilley-Burke, Gwelda](#); [Loftis, Curtis](#); [William Blume](#)
Subject: RE: Suggested Next Steps
Date: Monday, April 02, 2012 3:56:06 PM

Bill,

Thanks. I am available this Wednesday in the morning before I go out on vacation for the Easter Holidays and College School visits. I hope that works. I will answer all questions or concerns in our conference call. Thanks.

BO

From: Leidinger, Bill [mailto:Bill.Leidinger@sto.sc.gov]
Sent: Monday, April 02, 2012 12:32 PM
To: Tammy Nichols; Harper, Hershel; Tahiliani, Shakun; Condon, Bill; Lybrand, Douglas; Raven, Dinah; McDermott, Mike; Rebecca Gunnlaugsson; fwright@retirement.sc.gov
Cc: Abesamis, Bo; Swilley-Burke, Gwelda; Loftis, Curtis; wblume@retirement.sc.gov
Subject: Suggested Next Steps

Folks, now that we have finished our reference calls, I suggest we get together in the next few days, compare notes, ID any matters we want to follow up on, discuss conversion process, date and schedule, and "To Be" partners (either BoNY New York to BoNY Boston, BoNY New York to BoNY Boston and Deutsche, BoNY New York to State Street, BoNY New York to State Street and Deutsche or BoNY New York and Deutsche, or any other viable combination I may have overlooked) and discuss/decide site visits.

Bo, I don't know if you would prefer to attend in person or by telephone but you can be assured we want you fully involved in these discussions. One question we have for you already: Is BoNY Boston taking on so many new clients that we should have concerns about their ability to provide us with first class service, if we select them, both initially and on an ongoing basis?

Bo, let me know your availability and preference for how you want to participate in the above referenced meeting. I will then schedule the meeting.

Thanks everyone.....Bill

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Chief of Staff
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From: [Leidinger, Bill](#)
To: [Tammy Nichols](#); [Hershel Harper](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [Douglas W. Lybrand](#); [Raven, Dinah](#); [McDermott, Mike](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#)
Cc: abesamis@callan.com; swilley-burke@callan.com; [Loftis, Curtis](#); [William Blume](#)
Subject: Suggested Next Steps
Date: Monday, April 02, 2012 3:32:58 PM

Folks, now that we have finished our reference calls, I suggest we get together in the next few days, compare notes, ID any matters we want to follow up on, discuss conversion process, date and schedule, and “To Be” partners (either BoNY New York to BoNY Boston, BoNY New York to BoNY Boston and Deutsche, BoNY New York to State Street, BoNY New York to State Street and Deutsche or BoNY New York and Deutsche, or any other viable combination I may have overlooked) and discuss/decide site visits.

Bo, I don’t know if you would prefer to attend in person or by telephone but you can be assured we want you fully involved in these discussions. One question we have for you already: Is BoNY Boston taking on so many new clients that we should have concerns about their ability to provide us with first class service, if we select them, both initially and on an ongoing basis?

Bo, let me know your availability and preference for how you want to participate in the above referenced meeting. I will then schedule the meeting.

Thanks everyone.....Bill

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From: [Leidinger, Bill](#)
To: [Rebecca Gunnlaugsson](#)
Subject: FW: April 2 Conference Calls - UPDATED
Date: Monday, April 02, 2012 1:29:58 PM

FYI.....Bill

From: Wright, Amy
Sent: Monday, April 02, 2012 11:52 AM
To: Leidinger, Bill; Tammy Nichols; Harper, Hershel; Tahiliani, Shakun; Condon, Bill; Lybrand, Douglas; fwright@retirement.sc.gov; Raven, Dinah; McDermott, Mike
Cc: Loftis, Curtis; abesamis@callan.com; wblume@retirement.sc.gov; swilley-burke@callan.com
Subject: April 2 Conference Calls - UPDATED

This is the schedule of calls for Monday. Conference call information is listed below as well. Let me know if you have any questions. ****Do Not hang up after first call – second caller will just call in like before.***

Thanks,
Amy

Monday – April 2		
2:00 pm	BNY Mellon	Julie Hamilton Alaska Permanent Fund Corporation 907-796-1535
2:30 pm	BNY Mellon	Sandra Bragg Texas County & District Retirement System 512-637-3333

****Call in for afternoon calls:**

Meeting ID: 170862

Phone Number: 803-896-9993

USE OF THE TELECONFERENCING BRIDGE DURING AN EMERGENCY EVENT

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9. When finished, please press the # key.
10. You will hear an audible tone, notifying you that you have successfully entered the meeting.

Signature Redacted

Executive Assistant to the State Treasurer
South Carolina Office of State Treasurer
803-734-2016
803-734-2690 (Fax)
amy.wright@sto.sc.gov

From: [Douglas W. Lybrand](#)
To: [Rebecca Gunnlaugsson](#)
Subject: RE: April 2 Conference Calls - UPDATED
Date: Monday, April 02, 2012 1:04:01 PM

There have been 7 reference calls. Hershel was there for most.

From: Rebecca Gunnlaugsson
Sent: Monday, April 02, 2012 12:57 PM
To: Douglas W. Lybrand
Subject: RE: April 2 Conference Calls - UPDATED

Thanks! Have all the other calls taken place? Do you know if Hershel participated?

From: Douglas W. Lybrand
Sent: Monday, April 02, 2012 12:51 PM
To: Rebecca Gunnlaugsson
Subject: FW: April 2 Conference Calls - UPDATED

This is the latest.

From: Wright, Amy [<mailto:amy.wright@sto.sc.gov>]
Sent: Monday, April 02, 2012 11:52 AM
To: Leidinger, Bill; Tammy Nichols; Hershel Harper; Tahiliani, Shakun; Condon, Bill; Douglas W. Lybrand; Faith Wright; Raven, Dinah; McDermott, Mike
Cc: Loftis, Curtis; abesamis@callan.com; William Blume; swilley-burke@callan.com
Subject: April 2 Conference Calls - UPDATED

This is the schedule of calls for Monday. Conference call information is listed below as well. Let me know if you have any questions. ****Do Not hang up after first call – second caller will just call in like before.***

Thanks,
Amy

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****Call in for afternoon calls:**

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Phone Number: 803-896-9993

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Signature Redacted

Executive Assistant to the State Treasurer
South Carolina Office of State Treasurer
803-734-2016
803-734-2690 (Fax)
amy.wright@sto.sc.gov

From: Douglas W. Lybrand
To: Rebecca Gunnlaugsson
Subject: FW: April 2 Conference Calls - UPDATED
Date: Monday, April 02, 2012 12:50:32 PM

This is the latest.

From: Wright, Amy [mailto:amy.wright@sto.sc.gov]
Sent: Monday, April 02, 2012 11:52 AM
To: Leidinger, Bill; Tammy Nichols; Hershel Harper; Tahiliani, Shakun; Condon, Bill; Douglas W. Lybrand; Faith Wright; Raven, Dinah; McDermott, Mike
Cc: Loftis, Curtis; abesamis@callan.com; William Blume; swilley-burke@callan.com
Subject: April 2 Conference Calls - UPDATED

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Signature Redacted

Executive Assistant to the State Treasurer
South Carolina Office of State Treasurer
803-734-2016
803-734-2690 (Fax)
amy.wright@sto.sc.gov

From: [Leidinger, Bill](#)
To: [Leidinger, Bill](#); [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [Hershel Harper](#); [William Blume](#); [Loftis, Curtis](#); [Raven, Dinah](#); [McDermott, Mike](#)
Cc: [Abesamis, Bo](#); swilley-burke@callan.com; [AMY WRIGHT Amy.Wright@sto.sc.gov](mailto:AMY.WRIGHT@sto.sc.gov)
Subject: RE: State of South Carolina: BNY Mellon Response
Date: Friday, March 30, 2012 1:31:49 PM

Folks, BoNY Mellon – Boston - only had 1 client leave in the last 3 years and the identity is confidential under the terms of the agreement. I asked Bo about clients leaving in the last 5 years and he said that would be irrelevant.

I am asking Amy to go ahead and set up the BoNY reference conference calls for Monday and/or Tuesday. Hope you will all make the effort to be on these last calls.....Have a great weekend.....Bill

From: Leidinger, Bill
Sent: Friday, March 30, 2012 10:54 AM
To: Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Lybrand, Douglas; Tahiliani, Shakun; Condon, Bill; Leidinger, Bill; Harper, Hershel; William Blume; Loftis, Curtis; Raven, Dinah; McDermott, Mike
Cc: 'Abesamis, Bo'; swilley-burke@callan.com; Wright, Amy
Subject: FW: State of South Carolina: BNY Mellon Response
Importance: High

Folks, here is the proposed new BoNY Mellon Boston based client service team. References for existing clients are included but we are still waiting on former client references – we will set up reference conference calls as soon as we hear from Bo.....Thanks and have a great week end.....Bill

P.S. We may want to discuss with Bo the merit of a single point of contact at BoNY as opposed to many.....just thinking!

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Thursday, March 29, 2012 3:09 PM
To: Leidinger, Bill; Tahiliani, Shakun
Subject: FW: State of South Carolina: BNY Mellon Response
Importance: High

Bill,

This is the new team from BNY Mellon – Boston based and also the client references. See org chart of the team at the last page of the attachment wherein, Relationship Manager = Catherine Wargo and Client Service Officer = Kristian Pearson. The day to day contact for Client Accounting and Reporting would be Steve Cordo. The day to day contact for Private Investment Accounting and Administrative Services would be Cindy-Lee Chan. Thanks.

BO

From: claire.sonnenberg@bnymellon.com [<mailto:claire.sonnenberg@bnymellon.com>]

Sent: Wednesday, March 28, 2012 2:00 PM
To: Abesamis, Bo
Cc: vince.sands@bnymellon.com; laurin.moore@bnymellon.com; susan.swigor@bnymellon.com
Subject: State of South Carolina: BNY Mellon Response

Bo,

We all walked away from Friday's meeting with a greater appreciation and understanding of South Carolina's needs. Vince and Laurin felt a strong response was in order to accommodate our tenured client. The attached package from Vince Sands outlines our changes to the client team structure. I'd be glad to answer any questions you may have or supply any additional materials needed by the State of South Carolina.

Thank you.

Claire

Claire Sonnenberg
Managing Director
Consultant Insight
BNY Mellon Asset Servicing
BNY Mellon Center
201 Washington Street, 11th Floor
Boston, MA 02108-4408
Tel. #: 617.722.7853
Fax #: 617.722.3549
Cell #: 617.416.6271
Email: claire.sonnenberg@bnymellon.com

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From: [Leidinger, Bill](#)
To: [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [Leidinger, Bill](#); [Hershel Harper](#); [William Blume](#); [Loftis, Curtis](#); [Raven, Dinah](#); [McDermott, Mike](#)
Cc: [Abesamis, Bo](#); swilley-burke@callan.com; [AMY WRIGHT Amy.Wright@sto.sc.gov](mailto:AMY.WRIGHT@sto.sc.gov)
Subject: FW: State of South Carolina: BNY Mellon Response
Date: Friday, March 30, 2012 10:54:20 AM
Attachments: [State of South Carolina - BNY Mellon Response.pdf](#)
Importance: High

Folks, here is the proposed new BoNY Mellon Boston based client service team. References for existing clients are included but we are still waiting on former client references – we will set up reference conference calls as soon as we hear from Bo.....Thanks and have a great week end.....Bill

P.S. We may want to discuss with Bo the merit of a single point of contact at BoNY as opposed to many.....just thinking!

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Thursday, March 29, 2012 3:09 PM
To: Leidinger, Bill; Tahiliani, Shakun
Subject: FW: State of South Carolina: BNY Mellon Response
Importance: High

Bill,

This is the new team from BNY Mellon – Boston based and also the client references. See org chart of the team at the last page of the attachment wherein, Relationship Manager = Catherine Wargo and Client Service Officer = Kristian Pearson. The day to day contact for Client Accounting and Reporting would be Steve Cordo. The day to day contact for Private Investment Accounting and Administrative Services would be Cindy-Lee Chan. Thanks.

BO

From: claire.sonnenberg@bnymellon.com [<mailto:claire.sonnenberg@bnymellon.com>]
Sent: Wednesday, March 28, 2012 2:00 PM
To: Abesamis, Bo
Cc: vince.sands@bnymellon.com; laurin.moore@bnymellon.com; susan.swigor@bnymellon.com
Subject: State of South Carolina: BNY Mellon Response

Bo,

We all walked away from Friday's meeting with a greater appreciation and understanding of South Carolina's needs. Vince and Laurin felt a strong response was in order to accommodate our tenured client. The attached package from Vince Sands outlines our changes to the client team structure. I'd be glad to answer any questions you may have or supply any additional materials needed by the State of South Carolina.

Thank you.

Claire

Claire Sonnenberg
Managing Director
Consultant Insight
BNY Mellon Asset Servicing
BNY Mellon Center
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Tel. #: 617.722.7853
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March 28, 2012

Mr. Virgilio Abesamis
Executive Vice President
Callan
101 California Street
San Francisco, CA 94111

Dear Bo,

On behalf of BNY Mellon I want to personally thank you for your feedback and assistance with our long time and valued client, State of South Carolina.

As you know, since 1996 we have provided Global Master Trust and Custody services to the State of South Carolina. We have come to know them well and greatly appreciate our relationship. However, I understand there are times in some relationships that call for inflection and a need for change.

We want to respond positively to our client's desire for a new service team. Today we are happy to put forth new members of the State of South Carolina servicing team. This Boston based team has been hand selected because of their unsurpassed track record and extensive experience with large, complex, public pension funds. These are associates known for getting things done. Please see the attached team chart and professional biographies of key management service team members.

In addition, Susan Swigor, who South Carolina committee members met last week, will play an integral role in the South Carolina relationship as Public Funds Strategist. Lou Dirupo, who South Carolina committee members also met last week, will manage the Private Investment Accounting and Administrative Services for South Carolina. To provide a seamless transition, we would like to establish a mutually agreeable transition date and schedule a follow-up team meeting to include all the key BNY Mellon service team members.

Vincent V. Sands
Deputy CEO
BNY Mellon Asset Servicing

Telephone 412 234 4111 vincent.sands@bnymellon.com
BNY Mellon Center, 500 Grant Street, Pittsburgh, Pennsylvania 15258

As per your request we are providing three public fund references:

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Julie A. Hamilton, CPA

Chief Financial Officer

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Phone: (907) 796-1535

Email: jhamilton@alaskapermfund.com

Texas County & District Retirement System

Sandra Bragg

Deputy Investment Officer

Barton Oaks Plaza IV

901 Mopac S., Ste. 500

Austin, TX 78746

Phone: (512) 637-3333

Facsimile: (512) 328-8480

Email: Sandra@tcdrs.org

Texas Permanent School Fund

Catherine Civiletto

Deputy Executive Administrator

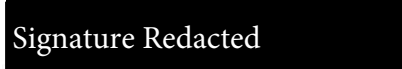
Phone: (512) 463-9201

Email: Catherine.civiletto@tea.state.tx.us

I look forward to continuing our relationship with South Carolina. As their Executive Sponsor, I stand ready to move forward, enable change and assist in achieving South Carolina's goals.

As always, please call me with any questions you may have.

Sincerely,

 Signature Redacted

Vincent Sands

Enclosure

BNY Mellon Executive Sponsorship

Vincent V. Sands, CFA – Executive Sponsor, South Carolina

Deputy Chief Executive Officer, BNY Mellon Asset Servicing

Vince Sands is Deputy CEO of BNY Mellon Asset Servicing. He is a member of the executive management team of Asset Servicing, as well as the Operating Committee of BNY Mellon Corporation. He is directly responsible for the Asset Servicing businesses in Canada, the US, and Latin America, as well as Global Securities Lending, Transition Management, Global Sales, and Global Product Management. Vince joined the firm in 1982, and has over 25 years experience managing all facets of the asset servicing business.

Vince is also Chairman of BNY Mellon of Pennsylvania. In this role he is responsible for the company's community involvement and philanthropic activities in Pennsylvania. He also serves on the Board of Directors of the Allegheny Conference on Community Development, a private, non-profit leadership organization focused on improving the economy and quality of life of the Pittsburgh region. He is also on the board of the BNY Mellon Charitable Foundation.

Vince is a board member of BNY Mellon's affiliated businesses: Eagle Investment Systems (a software company) and CIBC Mellon (BNY Mellon's asset servicing joint venture with CIBC, serving the Canada market).

He is a Chartered Financial Analyst (CFA), and holds a BS from Clarion University and an MBA from Gannon University.

Laurin E. Moore, Managing Director

Head, U.S. Corporate, Government & Not-for-Profit Group

Laurin E. Moore is a Managing Director and Head of the U.S. Corporate, Government & Not-for-Profit Group within BNY Mellon Asset Servicing. Laurin and her team are charged with creating and maintaining strong business partnerships through an effective strategic and consultative approach for approximately 1,100 clients with assets of \$2.5 trillion. These clients include U.S.-based Public Funds, Corporations, Endowments, Foundations, Religious, Healthcare and Taft-Hartley Plans.

Laurin has over 25 years of experience delivering trust and custody services. She joined BNY Mellon in 1984 and has an extensive background and managerial experience in trust operations, client service, marketing and Relationship Management. Before joining the firm, she was employed with Merrill Lynch, Pierce, Fenner & Smith and A.E. Masten and Co. Laurin received a Bachelor of Science degree in Economics with a Business Administration minor from Hollins College.

Relationship Management

Bruce T. Shain, Managing Director

Relationship Executive, Boston and Dallas offices

Bruce T. Shain is the Relationship Executive responsible for the BNY Mellon Asset Servicing Relationship Management teams located in Boston and Dallas. He has responsibility for servicing a variety of institutional clients including Corporate Multinationals and Public Funds, Taft-Hartley clients, and Endowment and Foundation clients. Bruce has been with BNY Mellon for 11 years. Prior to becoming the Relationship Executive in early 2008, he was responsible for the needs of our larger, more complex client relationships. Before joining BNY Mellon, Bruce spent 16 years at John Hancock Financial Services where he was a Relationship Manager for major U.S. corporations, assisting them with their pension plans for employees worldwide. Bruce received a Bachelor of Arts degree in Psychology from Colby College.

Susan Swigor – Public Funds Strategist

Managing Director, BNY Mellon Asset Servicing

Susan Swigor is a Managing Director and serves as Public Fund Strategist for BNY Mellon Asset Servicing. As Public Fund Strategist, she is responsible for serving as a resource for Relationship Managers handling public funds in support of their efforts to ensure we deliver innovative solutions and superior client service. She also plays a leadership role in the development and/or enhancement of new public fund product and service offerings. Susan began her career at BNY Mellon in 1992 as a Senior Auditor in our Internal Audit Department and later became the Manager of Risk and Compliance for the Global Securities Services Division. Susan left for several years and was a Relationship Manager at Northern Trust. She rejoined BNY Mellon Asset Servicing in 1998 as a Senior Client Service Officer and later became a Team Leader. In 2001, she was promoted to Business Unit Manager. In April 2004, she expanded her role by assuming direct Relationship Management responsibility for several clients. In October, 2011, she assumed her current responsibilities. Susan's prior experience includes serving as an Audit Supervisor for the trust-related departments of Bank One and Nations Bank in Texas. She is a Certified Public Accountant, and earned a Bachelor of Business Administration degree with a concentration in Accounting from Stephen F. Austin University in May of 1986.

Catherine Wargo, Vice President

Relationship Manager

Catherine Wargo, a Vice President and Relationship Manager of the BNY Mellon Asset Servicing team, is responsible for overall accountability of client relationships. Her three main functions as a Relationship Manager include understanding the client's needs and objectives; communicating on important topics; and ensuring client satisfaction. Catherine has held a Client Service/Relationship Management position since joining BNY Mellon in 2000 and has over 15 years of custody experience. Catherine's custody career started at BayBank and through mergers and acquisitions also worked for Bank of Boston and Fleet Bank (now Bank of America). Her prior experience includes management positions in trade settlement, corporate actions, income collection, and pricing. Catherine earned a Bachelor of Science in Finance from Bentley College.

Client Service

Maria Serra, Managing Director

Director of Client Service

Maria Serra is a Managing Director and the Director of Client Service for our U.S. Corporate, Government & Not-for-Profit business within BNY Mellon Asset Servicing. Maria joined BNY Mellon in 1984 and has extensive experience working in our Asset Servicing industry. In her current position as Director of Client Service, Maria is responsible for the overall Trust Administration, Legal/Compliance and coordination of our clients' daily service requirements. Maria is also responsible for strategically implementing best business practices and tools for the Client Service organization. She manages a professional team of Client Service Officers whose primary responsibility is to ensure that we provide excellent servicing and proactive daily communication in support of the client's investment process. Maria's team is the primary daily focal point for clients, ensuring all service requirements are met according to our service standards and trust agreements. She also manages a team of Best Practices Officers. This team is considered a Center of Excellence where various functions have been centralized in order to create a best practice on behalf of our clients. Prior to her current position, Maria was a Business Unit Manager for a subsection of our Employee Benefits business. She also managed our new Business Conversions group as well as our Global Cash Control area. Maria served as co-chair of our New England's United Way Campaign in 2003 and was a senior member of BNY Mellon Asset Servicing's Diversity Counsel. Maria received a Bachelor of Science degree from Suffolk University.

Barbara Doherty, Vice President

Client Service Team Leader

Barbara Doherty joined BNY Mellon in 1992 as a member of the Internal Audit Department. She began her career as a Staff Auditor and was soon promoted to Senior Staff Auditor. During her tenure in Audit, she received a Premier Achievement Award recognizing her outstanding performance. Barbara joined Client Services as an Assistant Client Service Officer on the Endowment/Foundation Team in 1994. She received a Premier Achievement Award for her performance and was honored at our annual kick-off event with an individual award for her contributions to the team. In 1997 she was promoted to Client Service Officer and was subsequently promoted to a Senior Client Service Officer in 2002. Responsibilities included client satisfaction and coordinating client requests for product delivery.

In 2010, Barbara was promoted to Team Leader within the Client Services and is responsible for managing a team of Client Service Professionals. She received a Bachelor of Science Degree in Accounting from Babson College in 1992.

Kristian Pearson, Vice President

Senior Client Service Officer

Kristian Pearson joined BNY Mellon in early 2005 and assumed his current role as Senior Client Service Officer in 2008. Kristian's responsibilities include: serving as the daily focal point for operational questions, establishing and monitoring service level agreements, participating in client implementations, overseeing customer billing, assisting with setting up new accounts and executing asset transfers, maintaining excellent communication through daily, weekly, monthly meetings and client site visits as necessary. Kristian will be a day to day servicing contact and will provide support on special client requests and client inquiries. Prior to his current role, Kristian held several other positions at the Bank of New York Mellon, including: Assistant Client Service Officer and Corporate Action Analyst. Prior to joining BNY Mellon, Kristian received a B.A. in Economics and a B.S.B.A. in Finance from the University of Pittsburgh. Kristian also recently passed the Level III CFA exam.

Securities Lending

William P. Kelly, Managing Director

Head of Global Client Relationship Management & Business Development

Bill directs global client relationship management and business development for BNY Mellon's securities lending unit. Bill's experience in the securities industry spans over 20 years. Prior to the merger of The Bank of New York Company, Inc. and Mellon Financial Corporation, he joined The Bank of New York in 2002 after 13 years with Deutsche Bank (Bankers Trust). His responsibilities at Deutsche Bank were managing the Global Sales and Client Management activities of the Global Portfolio Management Group, which was responsible for both securities lending and short term money management products. Prior to these assignments, Bill was responsible for the Insurance Industry Custody Group at Bankers Trust where he had sales, client management, operations and administration reporting to him. Bill is active in the Risk Management Association (RMA) and he is a frequent speaker and panel participant at securities lending industry conferences. Bill holds a B.S. degree from Eastern Connecticut State College.

Michael W. McDermott, Managing Director

U.S. Securities Lending Client Services

Mike McDermott manages BNY Mellon Asset Servicing's U.S. Client Securities Lending service staff. In this capacity, he oversees client service operations and ensures all client relationships are managed with the highest level of customer service. Earlier in his career with BNY Mellon, Mike was a senior salesperson and product specialist with the Company's new business development team and was a senior relationship manager. Before joining BNY Mellon, Mike was employed by Federated Investors, where his responsibilities included relationship management and sales responsibilities for the top 100 global bank clients, including many large custodial Securities Lending agents. Mike holds a Bachelor's degree in Finance and a MBA from Duquesne University.

Ray Kronz, Vice President

Client Service Officer, Securities Lending

Ray Kronz is a vice president and client service officer for Securities Lending. Ray has responsibility for the management of client relationships within the securities lending program. Prior to the merger of The Bank of New York Company, Inc. and Mellon Financial Corporation, he joined Mellon Human Resources & Investor Solutions in January of 2001 to support the defined contribution and deferred compensation business unit by providing investment management consulting services. In this capacity, he was responsible for providing investment consulting services to existing and prospective clients. Previously, Ray had over 14 years of experience working as a Relationship Manager for Federated Investors, Inc., where he managed cash flows for large institutional clients as well as designing investment portfolios for these clients. Ray attended LaRoche College in Pittsburgh.

Performance & Risk Analytics

Michael T. Burke

Performance & Risk Analytics Consulting Client Service Manager

Mike Burke joined BNY Mellon Asset Servicing as a Trust Specialist in 1994 and received the company Premier Achievement Award in October, 1995. He became a Trust Supervisor within the Client Accounting & Reporting department before joining the Performance & Risk Analytics group in 1999, where he is currently a Performance & Risk Analytics Consulting Client Service Manager. Mike is responsible for client service and support of investment contacts of plan sponsors and institutional investors. He promotes both client understanding and the use of our Performance & Risk Analytics products and services. He is a member of the Performance & Risk Analytics Leadership Forum responsible for providing input on the company's strategic direction. Mike earned a Bachelors of Science in Finance from Fairfield University in 1990.

Ed Fruscella

Performance & Risk Analytics Senior Consultant

As a Performance & Risk Analytics Senior Consultant, Ed Fruscella serves as your main point of contact for all Performance & Risk Analytics products and services. Focused on consultative client service, he is responsible for understanding your investment process and personalizing solutions that will meet your critical objectives. This includes assisting in your use and interpretation of investment analysis such as performance, attribution, risk and analytics, universe comparisons and monitoring investment guidelines. Ed is also responsible for defining client requirements and translating them into future product direction and development. Ed will work closely with Marisa Centrella, the Performance & Risk Analytics Consultant, to ensure all your Performance & Risk Analytics needs are met.

Ed began his career with BNY Mellon in 1996 as a Senior Service Delivery Specialist. He moved on to Performance & Risk Analytics in 1999 as a Senior Performance Measurement Analyst and then a Performance Measurement Supervisor prior to joining the Performance & Risk Analytics Consulting team. Ed received a Bachelor's degree in Finance and Marketing from Boston College (Wallace E. Carroll School of Management) in 1996.

Marisa Centrella

Performance & Risk Analytics Consultant

Marisa Centrella joined BNY Mellon Asset Servicing in June of 2000 as a Specialist within our Conversion Team. In 2002, Marisa was selected for our Management Training Program before becoming a Custody Client Service Liaison. She joined the Performance, Risk and Analytics group in 2004 and is now a Performance & Risk Analytics Consultant. Marisa works in tandem with Ed Fruscella, the Senior Performance & Risk Analytics Consultant, on client inquiries, creation of custom client reporting deliverables and participates in testing enhancements to P&RA products and services. Marisa has received numerous awards such as our Global Securities Team of the Year Award in 2001, our Premier Achievement Award in 2000 and 2001, and Performance, Risk and Analytics Shining Star Award in 2005. Marisa earned a Bachelor of Science Degree with a concentration in Finance from Bentley University.

Suzann Giarusso, Vice President

Performance & Risk Analytics, Performance Operations Manager

Suzann Giarusso joined BNY Mellon in 1990 as an Assistant Trust Specialist within the Client Accounting & Reporting Services group. She held various positions within the accounting group including Supervisor before joining the Performance & Risk Analytics product line. In 2003, she was promoted to her current role as Operations Manager of Performance Measurement and is responsible for managing all facets of investment performance measurement for internal and external clients with an emphasis on complex clients and elaborate departmental projects, as well as custom reporting. Her staff includes Performance Measurement Analysts, Managers, Trainers, a Supervisor and Operation Analysts. She earned a Bachelor of Arts degree in Finance from the University of Massachusetts.

Kristin Tafe, Vice President

Performance & Risk Analytics, Senior Performance Unit Manager

Kristin Tafe joined BNY Mellon in 2004 as a Performance Analyst in our Performance & Risk Analytics Group. After being promoted to Senior Performance Analyst, she excelled and received yet two additional promotions to her current position as Performance Operations Senior Unit Manager in 2009. In this role, Kristin is responsible for overseeing five Performance Analysts and assisting with their complex client processing, in addition to continuing to support a number of sensitive clients. Her dedication to excellence is evidenced by the numerous awards she and her team have won since joining the organization. Kristin studied Chemical Engineering at Colorado State University.

Client Accounting & Reporting Services

Charles D. Teeple, Managing Director

Senior Unit Manager, Client Accounting & Reporting Services

Charlie Teeple joined BNY Mellon in 1996 as a Specialist within our Accounting Department. Since joining the organization, Charlie has been promoted to Supervisor, Manager, and Senior Manager. In his present role, Charlie has direct oversight of 4 teams that service a diverse array of client relationships, including Public Retirement Systems, Treasury Systems, Corporate Retirement Plans, and Foundations/Endowments. Charlie's team has primary responsibility for their clients' daily and monthly accounting, client-directed cash, and internally managed trade processing. Charlie has been recognized for his exemplary performance: in 1998, he was named Global Securities Services' Employee of the Year, and in 2005, he was named a Mellon STAR, a prestigious program that recognizes exceptional performers across the entire company. Charlie earned a Bachelor of Science degree from Holy Cross College in 1996.

John McEvoy

Unit Manager, Client Accounting & Reporting Services

John McEvoy joined BNY Mellon in 2005 as a Accounting & Reporting Supervisor. He is currently a Unit Manager supporting accounting and reporting requirements. In his role, he has daily correspondence with clients regarding daily cash, trading, and income related activity. He provides monthly reconciliation to the client on all externally managed portfolios. He assists with client asset conversions and manages all aspects of client reporting. John graduated from University of Massachusetts in 1998 with a Bachelor of Science degree in Accounting.

Steve Cordo

Supervisor, Client Accounting & Reporting Services

Steve Cordo is a Supervisor in the Client Accounting & Reporting Services Group. Along with the accounting functions, Steve and his team also oversee the trading and cash operations for internally-managed portfolios. Steve has been a Supervisor for two and a half year and holds a degree from Boston College.

Private Investment Accounting and Administrative Services, Client Accounting & Reporting Services

Louis S. DiRupo, Managing Director

Accounting & Reporting Senior Manager and Private Investment Accounting and Administrative Services Group Manager, Client Accounting & Reporting Services

Louis S. DiRupo joined BNY Mellon in 1986 and has been an Accounting & Reporting Senior Manager for the past 11 years. He currently manages a staff of 60 Accounting & Reporting Specialists who are responsible for full global accounting and client directed cash services for an institutional client base consisting of pension funds, 401(k) savings plans, college and hospital endowments, charitable foundations, and welfare benefit plans. Lou gained extensive experience in trust services within our Global Cash Management department and the Global Accounting department. In addition to being an Accounting & Reporting Senior Manager, Lou also manages the Private Investment Accounting & Administrative Services Group. This group works directly with clients and is dedicated to the processing and support of private investment accounts. He has also worked in the Division Training department as a Training Specialist. Lou received a Bachelor of Science in Finance from Providence College in 1986. In addition, he received a C.E.B.S. (Certified Employee Benefits Specialist) designation in 1996.

Carrie Cassidy, Vice President

Private Investment Accounting and Administrative Services Unit Manager, Client Accounting & Reporting Services

Carrie Cassidy is the Unit Manager of the Private Investment Accounting and Administrative Services team, a centralized team within Client Accounting & Reporting Services (CARS) in the Asset Servicing Division of The Bank of New York Mellon Corporation. She has more than 12 years of financial services industry experience. Carrie started her career at BNY Mellon as a Trust Specialist in 1998. In 2000, she became a CARS Supervisor and managed a team of four individuals supporting monthly-valued Public Funds, Foundations, and Endowments. In 2008, Carrie was promoted to Unit Manager of the Private Investment Accounting and Administrative Services team. Her team provides administrative support for private investments structured as limited partnerships, including Accounting, Processing, Reconciliation, Data Management, Reporting, and Document Management.

Cindy Lee-Chan, Associate

Private Investment Accounting and Administrative Services Analyst, Client Accounting & Reporting Services

Cindy Lee-Chan joined BNY Mellon in 1994. In 2007, she was promoted to her current position as Analyst within the Private Investment Accounting & Administrative Services Group, which is a part of our Client Accounting & Reporting Services (CARS) Team. In this role, Cindy is responsible for overseeing the Limited Partnership team, converting new clients to the team, setting up new procedures, and training new associates. Before joining the Private Investment Accounting & Administrative Services Group, she held the position of CARS Supervisor.

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State of South Carolina**BNY MELLON | ASSET SERVICING**

From: [Abesamis, Bo](#)
To: Bill.Leidinger@sto.sc.gov
Cc: [Condon, Bill](#); [Raven, Dinah](#); [Tahilliani, Shakun](#); [McDermott, Mike](#); [Hershel Harper](#); [Douglas W. Lybrand](#); [Tammy Nichols](#); [Faith Wright](#); [William Blume](#); [Rebecca Gunnlaugsson](#); Curtis.Loftis@sto.sc.gov
Subject: Update - Commentary on Pending Pension Funding Bill
Date: Friday, March 23, 2012 1:39:33 PM
Attachments: [PendingPensionFundingBillandDI-March2012.pdf](#)

Good Morning! You may find the attached Commentary on Pending Pension Funding Bill of interest for Corporate Plans. Wanted to share this angle.

BO

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

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Pension Funding Bill Has the Potential to Impact LDI Strategies

On March 14, 2012, the U.S. Senate approved a bipartisan bill that would serve to ease cash contributions to corporate defined benefit plans by allowing plan sponsors to use interest rates based on a 25-year average (with some restrictions) rather than the 24-month average that is currently in practice. The current environment of low interest rates has negatively impacted funding requirements for many, because lower discount rates lead to higher liability values. In most cases, rising liability values lower funded ratios and increase cash contribution requirements. We believe many plan sponsors will be very tempted to employ the 25-year smoothing, since liabilities could fall in value by 10-30% right away (i.e., for each 1% rise in interest rates, the average pension liability value will fall by 10-15%).

Proponents of the bill see it as offering longer-term funding relief by stabilizing contributions from year to year. Many sponsors have argued that the current "look-back" period of 24-months adds too much volatility to required contributions. A longer look-back period, in contrast, would reduce interest volatility, smooth funding levels and stabilize contributions from year to year. Detractors see the reform as an opening to a potentially slippery slope for exacerbating pension underfunding, given the low funded ratios that exist today.

The proposed legislation is the second piece of funding relief since the 2008 meltdown. The first bill, The Pension Relief Act of 2010, allowed unfunded liabilities to be amortized over an extended period of time, rather than the seven-year requirement in the Pension Protection Act (PPA)¹. The new pension funding relief passed in the Senate is attached to a highway funding bill, and must still be approved by the House.

Investment Impact on LDI Strategies

Many plans have embraced liability-driven investing (LDI) as a risk-reward framework that explicitly recognizes their plan's unique pension liability in the investment process. A key component of LDI is to reduce the impact of interest rate volatility by better matching the duration of the asset portfolio with the duration of liabilities. Duration-matching as an investment strategy attempts to "immunize" the funded ratio from changes in interest rates. The new proposed legislation to extend interest rate smoothing to 25 years (from 24 months) has the potential to detract from the LDI approach. That is, the more smoothing that is used in the measurement of liabilities, the less the asset portfolio will track the changes in the liabilities.

Plan sponsors will need to understand both the funding and accounting implications before making any changes to their investment strategy. For example, under the PPA, plan sponsors make an interest rate election to use either the segment rates (i.e., averaging or smoothing method) or the full spot rate curve (i.e., no averaging nor smoothing). Segmenting essentially means using three rates instead of the full yield curve, with averaging over 0-5, 5-20 and 20-year

¹ The Bill had several components, but primarily it allowed sponsors to elect either a "2 plus 7" schedule or 15-year schedule to amortize shortfalls. The relief extended for any two plans years beginning 2008, 2009, 2010 and 2011.

**Pension Funding Bill Has the Potential
to Impact LDI Strategies (continued)**

or longer maturities. Each month, the Treasury publishes both spot and segmented (24-month smoothed) rates. The implication is that the higher the interest rate hedge ratio (i.e., 70% or more), the less desirable it will be to use smoothing and the more desirable it might be to use the full spot rate curve. Second, companies that follow U.S. GAAP (FAS 158) must still measure liabilities at current market interest rates, with no smoothing. Hence, plan sponsors focused on the balance sheet will still feel the impact of interest rate volatility.

In conclusion, the decision to pursue or maintain an LDI approach may still be valid, even with the proposed funding relief change. Plan sponsors that are sensitive to accounting will still feel the impact of interest rate volatility, and therefore will need to understand its effect on both funding and accounting before undertaking any further changes to their investment program.

Karen Harris, ASA, CFA, Vice President, Callan Associates Inc.

From: [Abesamis, Bo](#)
To: [Douglas W. Lybrand](#); [Leidinger, Bill](#); [Swilley-Burke, Gwelda](#); [_WCC - Docket Assignment](#)
Cc: [Condon, Bill](#); [Raven, Dinah](#); [Tahiliani, Shakun](#); [McDermott, Mike](#); [Hershel Harper](#); [Tammy Nichols](#); [Faith Wright](#); [William Blume](#); [Rebecca Gunnlaugsson](#)
Subject: RE: Specific Pricing
Date: Friday, March 23, 2012 10:38:55 AM

Doug,

Thanks. Will include (actually I specified this in the fee section of the RFP, but for this next round of fee clarification, I will ask.)

BO

From: Douglas W. Lybrand [<mailto:DLYbrand@ic.sc.gov>]
Sent: Friday, March 23, 2012 7:00 AM
To: Abesamis, Bo; Leidinger, Bill; gburke@callan.com; [_WCC - Docket Assignment](#)
Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; Hershel Harper; Tammy Nichols; Faith Wright; William Blume; Rebecca Gunnlaugsson
Subject: RE: Specific Pricing

Bo,

Please ask BNYM and State Street to be specific about their Universe Comparisons. For example, TUCS (which used to only offer very broadly defined asset classes and only quarterly results) is very different from BNY Mellon's monthly universe, which was far more timely and flexible. They used to also bundle their universe reporting with other tools like manager profiles and charting (graphing) capabilities. Inquire if these would still be bundled.

Thanks

Doug

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Thursday, March 22, 2012 4:58 PM
To: Leidinger, Bill; gburke@callan.com; [_WCC - Docket Assignment](#)
Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; Hershel Harper; Douglas W. Lybrand; Tammy Nichols; Faith Wright; William Blume; Rebecca Gunnlaugsson
Subject: RE: Specific Pricing

Bill,

I will do. Please note that Deutsche pricing is just for securities lending, there are no other a la carte services required from them. I will reach out to both BNY Mellon and State Street on a breakdown of fees. In actuality, the a la carte is in the Responses to the RFP Fee Section. I asked for both Flat Fee and An Actual Fee Calculation Worksheet.

Having said that, I will ask them to provide a recast Fee Calculation Worksheet again, with the following----

Custody and Asset Servicing
Accounting and Reporting, GASB Support
Performance Measurement, Monthly Return Calculations (Gross and Net)

Daily Performance
Universe Comparison
Attribution
Investment Compliance Monitoring
Commingled Fund Look Through or Drill Down of Not-Custodied Assets
Risk Analytics (VaR, Stress Testing, Scenario Testing)
Private Investment Support (Beyond Line Item Reporting, including Company Level Tracking, Capital Call Management, Doc Mgmt)
Hedge Fund Transparency and Administration
Transfer Agency Solution (General Account/LGIP)
Trade Execution

If I missed anything, please alert me before I start my query.

Thanks. BO

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Thursday, March 22, 2012 1:05 PM
To: Abesamis, Bo; gburke@callan.com; _WCC - Docket Assignment
Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; Harper, Hershel; Lybrand, Douglas; Tammy Nichols; Faith Wright; William Blume
Subject: Specific Pricing

Bo, I ask that contact BoNY Mellon, State Street and Deutsche Bank and ask them to specifically and separately price each service and tool that they have proposed to us. I believe this would best serve each and all of us as well as facilitate discussions and reach decisions regarding what each of us needs and is willing to pay for, especially in those instances where the particular service or tool would serve more than 1 of the 3 entities.

Thanks and let me hear from you about this.....Tomorrow I will get on the team structures for the reference checking.....Thanks much....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

From: [Abesamis, Bo](#)
To: [Hershel Harper](#); [Tammy Nichols](#)
Cc: [Condon, Bill](#); [Raven, Dinah](#); [Tahiliani, Shakun](#); [McDermott, Mike](#); gburke@callan.com; [Douglas W. Lybrand](#); [Faith Wright](#); [William Blume](#); [Rebecca Gunnlaugsson](#); [_WCC - Docket Assignment](#); [Leidinger, Bill](#)
Subject: RE: Specific Pricing
Date: Friday, March 23, 2012 10:20:01 AM

Herschel,

Will do include. Thanks.

BO

From: Hershel Harper [<mailto:HHarper@ic.sc.gov>]
Sent: Thursday, March 22, 2012 2:45 PM
To: Abesamis, Bo; Tammy Nichols
Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; gburke@callan.com; Douglas W. Lybrand; Faith Wright; William Blume; Rebecca Gunnlaugsson; [_WCC - Docket Assignment](#); Leidinger, Bill
Subject: RE: Specific Pricing

Bo...

I would add the data warehouse component to the al a carte pricing menu. In prior discussions (in 2009) with BNY, this was for their Eagle Pace and Access systems. Depending on the bells and whistles, it would have cost \$125,000 to \$375,000 annually.

Thanks,
HH

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Thursday, March 22, 2012 5:11 PM
To: Tammy Nichols
Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; gburke@callan.com; Hershel Harper; Douglas W. Lybrand; Faith Wright; William Blume; Rebecca Gunnlaugsson; [_WCC - Docket Assignment](#); Leidinger, Bill
Subject: RE: Specific Pricing

Tammy,

I am already preparing for that issue, when I query BNY Mellon. I will do it over the phone and show my displeasure and to share with them that it is a strategic mistake. Once I get over that hurdle, will ask BNY Mellon to then make the appropriate correction to their fees without that contingency. I am trying to be like Teddy Roosevelt – "Speak silently, but carry a big stick."

BO

From: Tammy Nichols [<mailto:Tnichols@retirement.sc.gov>]
Sent: Thursday, March 22, 2012 2:02 PM
To: Abesamis, Bo
Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; gburke@callan.com; Hershel Harper; Douglas W. Lybrand; Faith Wright; William Blume; Rebecca Gunnlaugsson; [_WCC - Docket Assignment](#); Leidinger, Bill

Subject: RE: Specific Pricing

At what point will you address BNY Mellon's contingency that we maintain a large cash balance to be invested in Dreyfus and the impact of removing this from their quote?

Tammy

From: Abesamis, Bo [<mailto:abesamis@callan.com>]

Sent: Thursday, March 22, 2012 4:58 PM

To: Leidinger, Bill; gburke@callan.com; _WCC - Docket Assignment

Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; Hershel Harper; Douglas W. Lybrand; Tammy Nichols; Faith Wright; William Blume; Rebecca Gunnaugsson

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Daily Performance
Universe Comparison
Attribution
Investment Compliance Monitoring
Commingled Fund Look Through or Drill Down of Not-Custodied Assets
Risk Analytics (VaR, Stress Testing, Scenario Testing)
Private Investment Support (Beyond Line Item Reporting, including Company Level Tracking, Capital Call Management, Doc Mgmt)
Hedge Fund Transparency and Administration
Transfer Agency Solution (General Account/LGIP)
Trade Execution

If I missed anything, please alert me before I start my query.

Thanks. BO

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Sent: Thursday, March 22, 2012 1:05 PM

To: Abesamis, Bo; gburke@callan.com; _WCC - Docket Assignment

Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; Harper, Hershel; Lybrand, Douglas; Tammy Nichols; Faith Wright; William Blume

Subject: Specific Pricing

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From: [Abesamis, Bo](#)
To: Bill.Leidinger@sto.sc.gov
Cc: [Condon, Bill](#); [Raven, Dinah](#); [Tahiliani, Shakun](#); [McDermott, Mike](#); [Hershel Harper](#); [Douglas W. Lybrand](#); [Tammy Nichols](#); [Faith Wright](#); [William Blume](#); [Rebecca Gunnlaugsson](#); [Swilley-Burke, Gwelda](#)
Subject: FW: South Carolina - Client Reference Check
Date: Thursday, March 22, 2012 6:03:34 PM
Importance: High

CLIENT REFERENCES PROVIDED BY STATE STREET. IF THIS DOES NOT WORK, I WILL GET ANOTHER BATCH FROM THEM.

From: Protasewich, Richard G [mailto:rgprotasewich@statestreet.com]
Sent: Thursday, March 22, 2012 11:17 AM
To: Abesamis, Bo
Cc: Schafer, Mark E
Subject: RE: South Carolina - Client Reference Check

Bo:

Per your request, below is the information for the existing client and lost client references:

Existing

Client	Client Contact	Telephone Number	Ancillary Services
Alabama County Employees' Retirement	Steve Lambdin	(334) 517-7111	Custody/Accounting Securities Lending Cash Management (STIF) Foreign Exchange Performance
Maryland State Retirement Agency	Victoria Willard	(410) 625-5614	Custody/Accounting Securities Lending Foreign Exchange Cash management (Treasury Plus Money Market/STIF) Performance Private Edge (Real Estate/Private Equity) Investment Compliance

Lost Client

Todd Hohenstein, CPA
Investment Operations Manager
State Teachers Retirement System of Ohio
275 East Broad St.
Columbus, OH 43215-3771

Phone: 614-227-2863

Email: hohenstt@strsoh.org

Walter Knox

Assistant Director, Investment Accounting
Ohio Public Employees Retirement System
277 East Town St.
Columbus, OH 43215-4642
Phone: 614-227-0316
Email: wknox@opers.org

Let me know if you have any questions.

Richard G. Protasewich, Vice President

State Street Global Services | Institutional Investors Services | One Lincoln Street, Boston, MA 02111
P 617-664-3788 | F 617-786-2079 | M 704-560-5560 | rprotasewich@statestreet.com
www.statestreetglobalservices.com

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From: Abesamis, Bo [<mailto:abesamis@callan.com>]

Sent: Thursday, March 22, 2012 10:56 AM

To: Protasewich, Richard G

Subject: South Carolina - Client Reference Check

Importance: High

Rich,

South Carolina would like to conduct client reference checks. Please provide 2 public fund client references that utilize the depth of your services and would the same profile as SC. In addition, we would like to have 2 public fund client references that departed your organization the last three years.

Thanks. BO

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

101 California Street
Suite 3500
San Francisco, CA 94111
P. 415.274.3074
F. 415.291.4016

www.callan.com

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From: [Abesamis, Bo](#)
To: Bill.Leidinger@sto.sc.gov
Cc: [Condon, Bill](#); [Raven, Dinah](#); [Tahilliani, Shakun](#); [McDermott, Mike](#); [Hershel Harper](#); [Douglas W. Lybrand](#); [Tammy Nichols](#); [Faith Wright](#); [William Blume](#); [Rebecca Gunnlaugsson](#); [Swilley-Burke, Gwelda](#)
Subject: FW: South Carolina - Client References from Deutsche Bank AG [I]
Date: Thursday, March 22, 2012 6:02:01 PM
Attachments: [Deutsche Bank Agency Securities Lending Program References 3 22 12.pdf](#)
Importance: High

CLIENT REFERENCES FOR DEUTSCHE SECURITIES LENDING PROGRAM.

From: Joseph Santoro [<mailto:joseph.santoro@db.com>]
Sent: Thursday, March 22, 2012 2:59 PM
To: Abesamis, Bo
Cc: Tim Smollen
Subject: Re: South Carolina - Client References from Deutsche Bank AG [I]

Classification: For internal use only

Dear Bo,

We thoroughly enjoyed visiting with you and the State of South Carolina's staff. I am delighted to submit references as requested. Please see the attached document.

I will respond with a client list shortly. I am conferring with Compliance on the request.

Best regards,
Joe Santoro

Joseph J. Santoro
Director - Marketing and Client Service

Agency Securities Lending Program
Global Transaction Banking
Deutsche Bank AG

60 Wall St – 26th Floor, Mail Stop NYC60-2615, New York, NY 10005-2858
phone: +1 (212) 250 4492 | fax: +1 (212) 797 0700
mobile: +1 (973) 641 3277
email: joseph.santoro@db.com



From: "Abesamis, Bo" <abesamis@callan.com>
To: Joseph Santoro/db/dbcom@DBAmericas
Cc: Tim Smollen/db/dbcom@DBAmericas
Date: 03/22/2012 10:54 AM
Subject: South Carolina - Client References

Joe,

State of SC would like to conduct client references. Kindly provide 2 client references (if possible) of a public fund client where you are the 3rd party seclending but custody is with BNY Mellon. We would also like to have 2 client references who departed your program the last 3 years.

Thanks.

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

101 California Street
Suite 3500
San Francisco, CA 94111
P. 415.274.3074
F. 415.291.4016

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This communication may contain confidential and/or privileged information. If you are not the intended recipient (or have received this communication in error) please notify the sender immediately and destroy this communication. Any unauthorized copying, disclosure or distribution of the material in this communication is strictly forbidden.

Deutsche Bank does not render legal or tax advice, and the information contained in this communication should not be regarded as such.

**Agency Securities Lending Program
References**

- 1. State of SC would like to conduct client references. Kindly provide 2 client references (if possible) of a public fund client where you are the 3rd party lending but custody is with BNY Mellon.**

Missouri State Employees' Retirement System (\$8 billion AUM)
907 Wildwood Dr.
Jefferson City, MO 65109

Tyson Rehfeld
Investment Officer Public Debt
573-632-6179
tysonr@mosers.org

MOSERS joined our program following reinvestment issues with the previous provider. The mandate entailed transitioning in Lehman bonds and MBS securities, which we manage at no cost under the securities lending relationship. Tyson Rehfeld is very knowledgeable in securities lending and interacts with our team frequently. Custody is with BNY-Mellon.

Florida State Board of Investment (\$154 billion AUM)
1801 Hermitage Boulevard
Suite 100
Tallahassee, Florida 32308

Trent Carter
Manager of Fixed Income Operations and Securities Lending
850-413-1422
Trent.Carter@sbafla.com

Florida State Board of Administration (SBA) has been lending with us for 15 years. We lend assets of the Florida Retirement System. We are SBA's only third-party lending agent. Custody is with BNY-Mellon.

- 2. We would also like to have 2 client references who departed your program the last 3 years.**

The following clients ceased program activities. Our program had only one public fund client suspend participation during the economic downturn, which is listed below.

Miami-Dade County (Approx. \$3 billion AUM)

Investment Consultant:
Scott McIntyre
Senior Vice President
First Southwest Asset Management, Inc.
300 W 6th St
Austin, TX 78701-3902
(512) 481-2009
smcintyre@firstsw.com

Miami-Dade County withdrew from securities lending due to concerns about the overall economy (see below). Rachel Baum, Finance Director, has since retired; however, Mr. Scott McIntyre is the investment consultant who provides oversight of the County's various investment programs and activities. Scott monitored the securities lending program, including a daily review of exposure reports and regular interaction with our staff. Scott is knowledgeable in securities lending, as well as our approach and capabilities.

The following is a quote from the letter suspending securities lending activities:

"Our decision is based solely on the current vastly fluctuating state of the economy and the implied risks of the uncertainties. Our decision should not be construed in any negative connotation regarding your firm. To the contrary, we acknowledge the professionalism of your firm and how well you have performed for us. When the financial situation stabilizes, we will revisit our position to determine if we can once again reestablish our relationship."

*Rachel Baum
Finance Director*

Apple Bank for Savings (Approx. \$7 billion in assets)
1075 Central Park Avenue
Scarsdale, NY 10583

Mr. Doug Van Horne
Senior Vice President and Chief Investment Officer
516-627-3854
dvanhorne@apple-bank.com

Apple Bank dates to 1863. It is the 3rd largest savings bank in the State of New York and one of the strongest depository institutions in the nation. Apple Bank suspended securities lending activities due to the economic downturn. Their program entailed lending large blocks of fixed income assets and investing cash collateral in repurchase agreements indemnified against loss ("indemnified repo"). We expect that Apple will one day return to the program.

From: [Abesamis, Bo](#)
To: [Tammy Nichols](#)
Cc: [Condon, Bill](#); [Raven, Dinah](#); [Tahiliani, Shakun](#); [McDermott, Mike](#); gburke@callan.com; [Hershel Harper](#); [Douglas W. Lybrand](#); [Faith Wright](#); [William Blume](#); [Rebecca Gunnlaugsson](#); [_WCC - Docket Assignment](#); [Leidinger, Bill](#)
Subject: RE: Specific Pricing
Date: Thursday, March 22, 2012 5:11:07 PM

Tammy,

I am already preparing for that issue, when I query BNY Mellon. I will do it over the phone and show my displeasure and to share with them that it is a strategic mistake. Once I get over that hurdle, will ask BNY Mellon to then make the appropriate correction to their fees without that contingency. I am trying to be like Teddy Roosevelt – “Speak silently, but carry a big stick.”

BO

From: Tammy Nichols [<mailto:Tnichols@retirement.sc.gov>]
Sent: Thursday, March 22, 2012 2:02 PM
To: Abesamis, Bo
Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; gburke@callan.com; Hershel Harper; Douglas W. Lybrand; Faith Wright; William Blume; Rebecca Gunnlaugsson; [_WCC - Docket Assignment](#); Leidinger, Bill
Subject: RE: Specific Pricing

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Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; Hershel Harper; Douglas W. Lybrand; Tammy Nichols; Faith Wright; William Blume; Rebecca Gunnlaugsson
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Bill,

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From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
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To: Abesamis, Bo; gburke@callan.com; _WCC - Docket Assignment
Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; Harper, Hershel; Lybrand, Douglas; Tammy Nichols; Faith Wright; William Blume
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Cc: [Condon, Bill](#); [Raven, Dinah](#); [Tahiliani, Shakun](#); [McDermott, Mike](#); [Hershel Harper](#); [Douglas W. Lybrand](#); [Tammy Nichols](#); [Faith Wright](#); [William Blume](#); [Rebecca Gunnlaugsson](#)
Subject: RE: Specific Pricing
Date: Thursday, March 22, 2012 4:58:06 PM

Bill,

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From: [Abesamis, Bo](mailto:Abesamis.Bo)
To: [William Blume](mailto:William.Blume@sto.sc.gov); Bill.Leidinger@sto.sc.gov
Cc: [Tammy Nichols](mailto:Tammy.Nichols); [Faith Wright](mailto:Faith.Wright); [Rebecca Gunnlaugsson](mailto:Rebecca.Gunnlaugsson); [Douglas W. Lybrand](mailto:Douglas.W.Lybrand); [Tahiliani, Shakun](mailto:Tahiliani.Shakun); [Condon, Bill](mailto:Condon.Bill); [Hershel Harper](mailto:Hershel.Harper); [Loftis, Curtis](mailto:Loftis.Curtis); [Hershel Harper](mailto:Hershel.Harper); [Swilley-Burke, Gwelda](mailto:Swilley-Burke.Gwelda)
Subject: RE: Custody Bank Client Reference Check - 5 Minute Drill
Date: Thursday, March 22, 2012 12:05:08 PM

Bill,

That is actually the intent of the Evaluation Team for the client references. You can reach out to your Public Fund colleagues so that you can control the process.

In terms of the full gamut of services (from traditional to alternatives) including custody, accounting, performance measurement, risk management tools, advanced analytics, private equity support, hedge fund transparency, and the servicing of the General Accounts/LGIP, specific clients from each provider are in order and SC may want to reach out to the below independently.

State Street – Their clients that are similar to the investment structure to SC are – Texas Teachers, CalPERS, CasSTRS, Maryland and Michigan.

BNY Mellon – As was noted in the meetings, BNY Mellon is about to introduce a myriad of tools and they do not have a real power user to date. In terms of investment profile similar to SC, you may want to reach out to Indiana Retirement Systems, SWIB, North Carolina, Texas ERS, Pennsylvania State Teachers, etc.

Thanks. BO

From: William Blume [mailto:WBlume@retirement.sc.gov]
Sent: Thursday, March 22, 2012 8:10 AM
To: Abesamis, Bo; Bill.Leidinger@sto.sc.gov
Cc: Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Douglas W. Lybrand; Tahiliani, Shakun; Condon, Bill; Hershel Harper; Loftis, Curtis; Hershel Harper; Swilley-Burke, Gwelda
Subject: RE: Custody Bank Client Reference Check - 5 Minute Drill

Can we have this discussion (below) with **any of the Custodian's clients** not just those that were provided by the Custodian ? As all of you know, we are only given the references of satisfied customers! In the alternative, can we obtain the names of their clients which have terminated the client relationship over the last three(3) years ? We will receive more informative results from these inquiries versus calling on current references provided by the Custodian.

Bo, just to let you know, I have had significant experience with proposal opportunities from the professional service provider perspective. Call me if you would like to discuss.

Thanks for all your contributions. I have heard nothing but good reports regarding your assistance.

Bill

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Thursday, March 22, 2012 10:07 AM
To: Bill.Leidinger@sto.sc.gov
Cc: Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Douglas W. Lybrand; Tahiliani, Shakun; Condon, Bill; Hershel Harper; William Blume; Loftis, Curtis; Hershel Harper; Swilley-Burke, Gwelda
Subject: Custody Bank Client Reference Check - 5 Minute Drill

Importance: High

As promised, the 5 minute drill for client reference.

Given that client reference checks can be laborious and can be burdensome or impose on the time of the person that one is calling, Callan devised the following questions to achieve the most in a client reference check within 5 minutes. This is a guide or script that SC can utilize.

"SC is in the final stages of our Due Diligence Search Process. _____ is one of two trustee/custodian that is under consideration. If it's possible, we would like to ask you a few short questions.

- (1) How long have you had _____ as Custodian?**
- (2) What were the three main factors of differentiation that your organization considered in your decision to hire _____? By the way, who was your second choice?**
- (3) Has the experience with _____ been positive? What is the glue (or lynchpin) that makes the relationship with _____ work?**
- (4) What areas of the relationship needs improvement or enhancement?**
- (5) Is there anything that SC should watch out for during the transition/conversion?**
- (6) Will you hire them again? Thanks for taking the time.**

We at SC, our participants and beneficiaries greatly appreciate your feedback."

The above script is just a suggestion. If you have questions, please give me a call.

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

101 California Street
Suite 3500
San Francisco, CA 94111
P. 415.274.3074
F. 415.291.4016

www.callan.com

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From: [Abesamis, Bo](#)
To: Bill.Leidinger@sto.sc.gov
Cc: [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [Hershel Harper](#); [William Blume](#); [Loftis, Curtis](#); [Hershel Harper](#); [Swilley-Burke, Gwelda](#)
Subject: Custody Bank Client Reference Check - 5 Minute Drill
Date: Thursday, March 22, 2012 10:07:28 AM
Importance: High

As promised, the 5 minute drill for client reference.

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From: [Tahiliani, Shakun](#)
To: [Leidinger, Bill](#); [Abesamis, Bo](#)
Cc: [Hershel Harper](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#); [Tammy Nichols](#); [Condon, Bill](#); [Douglas W. Lybrand](#)
Subject: RE: Custody and SecLending Presentations
Date: Friday, March 16, 2012 5:46:51 PM

Bo, due to the number of presenters for the meetings next week we have changed the meeting room to the Governor's Conference Room on the 1st floor in our office building. This conference room does not have the wireless connection but it does have the internet connection. Our IT person will be on hand to make sure everything works. Please let all the presenters know about it.

Thanks and have a great weekend,
Shakun

From: Leidinger, Bill
Sent: Friday, March 16, 2012 1:21 PM
To: Abesamis, Bo
Cc: Harper, Hershel; Rebecca Gunnlaugsson; Faith Wright; Tammy Nichols; Tahiliani, Shakun; Condon, Bill; Lybrand, Douglas
Subject: RE: Custody and SecLending Presentations

Thanks, Bo.....Bill

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Friday, March 16, 2012 12:10 PM
To: Leidinger, Bill
Cc: Harper, Hershel; Rebecca Gunnlaugsson; Faith Wright; Tammy Nichols; Tahiliani, Shakun; Condon, Bill; Lybrand, Douglas
Subject: Custody and SecLending Presentations

Bill and All,

I formulated the following "Questions to Note" for the Custody and Securities Lending Presentations next week -

Organization and Experience

Given market dynamics, what is your competitive advantage relative to the competition?

What are your strengths and weaknesses?

Client servicing means a lot to the operational functionality of the SC Stakeholders. What makes this service team special?

Accounting and Custody

What is distinct about your capabilities within Accounting and Custody that a Public Fund like SC should know about? Why?

What is the reconciliation discipline that will give as the assurance that our reports are accurate, timely and easy to understand?

Technology and Systems

Does the system handle all asset classes?

Why is your platform easy to use, intuitive, and yet provide a robust data mining capability?

How about corporate governance tools – compliance monitor, tracking of failed trades, and drill down capabilities?

Alternative Asset Class Support

What are your alternative asset class support initiatives to help plans like SC understand their overall investments?

How about capital call management?

What extraordinary reconciliation process and applications deployed by your firm in the world of private equity and hedge funds?

Securities Lending

Have your clients experienced losses in their securities lending program?

What have learned and how have you improved risk management?

What is the extent of your indemnification to protect clients from losses?

Callan

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From: [Abesamis, Bo](#)
To: Bill.Leidinger@sto.sc.gov
Cc: [Hershel Harper](#); [Rebecca Gunnlaugsson](#); [Faith Wright](#); [Tammy Nichols](#); [Tahillani, Shakun](#); [Condon, Bill](#); [Douglas W. Lybrand](#)
Subject: Custody and Secending Presentations
Date: Friday, March 16, 2012 12:15:20 PM

Bill and All,

I formulated the following "Questions to Note" for the Custody and Securities Lending Presentations next week -

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Given market dynamics, what is your competitive advantage relative to the competition?

What are your strengths and weaknesses?

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From: [Leidinger, Bill](#)
To: [Hershel Harper](#)
Cc: [Loftis, Curtis](#); [Allen Gillespie](#); [Adam Jordan](#); [Gary Li](#); [Rebecca Gunnlaugsson](#)
Subject: RE: Meeting with Gary Li
Date: Friday, March 09, 2012 1:33:13 PM

Thanks, Hershel....as you know the STO portfolio is virtually, if not all, fixed rate and short term. We would like the tutorial to focus on the IC portfolio and other similar public trust portfolios.....Thanks.....Bill

From: Hershel Harper [mailto:HHarper@ic.sc.gov]
Sent: Friday, March 09, 2012 10:57 AM
To: Leidinger, Bill
Cc: Loftis, Curtis; Allen Gillespie; Adam Jordan; Gary Li; Rebecca Gunnlaugsson
Subject: RE: Meeting with Gary Li

Bill,

We are happy to assist. We do not have any "off the shelf" tutorials readily available, so we will create one. Risk is a very broad topic, so I want to make sure we are covering what you want and not repeating something that you already know. Can you provide an overview of how your office measures and monitors risk for the \$12 billion that you manage. I will ask Gary to construct a tutorial to complement your risk process.

For reporting practices, I will work with Rebecca on this tutorial. We will come back to you with some questions to make sure we are on the same page on what you would like for us to cover.

Thanks!
Hershel

From: Leidinger, Bill [mailto:Bill.Leidinger@sto.sc.gov]
Sent: Wednesday, March 07, 2012 11:46 AM
To: Hershel Harper
Cc: Loftis, Curtis
Subject: Meeting with Gary Li

Hershel, the Treasurer requests that Gary Li, Director of Risk Management and Asset Allocation, come to the Treasurer's Office and conduct a "tutorial" for the Treasurer's Office on standard existing and emerging industry risk measurement techniques and reporting practices for all asset classes, including alternatives and strategic partners.

The meeting will be interactive with questions and answers and other information sharing as opposed to a straight "presentation" by Mr. Li and the meeting, for planning purposes, could run for 1½ to 2 hours.

Please let me know as soon as convenient so we may schedule.....
Thanks.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

From: [Tahiliani, Shakun](#)
To: [Abesamis, Bo](#); [Leidinger, Bill](#)
Cc: [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Condon, Bill](#); [Hershel Harper](#); [William Blume](#); [Loftis, Curtis](#)
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)
Date: Wednesday, March 07, 2012 5:52:55 PM

Bo, we can provide this. Our conference room is set up with the projection screen, internet access and we will have the projector as well.

Thanks,
Shakun

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Wednesday, March 07, 2012 4:25 PM
To: Leidinger, Bill
Cc: Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Lybrand, Douglas; Tahiliani, Shakun; Condon, Bill; Harper, Hershel; William Blume; Loftis, Curtis
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)

Bill and All,

Thanks.

Everybody would have time to ask questions during the presentations. The "heat seeking" type question variety is better, since the impact has an element of utmost impunity.

Bill, do you by chance can provide a laptop projector, internet access, and projection screen for the presentations?

Thanks. B/O

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Wednesday, March 07, 2012 8:08 AM
To: Abesamis, Bo
Cc: Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Lybrand, Douglas; Tahiliani, Shakun; Condon, Bill; Leidinger, Bill; Harper, Hershel; William Blume; Loftis, Curtis
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)

Bo, the schedule is OK from this end. Please make sure we have full and sufficient time for questions and answers built into each bank presentation period.....Thanks....Bill

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Monday, March 05, 2012 11:51 AM
To: Leidinger, Bill
Cc: Tahiliani, Shakun
Subject: Custody and Securities Lending Presentations (March 20 and 21)
Importance: High

Bill,

Just wanted to relay that BNY Mellon, State Street and Deutsche Bank (SecLending only) are participating in the presentations on March 20 and 21. Here is what I am thinking.

CUSTODY PRESENTATIONS

March 20, 2012 (Tuesday)

State Street (8:30 am to 11:30 am)

BNY Mellon (1:00 pm to 4:00 pm)

Custody Topic for Discussion

Organization

Client Service Team

Custody and Accounting + Reporting

Performance Measurement and Risk Analytics

Alternative Investment Support (P/E, Real Estate, and Absolute Strategies)

SECURITIES LENDING PRESENTATIONS

March 21, 2012 (Wednesday)

BNY Mellon (8:30 am to 9:30 am)

State Street (10:00 am to 11:00 am)

Deutsche Bank (11:30 am to 12:30 pm)

Securities Lending Topic for Discussion

Organization and Experience

Program Structure (Distinct Capabilities)

Risk Management and Indemnification

Revenue Generation

Kindly check with everybody if this is acceptable, so that I can relay to BNY Mellon, State Street and Deutsche the agenda and topics to cover, and at least give them time to arrange travel to Columbia.

Thanks.

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To: [Leidinger, Bill](#)
Cc: [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [Hershel Harper](#); [William Blume](#); [Loftis, Curtis](#)
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)
Date: Wednesday, March 07, 2012 4:25:16 PM

Bill and All,

Thanks.

Everybody would have time to ask questions during the presentations. The "heat seeking" type question variety is better, since the impact has an element of utmost impunity.

Bill, do you by chance can provide a laptop projector, internet access, and projection screen for the presentations?

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Sent: Wednesday, March 07, 2012 8:08 AM
To: Abesamis, Bo
Cc: Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Lybrand, Douglas; Tahiliani, Shakun; Condon, Bill; Leidinger, Bill; Harper, Hershel; William Blume; Loftis, Curtis
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)

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Cc: Tahiliani, Shakun
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Cc: [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [Leidinger, Bill](#); [Hershel Harper](#); [William Blume](#); [Loftis, Curtis](#)
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)
Date: Wednesday, March 07, 2012 11:07:51 AM

Bo, the schedule is OK from this end. Please make sure we have full and sufficient time for questions and answers built into each bank presentation period.....Thanks....Bill

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Monday, March 05, 2012 11:51 AM
To: Leidinger, Bill
Cc: Tahiliani, Shakun
Subject: Custody and Securities Lending Presentations (March 20 and 21)
Importance: High

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To: [Faith Wright](#); [Tammy Nichols](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [McDermott, Mike](#)
Cc: [Adams, Clarissa](#); [Swilley-Burke, Gwelda](#)
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)
Date: Monday, March 05, 2012 1:43:49 PM

Thanks.....Bill

From: Faith Wright [<mailto:FWright@retirement.sc.gov>]
Sent: Monday, March 05, 2012 1:34 PM
To: Leidinger, Bill; Tammy Nichols; Rebecca Gunnlaugsson; Lybrand, Douglas; Tahiliani, Shakun; Condon, Bill; McDermott, Mike
Cc: Adams, Clarissa; Swilley-Burke, Gwelda
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)

This is fine with me Bill.

Thanks,
Faith

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Monday, March 05, 2012 1:05 PM
To: Leidinger, Bill; Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Douglas W. Lybrand; Tahiliani, Shakun; Condon, Bill; McDermott, Mike
Cc: Adams, Clarissa; Swilley-Burke, Gwelda
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)

Folks, please try to get your comments, if any, to me by Wednesday at 10AM. I will review, consolidate and forward to Bo....Thanks....Bill

From: Leidinger, Bill
Sent: Monday, March 05, 2012 12:00 PM
To: Tammy Nichols; 'Faith Wright'; 'Rebecca Gunnlaugsson'; Lybrand, Douglas; Tahiliani, Shakun; Condon, Bill; Leidinger, Bill; McDermott, Mike
Cc: Adams, Clarissa; 'Swilley-Burke, Gwelda'
Subject: FW: Custody and Securities Lending Presentations (March 20 and 21)

Folks, please look over Bo's suggested agenda for the bank presentations and let me know **ASAP** if you have questions, suggestions, additions, deletions, etc.....Thanks Much.....Bill

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Monday, March 05, 2012 11:51 AM
To: Leidinger, Bill
Cc: Tahiliani, Shakun
Subject: Custody and Securities Lending Presentations (March 20 and 21)
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To: [Tahiliani, Shakun](#); [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Condon, Bill](#); [McDermott, Mike](#)
Cc: [Adams, Clarissa](#); [Swilley-Burke, Gwelda](#)
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)
Date: Monday, March 05, 2012 1:26:08 PM

Thanks, Shakun.....Bill

From: Tahiliani, Shakun
Sent: Monday, March 05, 2012 1:20 PM
To: Leidinger, Bill; Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Lybrand, Douglas; Condon, Bill; McDermott, Mike
Cc: Adams, Clarissa; Swilley-Burke, Gwelda
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)

I am good with this.

Thanks,
Shakun

From: Leidinger, Bill
Sent: Monday, March 05, 2012 12:00 PM
To: Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Lybrand, Douglas; Tahiliani, Shakun; Condon, Bill; Leidinger, Bill; McDermott, Mike
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From: [Tahiliani, Shakun](#)
To: [Leidinger, Bill](#); [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Condon, Bill](#); [McDermott, Mike](#)
Cc: [Adams, Clarissa](#); [Swilley-Burke, Gwelda](#)
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)
Date: Monday, March 05, 2012 1:25:40 PM

I am good with this.
Thanks,
Shakun

From: Leidinger, Bill
Sent: Monday, March 05, 2012 12:00 PM
To: Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Lybrand, Douglas; Tahiliani, Shakun; Condon, Bill; Leidinger, Bill; McDermott, Mike
Cc: Adams, Clarissa; Swilley-Burke, Gwelda
Subject: FW: Custody and Securities Lending Presentations (March 20 and 21)

Folks, please look over Bo's suggested agenda for the bank presentations and let me know **ASAP** if you have questions, suggestions, additions, deletions, etc.....Thanks Much.....Bill

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Monday, March 05, 2012 11:51 AM
To: Leidinger, Bill
Cc: Tahiliani, Shakun
Subject: Custody and Securities Lending Presentations (March 20 and 21)
Importance: High

Bill,

Just wanted to relay that BNY Mellon, State Street and Deutsche Bank (SecLending only) are participating in the presentations on March 20 and 21. Here is what I am thinking.

CUSTODY PRESENTATIONS

March 20, 2012 (Tuesday)

State Street (8:30 am to 11:30 am)
BNY Mellon (1:00 pm to 4:00 pm)

Custody Topic for Discussion

Organization
Client Service Team
Custody and Accounting + Reporting
Performance Measurement and Risk Analytics
Alternative Investment Support (P/E, Real Estate, and Absolute Strategies)

SECURITIES LENDING PRESENTATIONS

March 21, 2012 (Wednesday)

BNY Mellon (8:30 am to 9:30 am)
State Street (10:00 am to 11:00 am)
Deutsche Bank (11:30 am to 12:30 pm)

Securities Lending Topic for Discussion

Organization and Experience
Program Structure (Distinct Capabilities)
Risk Management and Indemnification
Revenue Generation

Kindly check with everybody if this is acceptable, so that I can relay to BNY Mellon, State Street and Deutsche the agenda and topics to cover, and at least give them time to arrange travel to Columbia.

Thanks.

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

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From: [Leidinger, Bill](#)
To: [Leidinger, Bill](#); [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [McDermott, Mike](#)
Cc: [Adams, Clarissa](#); [Swilley-Burke, Gwelda](#)
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)
Date: Monday, March 05, 2012 1:05:54 PM

Folks, please try to get your comments, if any, to me by Wednesday at 10AM. I will review, consolidate and forward to Bo....Thanks....Bill

From: Leidinger, Bill
Sent: Monday, March 05, 2012 12:00 PM
To: Tammy Nichols; 'Faith Wright'; 'Rebecca Gunnlaugsson'; Lybrand, Douglas; Tahiliani, Shakun; Condon, Bill; Leidinger, Bill; McDermott, Mike
Cc: Adams, Clarissa; 'Swilley-Burke, Gwelda'
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Cc: [Adams, Clarissa](#); [Swilley-Burke, Gwelda](#)
Subject: FW: Custody and Securities Lending Presentations (March 20 and 21)
Date: Monday, March 05, 2012 12:05:25 PM

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Cc: Tahiliani, Shakun
Subject: Custody and Securities Lending Presentations (March 20 and 21)
Importance: High

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From: [Leidinger, Bill](#)
To: [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [Leidinger, Bill](#); [McDermott, Mike](#)
Cc: [Abesamis, Bo](#); [Swilley-Burke, Gwelda](#)
Subject: FW: Callan Memo - Consolidated Results of Custody and SecLending Deliberation by Evaluation Team
Date: Friday, March 02, 2012 10:33:31 AM
Attachments: [Callan Memo - SC Collective SCORE - RFP Custody-SecLend Mar-1-2012.pdf](#)
Importance: High

FYI.....please keep **CONFIDENTIAL**.....Bo is proceeding to schedule interviews/presentations with banks.....Have a great weekend.....Bill

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Friday, March 02, 2012 9:34 AM
To: Leidinger, Bill
Cc: Tahiliani, Shakun; Swilley-Burke, Gwelda
Subject: Callan Memo - Consolidated Results of Custody and SecLending Deliberation by Evaluation Team
Importance: High

Bill,

Attached please find the Callan Memorandum – Custody and Securities Lending Evaluation. This summarizes the collective discussion and deliberation by the Evaluation Team and Callan specific to the RFP for Trust/Custody and Securities Lending Services. Kindly distribute in Confidence, accordingly.

I would also like to take this opportunity to seek permission to direct Callan to reach out to BNY Mellon, State Street and Deutsche Bank specific to their presentations on Mar.20, 21 and/or 22 in Columbia. Thanks.

Callan

Bo Abesamis | Executive Vice President
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Memorandum

To: Bill Leidinger (Chief of Staff, State of South Carolina Treasurer's Office)
From: Bo Abesamis
CC: Shakun Tahiliani, Tammy Nichols, Faith Wright, Rebecca Gunnlaugsson, Douglas Lybrand, Bill Condon, and Gwelda Swilley-Burke
Date: March 1, 2012
Subject: Custody and Securities Lending RFP Evaluation

As requested, Callan consolidated the results of the analysis of the Request for Proposals for Trust/Custody and Securities Lending Services by the Evaluation Team from the State Treasurer's Office, Investment Commission and Retirement Systems.

After careful deliberation of the core factors specific to custody and securities lending services, the Evaluation Team collectively agreed that BNY Mellon, State Street and Deutsche Bank (securities lending only mandate) deserve further consideration in the due diligence review process. Kindly refer to Table 1 - Custody Services and Table 2 - Securities Lending Services for the consolidated results of the deliberation. All three providers would be invited for interviews by the Evaluation Team and would be required to present their capabilities to get a deeper understanding of their core product and service deliverables.

Table 1
Custody Services

CORE FACTORS	BNY Mellon	JP Morgan Chase	State Street	Wells Fargo Bank
Organization, Experience, Client Service Structure, Client Base (20 Points)	18	14	16	10
Custody, Accounting, Investment Management Feedback (20 Points)	18	15	18	10
Core Technology, Systems, On-line and Web Applications (20 Points)	16	12	18	10
Risk Analytics, Advanced Performance Measurement (20 Points)	15	12	17	10
Ancillary Services - Cash Management, Alternative Inv Support, Others (20 Points)	18	12	17	10
TOTAL SCORE (100 Points)	85	65	86	50

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Table 2
Securities Lending Services

CORE FACTORS	BNY Mellon	Citi	Deutsche Bank	JP Morgan Chase	Northern Trust	State Street
Organization, Experience, Client Turnover, Client Base (20 Points)	16	17	16	16	15	17
Aggregate Program Duration Mismatch (20 Points)	10	15	20	15	10	10
Utilization - All Asset Class (20 Points)	15	10	20	15	20	20
Risk Management and Indemnification (20 Points)	15	15	20	15	15	15
Revenue Sharing Arrangement (20 points)	18	20	20	18	15	18
TOTAL SCORE (100 Points)	74	77	96	79	75	80

If you have any questions, please do not hesitate to give me a call or via email, whichever is most convenient.

From: [Leidinger, Bill](#)
To: [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [Leidinger, Bill](#)
Cc: [Abesamis, Bo](#); [Swilley-Burke, Gwelda](#)
Subject: FW: Follow-Up Items on Securities Lending Discussion
Date: Thursday, March 01, 2012 4:35:31 PM
Attachments: [Callan Research - SecLendSurvey 2009 Final.pdf](#)
[Callan Research - SecLendingAskTheExpert-March2008.pdf](#)
[Callan Research - ODD.PDF](#)
[SEC Amendment to Custody Rule.pdf](#)
Importance: High

FYI from Bo.....Bill

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Thursday, March 01, 2012 12:18 PM
To: Leidinger, Bill
Cc: Condon, Bill; Tahiliani, Shakun; Swilley-Burke, Gwelda
Subject: Follow-Up Items on Securities Lending Discussion
Importance: High

Bill,

As you requested, below are my general observations on the characteristics of a risk averse securities lending program. The decision to go with a custodian lending program (bundled with custody provider) or 3rd party agent lender (unbundled from custody) should really be tempered by the risk/reward trade-off of a risk averse approach. In short, if both custody lending or 3rd party lending can generate the same level of revenues in a very tight risk averse seclending program, one would gravitate to a custodian lending just because of the ease of implementation, and less operational costs & headaches.

What are the general characteristics of a risk averse program?

There are a multitude of risks in securities lending (i.e., operational risks, borrower default risks, collateral reinvestment risks). As manifested during the credit and liquidity crisis of 2008, collateral reinvestment risks are largely borne by the lender (the plan sponsor or fund) lending the securities. The lending agent (whether custody or 3rd party) does not bear the risk of loss on the collateral. In order to mitigate such risks, the following would be the general parameters of a risk averse program.

- Collateral posted by the borrower (when the client loans out the security), should follow the safe harbor provisions of ERISA DoL PTE 81-6 where the acceptable collateral are US\$ cash, US Gov't/Treasurer, and Irrevocable Letters of Credit. DoL made amendments to ERISA DoL PTE 81-6 via PTE 2006-16 where other forms of non-cash collateral (e.g. Sovereign Debt, OECD Debt, etc.) are acceptable. Callan believes that PTE 81-6 guidelines would be the more prudent approach.
- When Cash Collateral is posted by the borrower, the reinvestment guidelines of the cash collateral should seek an Overnight Indemnified REPO (REPO collateralized by US Treasury/Govts Only). The intent is to manage credit and liquidity risks. This also mitigates duration mismatch or gap between the duration of the loan and the duration of the investments.
- When Non-Cash Collateral is posted, the acceptable form should only be US Govt/Treasury and Irrevocable Letters of Credit. It is common thinking that accepting Non-Cash Collateral alleviates cash collateral reinvestment risks; but we believe that caution should be applied. The lending agent (whether Custody or 3rd Party Lending) should indemnify the plan sponsor or client not only to cover broker default, but also should rectify SIPC Guidelines on "Bankruptcy Stay" and

Dodd Frank issues. If non-cash collateral is posted, the collateral should be "Perfected" to mean that the lender or client has outright unmitigated access to the non-cash collateral for immediate liquidation so that client (through the lending agent) can buy back the securities that is out on loan.

- In order to "Perfect" the collateral, it is also required that the collateral be custodied by the bank custodian of the fund assets. In 3rd Party programs or in certain instances bank program, the collateral may not necessarily be custodied under the name of the client. If this is not the case, then I do believe that the collateral is not Perfected because we need to have un-incumbered right to seize the collateral to protect the interest of the client if we need to liquidate and do a "buy-in" of the securities out on loan in the marketplace.
- A risk averse program also focuses on Intrinsic Value Lending wherein the demand spread of the securities should dictate what needs to be out on loan.
- A risk averse program should be transparent and full disclosure. Thus, daily access to the program (i.e., what is out on loan, who is the borrower, the collateral and margins posted, how cash collateral is reinvested, and spreads are disclosed) is required.

In the case of SC, the Investment Commission is charged with setting Investment Guidelines, while the custody of the Collateral posted by the borrower is still the responsibility of the State Treasurer as custodian of assets. This is an approach that is consistent with other Public Funds who are active participants in securities lending.

I also included the Callan Research on Survey of Seclending Programs and the Research – Ask the Expert on Securities Lending Mechanics Revisited. I also included the Operational Due Diligence Paper I showed yesterday to the group and wanted to share the SEC Amendment to the Custody Rule where investment managers and brokers have to have a distinct custodian of assets for commingled funds, collective trusts, etc. You can share this with everybody at the meeting so that we are all on the same page.

BO

Callan

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Operational Due Diligence

The Underbelly of Hedge Fund Research

- Hedge fund operational due diligence (ODD) is often viewed as mundane and complex, but recent market and industry events have put a spotlight on this integral part of hedge fund due diligence.
- Multiple front-page headline hedge fund fraud cases and new financial regulations have led to dramatic improvements in hedge fund ODD over the past several years. The industry has stepped up risk management in order to avoid a repeat of the crisis of confidence witnessed in 2008, and the boundary between hedge funds' protection of trade secrets and investors' need for transparency is being redefined.
- It is essential for investors to understand and examine the roles and relationships between the major actors in the hedge fund operational structure: the prime broker/custodian, administrator, auditing/accounting and legal, and risk management systems.
- ODD has evolved beyond a simple checklist to a comprehensive, ongoing process that should permeate all aspects of a hedge fund's operations.

Introduction

Let's face it—no one wanted to talk about operational due diligence (ODD) before. It involves the more mundane, generally unsexy, side of hedge fund investments. With ODD, lawyers, accountants, custodians and administrators interact with investors to explore the minutia of financial operations. Investors often skim through the numerous and tedious issues that pertain to ODD. When they do find something concerning, it just means additional work with no apparent upside. Furthermore, any potential operational issues may or may not result in actual loss of money, for there are various shades of gray in ODD risk. But make no mistake—ODD has become an integral part of hedge fund due diligence.

Authored by Callan Associates Inc.

If you have any questions or comments, please email institute@callan.com.

About Callan Associates

Founded in 1973, Callan Associates Inc. is one of the largest independently owned investment consulting firms in the country. Headquartered in San Francisco, Calif., the firm provides research, education, decision support and advice to a broad array of institutional investors through four distinct lines of business: Fund Sponsor Consulting, Independent Adviser Group, Institutional Consulting Group and the Trust Advisory Group. Callan employs more than 150 people and maintains four regional offices located in Denver, Chicago, Atlanta and Florham Park, N.J.

About the Callan Investments Institute

The Callan Investments Institute, established in 1980, is a source of continuing education for those in the institutional investment community. The Institute conducts conferences and workshops and provides published research, surveys and newsletters. The Institute strives to present the most timely and relevant research and education available so our clients and our associates stay abreast of important trends in the investments industry.

Previously, investors were acquiescent about ODD, having grown accustomed to the regulatory-confined paradigm of the mutual fund industry. Concerns such as liquidity, leverage and counterparty risk were moot issues given regulations for leverage, reporting, manager/fund registration, and the industry's existing operational framework of global custodians and administrators. The 2008 credit crisis created a watershed moment for ODD and the hedge fund industry. It provided the litmus test that compared investors, whether fund-of-funds (FoF) managers or direct investors, who preached disciplined ODD to those who actually practiced it. Obviously, headline hedge fund fraud stories (e.g., Madoff, Bayou,

Amaranth, take your pick) have placed a massive spotlight on the issue. Some industry veterans who knew of the now obvious operational issues that hedge funds faced turned a blind eye to these problems. Given this newfound awareness, ODD has dramatically improved over the past several years. Investors immediately realized hedge fund research involved more than just simply looking at the investment strategy of a manager. What originally started as "cocktail due diligence" among ultra-high net worth investors has evolved into an integral branch of hedge fund research. This white paper examines the various facets of hedge fund ODD and provides a general overview of the new and ongoing efforts in the space.

Hedge Fund Operational Structure

The operational structure of hedge funds is divided into four parts: prime broker/custodian, administrator, auditing/accounting and legal, and risk management systems. As illustrated in **Exhibit 1**, each

part is connected to the others and to the hedge fund. ODD research analysts have placed more scrutiny on the operations of each of the parts as they relate to each other and to the hedge fund.

Exhibit 1 The Operational Structure of Hedge Funds

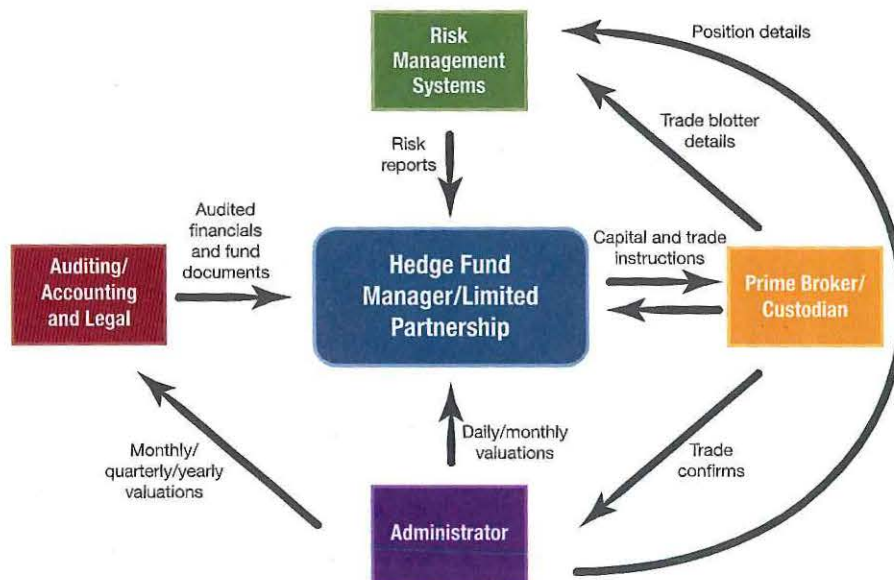
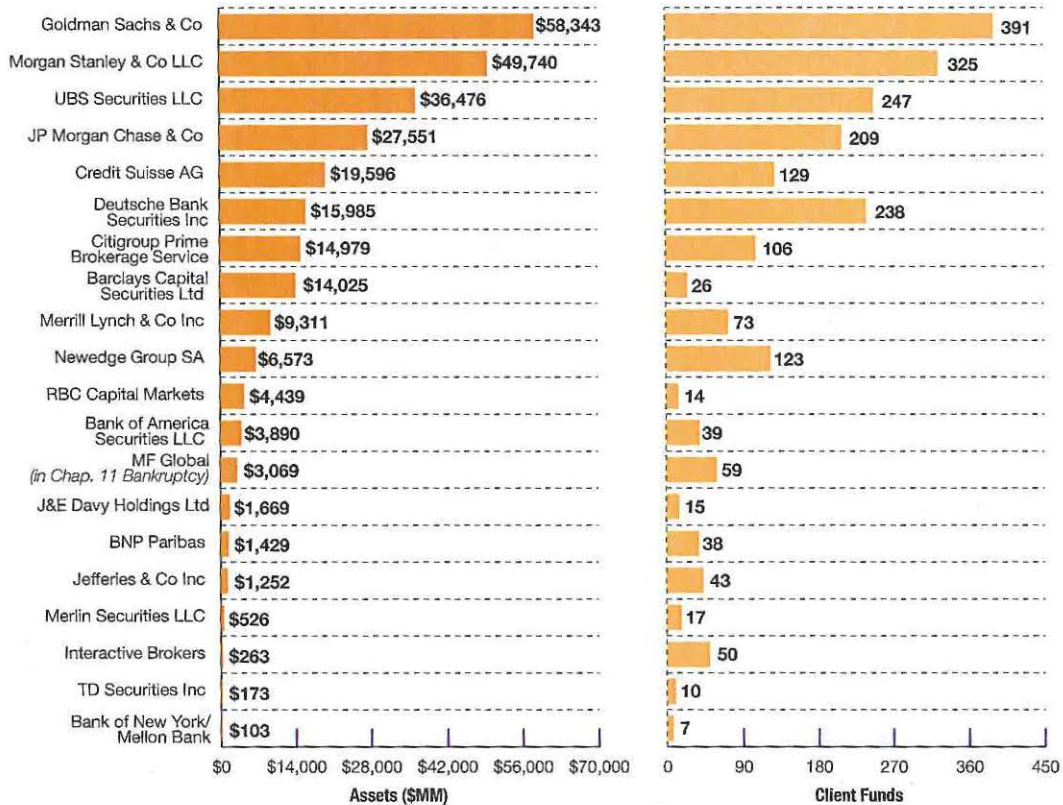


Exhibit 2 20 Largest Hedge Fund Prime Brokers as of 9/13/2011



Prime Broker/Custodian

Generally, a hedge fund's prime broker (PB) is also its custodian. Consequently, all underlying hedge fund assets, except unencumbered cash, typically reside with the PB. This structure is different from that of traditional institutional investments like equity and fixed income, which are typically held with the investor's global custodian (e.g., State Street, Bank of New York, etc.) through either a commingled or separate account vehicle. Investors are able to see these investments at all times in their unified custodial accounts. For hedge funds, the underlying assets are held with the PB and not with the global custodian. The hedge fund's administrator is responsible for providing valuation

reconciliation and reporting to the investor and/or its global custodian. As such, PBs primarily provide four major services to hedge funds:

- Centralized securities trading and clearing facility
- Global custody
- Securities lending
- Margin financing

Investment banks and traditional broker-dealers typically provide prime brokerage services, given their capabilities to offer a wide range of financial services. See **Exhibit 2** for a list of the 20 largest prime brokers. These banks also provide administrative services, discussed in the next section.

Hedge fund managers primarily work with PBs that can meet the custodial and trading needs of their investment strategy. For instance, global long/short equity managers will look for PBs that have trading operations in multiple international markets and can handle servicing illiquid securities while dealing with local regulatory issues. PBs must also be able to provide robust technology systems with integrated risk management systems (to be addressed later) and process the multitude of transactions that hedge funds are undertaking. Capital introduction—where PBs leverage their business relationships in the financial services industry to help emerging hedge fund managers raise capital—is another ancillary service that PBs can offer.

In addition to custody and trading services, PBs also provide lending and short-selling capabilities, which add complexity to their operations. The addition of leverage allows hedge fund clients to purchase or short additional securities beyond what they own for the purposes of enhancing returns. This increases market exposure for the hedge fund managers and adds additional risk to both parties, as both undertake responsibility in maintaining the borrowed positions. Operationally, PBs commingle all client securities available for lending

into one unified account, called their “box.” Securities in the box can then be lent to other clients and to other broker-dealers for borrowing and/or short-selling. For hedge fund clients who wish to short a certain stock, PBs must search their box for shares to lend. If none can be located, they go to the street to find any other broker-dealers that have an available position in that stock.

Performing due diligence on PBs is difficult, to say the least. Given their extensive structure in capital markets trading and securities lending, a primary risk to hedge funds is the PB’s solvency, especially during periods of financial market duress. It is questionable whether proper ODD could have foreseen the demise of Bear Stearns, Lehman Brothers and most recently MF Global. Because hedge funds are certainly cautious of the risks PBs may pose, they diversify their holdings across multiple PBs and segregate cash assets to non-PB custodians. Ultimately, the ability to provide liquidity to clients rests on the PB’s risk management and overall credit-worthiness.

Administrator

Hedge funds utilize third-party administrators to help sort through their investment holdings.

HEDGE FUND UNCERTAINTY DURING LEHMAN’S DEMISE

Hedge funds that held their assets with Lehman Brothers during its downfall faced a grave uncertainty over whether they could access and liquidate their accounts. Lehman’s prime brokerage unit had lent the majority of their “box” (all client securities available for lending under one unified account) shares to other clients and to other broker-dealers multiple times over, making it extremely difficult to track where actual positions resided. Furthermore, some hedge funds entered into private, over-the-counter derivative transactions with Lehman as their counterparty. The payout on any profitable contract depended solely on Lehman’s solvency.

The typical services that administrators provide include:

- Trade settlement and PB reconciliation
- General fund accounting
- Net asset value calculations/fund valuation
- Preparation of monthly/annual reports

These services require the administrator to act independently within the hedge fund operational structure. **Exhibit 3** provides a list of 20 major fund administrators.

Valuation services, in particular, have been a major focal point of ODD in recent years. Heavy scrutiny

has been given to the valuation of illiquid assets that have thinly traded markets or are privately placed. Administrators have assumed much of a hedge fund's valuation responsibilities that demand valid third-party pricing and/or provide a valid structure and procedure for price determination. Given the greater function, administrators have beefed up their capabilities over the past several years. Previously, much of their pricing and valuation operations were spreadsheet-driven manual work. Administrators now have invested in technology to better handle large quantities of trade data from hedge fund clients and to directly link their systems to data providers.

Exhibit 3 20 Largest Hedge Fund Administrators as of 9/13/2011

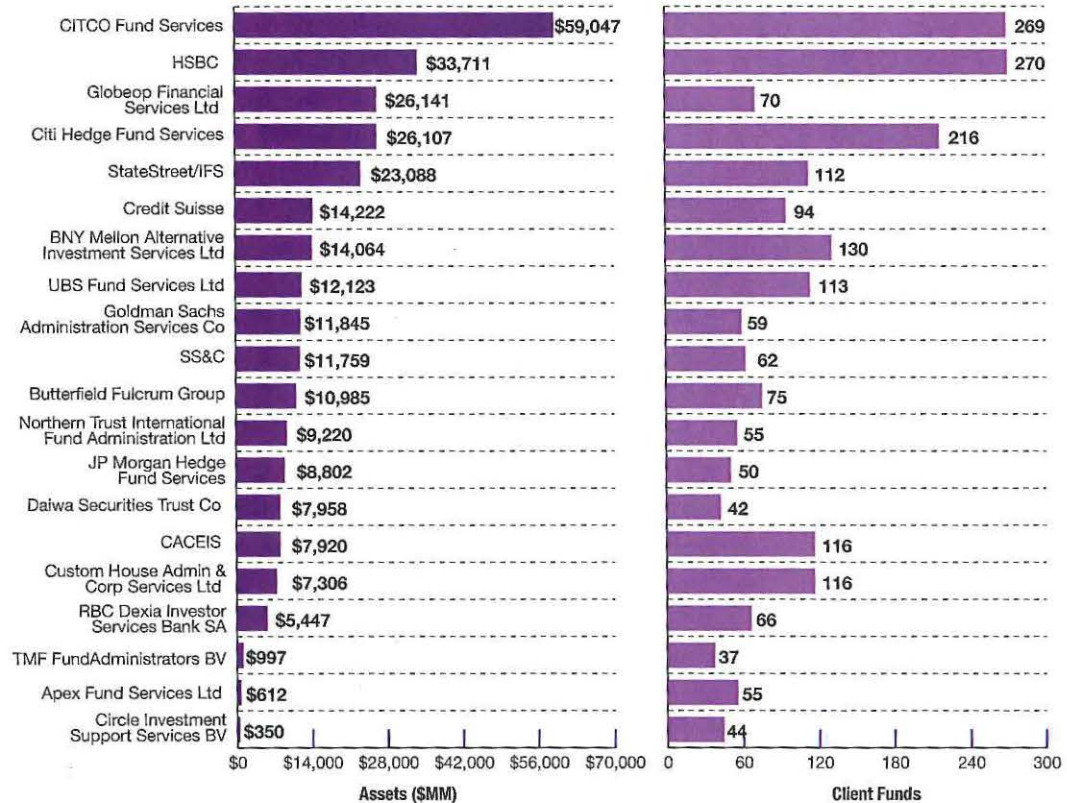
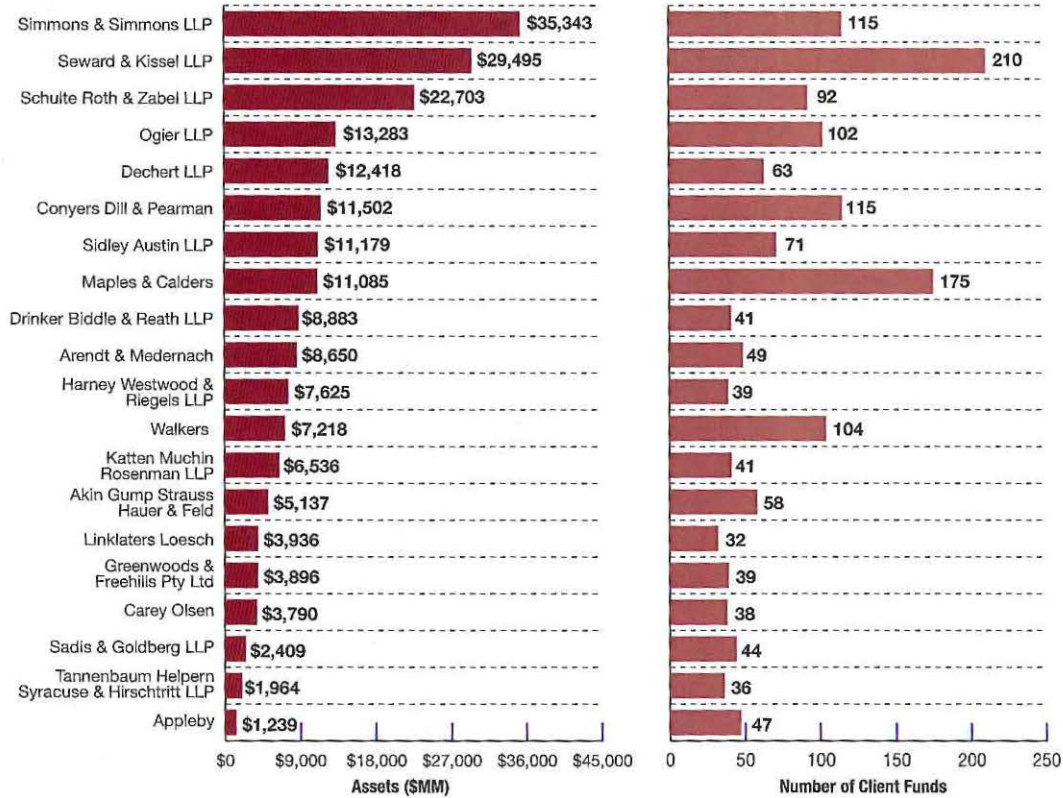


Exhibit 4 20 Largest Hedge Fund Law Firms as of 9/13/2011



As indicated in Exhibit 1, the administrator holds an integral relationship with all parties in a hedge fund's operations. The administrator must have a direct connection to a fund's PB and be able to access their trade information independently in order to provide reporting back to the manager and its accountant for proper auditing. Given the integral connections the administrator holds in a hedge fund's operational structure, unbiased and accurate reporting must be maintained throughout its process. Understandably, the potential risk of fraud exists, and investors must be mindful to scrutinize these various relationships.

Auditing, Accounting and Legal

All businesses require auditing and accounting services—hedge funds are no exception. Hedge funds and FoFs also have dedicated groups of lawyers and operational specialists to handle the various facets of due diligence, new regulations and fund structuring. Exhibit 4 lists the 20 largest hedge fund law firms.

These law firms devote their efforts to reviewing regulatory filings and creating and augmenting fund documents to serve their clients, among

other tasks. Additionally, these legal groups must interact with fund custodians, administrators and auditors to maintain regulatory compliance and protect against any fraudulent, money laundering and inside trading activities.

With auditing and accounting, the added wrinkle for hedge funds is the complexity of their transactions (e.g., OTC derivatives, short-selling, etc.) Typically, most well-established hedge funds have chosen one of the four major accounting firms (i.e., PricewaterhouseCoopers, Deloitte, KPMG, Ernst & Young) that are most familiar with these

transactions, to provide brand-name auditing services.

Focus on ODD auditing/accounting has certainly increased given the Madoff scandal. Madoff had employed a three-person accounting firm—Friedling & Horowitz, located in a New York suburban strip mall—to “rubber stamp” his firm’s financials. Much like custodial relationships, auditors should have a direct link to data and information provided by the fund’s third-party administrator to ensure independent verification of their books.

Risk Management Systems

As recently as 2006, hedge fund due diligence mostly relied on manager interviews and office visits. Hedge fund managers were extremely resistant to provide any type of transparency to potential and existing investors; they argued that it would compromise their competitive edge and trade secrets. However, investors have demanded more risk management since 2008, which forced managers to reverse their staunch opposition to transparency.

Given the shifting emphasis on risk management, hedge funds have increased their efforts in putting together unified risk systems to help them articulate the unique risks of their funds. Managers have developed or revised internal processes and operational frameworks to better monitor ongoing risk on process and exposure levels. They have developed proprietary systems that provide at-the-moment risk reports highlighting current portfolio exposures. Risk management is not simply a reporting system, but also an ongoing process in which all parties actively participate in evaluating their investments. As part of the new emphasis on

HEDGE FUND FRAUD: THE CASE OF MADOFF

One of the most egregious examples of outright fraud within the administrator structure is Bernard Madoff. Bernard L. Madoff Securities LLC was both the broker-dealer/PB and administrator of its own investments. Because Madoff controlled both the trading and reporting, he circumvented any type of third-party verification that confirmed counterparty settlements. Concerns of self-administration have also drawn attention to other hedge fund managers, such as Citadel LLC. While not illegal, Citadel self-administered its funds since its inception, advocating that it did a better job than other third-party entities. However, this attracted unwanted scrutiny to its hedge fund operations in light of the 2008 market blowup. To placate concerns, it decided to sell its administration business to Northern Trust this past summer.¹

¹ Market Watch. “Northern Trust Completes Acquisition of Omnium from Citadel.” July 29, 2011. <http://www.marketwatch.com/story/northern-trust-completes-acquisition-of-omnium-from-citadel-2011-07-29>

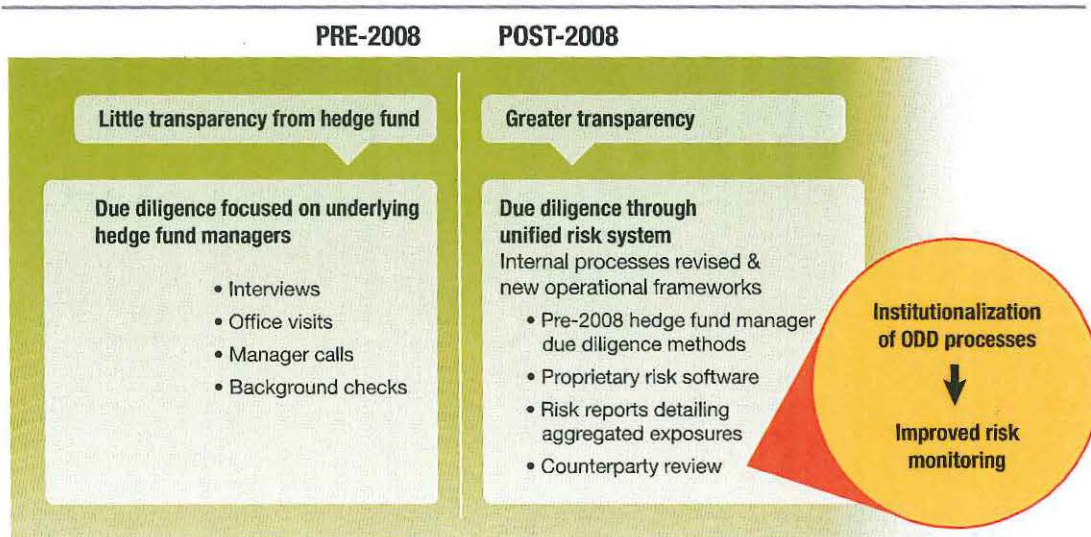
risk management, advancements in risk management systems have had a considerable impact on ODD and the hedge fund industry.

Currently, risk management systems can provide individual hedge fund managers with analytical risk exposures by accessing the raw trade blotter data and/or position-level holdings from the manager's PB or fund administrator. The data is then input into a variety of risk factor models based on market and economic trends, yielding a number of different queries and drop-down reports for users to view. These reports include standard value-at-risk (VAR) reports, leverage reports, gross and net exposures, and sensitivity analysis to various macroeconomic/asset class shocks, along with the ability to build custom ad-hoc reporting. Effectively, these systems allow hedge funds and other users to digest large amounts of trade data to yield relevant risk management reports and research.

In addition to risk management, the level of information these systems provide has changed the way some FoFs manage portfolios. Previously, FoFs based their portfolio construction largely on interviews and anecdotal reports from individual managers. Now FoFs require risk reports from individual funds to have the ability to aggregate individual exposures into combined portfolio exposures. It is important to note that the FoFs may receive exposure reports delayed by one to three months from individual managers. Notwithstanding some delayed data points, these systems afford FoFs the ability to further customize their core and tactical portfolio allocations based on quantitative data and to have better control of their systematic exposures.

Despite the call for more transparency, hedge funds still require degrees of limited visibility to protect their investment edge. The structure of risk management systems may provide this balance. Position-level data of a hedge fund usually

Exhibit 5 Risk Management Before and After 2008



THE EVOLUTION OF RISKMETRICS

Two of the most well-known and frequently used risk management systems are RiskMetrics (RM) and Measurisk (MR). Both of these systems share a colorful history. RM was first developed as an internal risk management system in 1989 for JP Morgan when the bank's chairman, Dennis Weatherstone, asked for more risk safeguards. RM expanded to external clients and catered to hedge fund clientele, specifically long/short equity and global macro funds. Due to its overall market demand and growth, JP Morgan decided to spin off the group in June 2008 as a separate company that was then acquired by MSCI in June 2010.

Bear Stearns had previously acquired MR as its proprietary risk system. While MR also catered to hedge fund clientele, it focused on helping institutional clients manage portfolio risk. When Bear Stearns collapsed in March 2008, JP Morgan consequently acquired Bear Stearns's assets, including MR. In 2010, MSCI purchased RM shortly before it also acquired MR from JP Morgan, thereby merging two of the largest risk aggregation systems in the hedge fund industry under one corporate umbrella.

Given the popular use of RM software among FoFs and investors, it has become somewhat of the de facto standard of hedge fund risk management systems. This has resulted in capacity issues, or growing pains, as RM faces the routine tasks of "onboarding" new managers that want to use their platform while integrating the MR acquisition.

comes from a fund's custodian/administrator, providing investors greater confidence in the validity of data. Risk management systems roll up the raw financial data to provide exposure-level reports, thereby masking the actual underlying positions, unless specifically permitted by the individual manager. This format of aggregated exposures allows hedge funds to maintain confidentiality with the flexibility to implement their trades discretely.

Risk management systems are not without drawbacks. Perhaps the biggest criticism lodged by hedge fund managers is the treatment of illiquid securities. The factor models depend on accurate data from liquid markets for their calculations. Given the lack of volume and precise valuation for il-

liquid assets, it is challenging to ascertain the correct risk factors. These factor models also focus more on macro-systematic variables within assets, and consequently they face difficulties in trying to analyze assets with idiosyncratic variables (e.g., bonds with unique covenants or bonds where their risk of default is based on specific capital structure arrangements). These systems operate well with hedge fund strategies that trade in liquid public markets, such as long/short equity, managed futures and global macro, but struggle with illiquid strategies such as distressed, capital structure arbitrage and other credit-oriented strategies.

As risk management systems continue to grow and expand in capabilities, investors have also

asked for standardization and reporting consistency within the industry. Hedge funds are actively engaging risk management systems for risk management services to help funds become more marketable to investors.

As an alternative to large scale risk management systems, such as RM/MR, an industry working group called OPERA (Open Protocol Enabling Risk Aggregation) is looking to provide “standardized

reporting procedures for collection, collation and conveying hedge fund risk information” across the hedge fund industry.² Early supporters who are part of the OPERA Working Group include Albourne Partners, Och-Ziff, Utah Retirement Systems, CITCO and Thomson Reuters. Interestingly, while RiskMetrics is not part of the group, they have begun formatting some of their risk reports to fit the OPERA protocol template.

Legal and Regulatory Changes

Hedge funds have ramped up their legal expertise during the past three years due to massive changes in the regulatory landscape of the hedge fund industry. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), passed in 2009, has had the greatest impact. Hedge fund managers must now register with the Securities and Exchange Commission (SEC), according to the updated Investment Advisers Act of 1940, and report their firm information and overall assets under management. Previously, hedge funds were notoriously secretive about their inner workings and investments. Dodd-Frank forces all relevant managers to disclose their organizations to the government and the public eye.

Already, these regulatory changes have impacted some of the world’s largest hedge fund managers. In July 2011, George Soros said he was converting his investment firm, Soros Fund Management LLC, to a family office and was returning capital to its remaining outside investors, so he may manage his own money privately and avoid the reporting

requirements of Dodd-Frank.³ Stanley Druckenmiller, Soros’s former chief strategist who started and ran Duquesne Capital Management LLC, also converted his investment company into a family office for the same reason.

Another massive impact of Dodd-Frank has been the passing of the Volcker Rule, which basically limits commercial banks from engaging in proprietary trading activities. It also constrains these banks from owning or investing in hedge funds or private equity. Specifically, the rule aims to prevent banks from redeploying capital from deposits into more risky trading activities. This has raised many concerns for hedge funds that are sponsored by, or have received significant capital from, commercial banks. Additionally, proprietary trading is a vital service within the hedge fund industry and the deletion of some of the largest capital market trading desks could greatly impact the entire industry. The dust has yet to settle on this rule, but it clearly raises more questions than answers for ODD.

2 Open Protocol Enabling Risk Aggregation, 2011.

<http://www.theopenprotocol.org/theproject.jsessionid=04B1C440B4761EA80DAAE4F1CFC84F46>

3 Burton, Katherine. “Soros to End Four-Decade Hedge-Fund Career.” Bloomberg News. July 26, 2011. <http://www.bloomberg.com/news/2011-07-26/soros-to-end-four-decades-as-hedge-fund-leader-by-returning-investor-cash.html>

Dodd-Frank also changed the definition of the Accredited Investor test and the requirements for individuals to invest in private placements. The test stipulates that qualified investors must meet an average minimum net worth of \$1 million over the most recent two-year period, excluding their primary residence, before they can invest in private placements. Any hedge funds or FoFs that market to high net worth individuals must reevaluate their investor base and remove prospective investors who do not meet this test.

Dodd-Frank is not the only material regulatory change to impact hedge funds. The amended Custody Rule of 2010, under the Investment Advisers Act of 1940, also created additional operational requirements for hedge funds. Hedge funds must now have independent, qualified custodians and PBs. This has placed additional operational strains on some to become compliant or be subjected to random, “surprise” inspections by third-party auditing firms on a regular basis.⁴ The Custody Rule also requires hedge funds to document any potential conflicts of interest. It asks that hedge funds provide SAS (Statement on Auditing Standards) 70 Type II reports, which are generally produced by fund administrators and legal teams to document and review internal fund controls. Hedge funds must undergo an annual audit to review operational protocols and processes and disclose any internal conflicts of interests.

Hedge funds and FoFs must navigate through the recent regulatory changes while also dealing with the legal complexities of fund structuring. For instance, the taxable versus non-taxable status of investment vehicles determines whether or not

tax-exempt organizations (e.g., pension funds, endowments) and qualified investment accounts (e.g., IRAs) can invest in hedge funds. This mainly concerns the unrelated business taxable income that hedge funds can potentially generate through their use of leverage. Hedge funds and FoFs must mitigate this issue by creating offshore investment vehicles to shield against these tax concerns.

Some hedge fund managers also create multiple fund classes to accept both institutional and retail investors. This is often accomplished by a master-feeder fund structure, where each feeder class is devoted to a client segment and invests into the fund’s master portfolio. For instance, a retail feeder might have the ability to pay out commissions and trailer fees to distributing broker relationships, whereas the institutional feeder will not have any fees. Managers may also want the ability to set up completely separate fund vehicles for institutional clients who require more investment customization, control and flexibility. This is necessary for institutional clients looking for fund-of-one solutions or separately managed account structures.

A **hedge fund-of-one** is a customized hedge fund-of-funds with only one limited partner investor. The fund is professionally managed by a fund manager, but its investment objectives are tailored to fit the investor’s needs. Investors have the opportunity to define and better control fund operational issues such as liquidity, transparency, leverage, etc., through the fund-of-one. Typically, FoFs require a minimum investment of \$100 million in order to implement this type of structure.

⁴ Securities and Exchange Commission. “Custody of Funds or Securities of Clients by Investment Advisers.” Release No. IA-2968. December 2009. <http://www.sec.gov/rules/final/2009/ia-2968.pdf>

Best Practices

ODD has evolved beyond a simple checklist to a comprehensive, ongoing process that should permeate all aspects of a hedge fund's operations. Most important to ODD are not the myriad operational intricacies that this white paper briefly covers, but the overall investigative thought process. Bo Abesamis, Executive Vice President of the Trust, Global Custody and Securities Lending Group at Callan, advocates the SPIT process: Sniff, Pursue, Interrogate and Test. Each of the four major parts of ODD should be examined not only for verification purposes, but more thoroughly for their relationship to the hedge fund and effects on each other. Investors should take a "trust but verify" approach when implementing ODD.

FoFs now devote large amounts of money and resources to ODD in addition to their efforts in investment due diligence. Typically, ODD teams are comprised of lawyers, accountants and other

non-investment personnel to handle the myriad operational risks. In fact, most FoFs have ODD individuals or teams as part of their core investment research group. The ODD staff often has absolute veto power in fund investment decisions.

Several companies also devote their core business to providing ODD services for investors, including FoFs. One of these firms, Castle Hall Alternatives, caters to both institutional investors and FoFs for their ODD needs. Given the enormous task of ODD, institutional investors that want to invest directly in hedge funds have also partnered directly with FoFs to outsource their ODD needs. With these strategic advisory relationships, investors can leverage the FoF's infrastructure, resources and experience. In addition, FoFs often provide education and assistance so that investors may complete their own ODD.

Conclusion

The advancement in ODD since 2008 is impressive. The investment industry is now better equipped to filter through the variety of operational risks that hedge funds pose. In a sense, ODD has undergone an "institutionalization" in terms of processes, regulations and practice. What is important to note is that ODD today is not simply researching the underlying hedge fund manager—it also requires an examination of the operational entities (i.e., prime broker/custodian,

administrator, auditing/accounting and legal, and risk management systems) that are connected to the hedge fund. Each of these relationships should remain unbiased and independent in order to properly serve investors. Hedge fund managers will continue to draw a line between transparency and their trade secrets. However, the need for better risk management in order to avoid another crisis of confidence, like that of 2008, is redefining this boundary.

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CALLAN INVESTMENTS INSTITUTE

2009 SECURITIES LENDING SURVEY

U.S. TAX-EXEMPT INSTITUTIONAL INVESTORS

JUNE 2009

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Executive Summary

Securities lending virtually ground to a halt in 2008 as a result of the deepening credit crisis and extreme market volatility that swept over capital markets violently stirred by Lehman Brothers' bankruptcy last September. The vast majority of institutional investors who participate in securities lending, either through stand-alone programs or collective trusts, have been impacted by the credit crunch.

Callan Associates conducted a survey of fund and plan sponsors in May 2009 to report on securities lending practices and trends in the midst of this market turmoil. More than 70 organizations participated in our Securities Lending Survey for U.S. Tax-Exempt Institutional Investors, providing detailed information on their securities lending programs, current practices and program issues. Collectively these organizations represent approximately \$1 trillion in assets.

The key objectives of the survey are to:

- ▶ Understand the shared experience and collective pulse of institutional tax-exempt investors and the current state of their securities lending programs—whether direct (custody or third party lending) or indirect (index funds, target date funds, commingled funds, mutual funds, etc.);
- ▶ Formulate best practice information in programs going forward, including policies and guidelines;
- ▶ Examine all options currently utilized to unwind, exit or manage down securities lending programs; and
- ▶ Utilize the survey results to develop solutions and achieve meaningful dialogue within the securities lending industry.

Securities Lending Trends

Securities lending cash collateral reinvestment losses (realized and unrealized) are prevalent across all fund and plan types and sizes. This has impacted the risk profile of programs, created confusion on redemption/exit strategy issues and resulted in liquidity and rebalancing quandaries.

Patience and thoughtful consideration of risk management are key ingredients in getting through the crisis. Fund and plan sponsors are going through cautious, controlled withdrawals (or unwinds) of securities lending programs with the objective of not triggering unrealized losses into realized, and at the same time transforming legacy programs to have lower risk profiles.

Fund and plan sponsors are reviewing their investment policies and guidelines with a clear resolve to manage risk, understand the attribution of earnings, tighten compliance, seek better transparency and disclosure, and strengthen accountability.

Intrinsic value lending will be a core focus going forward. The back to basics mentality places demand spreads, as opposed to reinvestment spreads, as the anchor to any lending program.



Executive Summary (continued)

Key findings of the survey include:

- ▶ More than half of respondent firms participate in securities lending both directly, through a custodian or third party lender, and indirectly, through a collective vehicle that uses securities lending. One-third participate in direct lending exclusively, while approximately one out of 10 participate indirectly only.
- ▶ The vast majority of funds indicate they have an intermediate to advanced level of understanding of securities lending. Funds that indicate a basic level of knowledge of securities lending are split between small and mid-sized funds.
- ▶ Securities lending income is most often utilized to offset costs including custody and investment management fees, and/or internal administration costs. By contrast, one-fifth of participants use securities lending income to enhance performance. Remaining firms utilize income to both offset costs and enhance performance.
- ▶ Four out of five securities lending participants do not formally benchmark either their lending activity or the reinvestment of the cash collateral. Respondents that benchmark their programs generally use a “soft” benchmarking process involving peer group comparisons.
- ▶ Cash collateral reinvestment losses—both realized and unrealized—ranked as the leading issue or concern among survey respondents relating to their securities lending programs. Disclosure regarding the risk profile and program structure, along with redemption issues and exit strategies, also ranked highly as relevant concerns or issues. Only 14% of respondent firms with securities lending expressed no issues or concerns with their programs.
- ▶ More than half of respondent firms with securities lending indicate they are contemplating changes to their securities lending program. Nearly one-quarter of respondent firms indicate they might terminate their securities lending program. Across respondent firms that are considering program changes, the most common anticipated change is fine-tuning cash collateral reinvestment guidelines, including weighing the merits of the vehicle structure for the cash collateral reinvestment.
- ▶ Nearly half of respondent firms with securities lending programs indicate they are going through a “work out” (controlled unwind)—or managing down to a more controlled level—the securities lending program and the cash collateral pool. Most often the fund or plan sponsor is utilizing the current custodian or securities lending provider for the work out.

Executive Summary (continued)

Key findings (continued):

- ▶ Controlled withdrawal is the most common strategy used within work out solutions across respondent firms. Those using this strategy indicate they are doing so for rebalancing purposes, to raise cash for liquidity and to lower the fund's risk profile. Most respondent firms believe the controlled unwind will take one to three years to complete.
- ▶ The majority of survey participants do not intend to restrict allowable lending at the security, sector/industry, portfolio, asset class or total fund levels.
- ▶ Overnight investment—repo and Treasury only—is the most commonly used guideline by survey participants specific to their cash collateral investments. Most respondent firms use their custodian or securities lending provider to manage the cash collateral specific to the guidelines, as opposed to using a third party cash or short fixed income manager or managing the cash collateral internally.
- ▶ When asked about the likelihood of implementing certain intrinsic value-oriented approaches in designing a securities lending program from scratch, respondents reveal a slightly higher level of interest in demand and general collateral lending spreads, but only with full repo and cash reinvestment risk indemnifications provided.

Methodology and Organization of Findings

In May 2009, Callan conducted a survey of fund and plan sponsor organizations regarding securities lending practices and trends. Responses were supplemented by follow-up discussions with participants and Callan's experience to yield the results reported in this document. This report is organized into 12 areas.

ORGANIZATION OF FINDINGS

- ▶ **Survey Respondent Profile**
- ▶ **Securities Lending Participation**
- ▶ **Securities Lending Program Profiles**
- ▶ **Top Securities Lending Issues and Concerns**
- ▶ **Expected Changes and Future Considerations**
- ▶ **Securities Lending Controlled Unwinds**
- ▶ **Caps on Lending Activity**
- ▶ **Cash Collateral Reinvestment Guidelines**
- ▶ **The Ideal Securities Lending Program – Future Trends**
- ▶ **Qualitative Comments Regarding Securities Lending**
- ▶ **Glossary**
- ▶ **Disclaimer**



Survey Respondent Profile

Survey results incorporate responses from 72 institutional investors. By fund type, public funds (42%) and corporate funds (38%) comprise the bulk of respondents. By fund size, just over half the respondents (54%) have fund assets between \$1 and \$9 billion and 19% have fund assets less than \$1 billion. The remaining respondents are split between funds over \$25 billion at 13% of respondents and \$10 to \$24 billion at 14%.

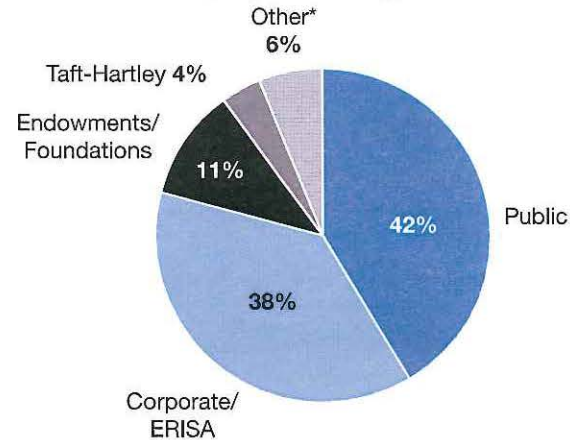
Throughout the survey, fund size is defined as:

- Mega:** larger than \$25 billion;
- Large:** \$10 billion to \$24 billion;
- Mid-sized:** \$1 billion to \$9 billion; and
- Small:** less than \$1 billion.

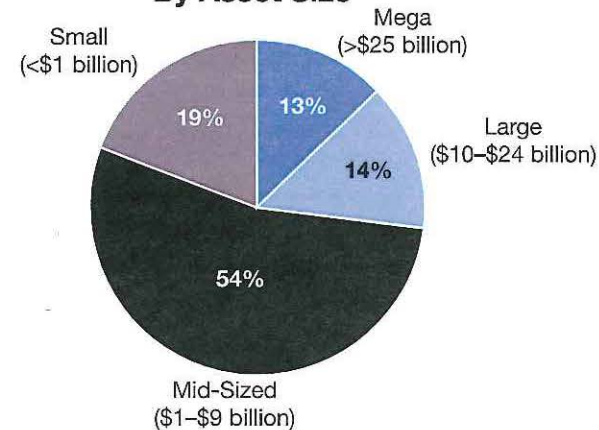
Of the 72 respondent firms, 32% have defined benefit (DB) plans and 15% have defined contribution (DC) plans (including some firms with both DB and DC plans).

Respondent Profile

By Sponsor Type



By Asset Size



* "Other" includes nonprofit operating and corporate guarantee funds and nuclear decommissioning trusts.
 Note: Numbers may not total 100% due to rounding.

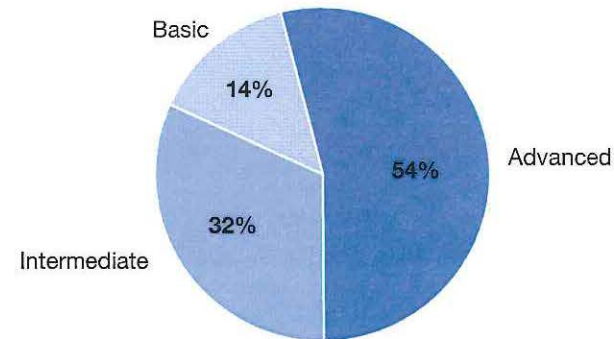
Securities Lending Participation

Across survey respondents, slightly more than half (54%) indicate they have an advanced level of knowledge of securities lending. Approximately one-third (32%) report an intermediate knowledge level of the topic and 14% indicate they have a basic level of understanding.

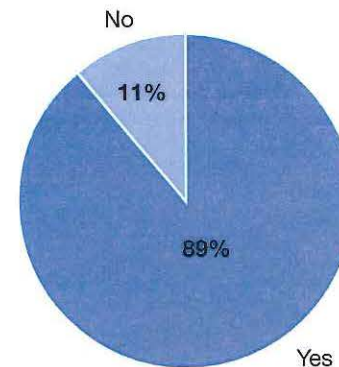
Fund size and level of understanding of securities lending are generally positively correlated: the larger the fund, the more advanced the level of understanding of securities lending. Smaller funds were more likely to report basic or intermediate levels of understanding.

Nearly nine out of 10 respondent firms (89%) participate in securities lending. Respondents that do not participate in securities lending are generally smaller funds, most citing perceived risk as the reason they do not participate in securities lending. One-quarter of these funds previously participated in securities lending but terminated their programs in 2008. Approximately two-thirds (63%) of these funds do not plan to participate in securities lending in the next two years.

Indicate the organization's general level of understanding of securities lending.



Does your fund participate in securities lending?



Note: Numbers may not total 100% due to rounding.

Securities Lending Program Profiles

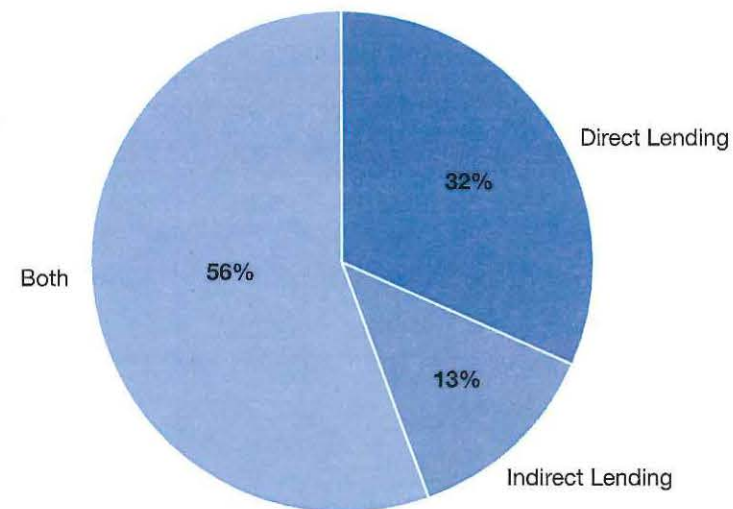
Over half of respondent firms (56%) participate in securities lending both directly through a custodian or third party lender and indirectly through a collective vehicle that employs securities lending. One-third of respondents participate only through direct lending and 13% participate solely through indirect lending. Most funds participating via indirect lending are smaller funds, reflecting their use of collective vehicles and potentially lack of size or resources to implement direct lending. Forty-two percent of small funds and 13% of mid-sized funds participate through indirect lending only.

By fund size, mega and large firm respondents do not participate in indirect lending only, but are more likely to participate in either direct only or a combination of both direct and indirect lending.

The majority (80%) of funds that participate in direct lending use a single provider. Funds using multiple providers utilize between two and four providers.

Across respondent firms, none use a principal (internal) program and only 3% employ an auction-based lending program (hybrid of agent and principal programs).

How does your fund participate in securities lending?



Note: Numbers may not total 100% due to rounding.

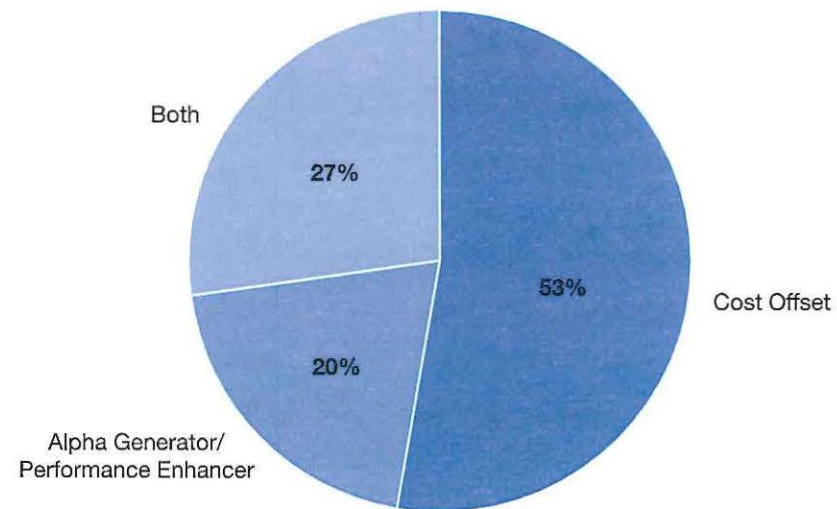
Securities Lending Program Profiles (continued)

Slightly more than half of the respondent firms use securities lending income to offset costs such as custody fees, investment management fees and/or internal administration costs. One out of five plans utilize income for alpha generation or to enhance fund performance. Approximately one-quarter (27%) of respondent firms use income for both purposes.

Close to 80% of respondents do not benchmark their securities lending programs in either utilization (lending activity) or the reinvestment of cash collateral. The rest typically use a "soft" benchmarking process. Soft benchmarking is often done on the lending activity using peer group comparison. Utilization is compared relative to asset class, plan sponsor type, asset size, lending income and intrinsic versus general collateral. Notable comparative measures utilized by respondents are SunGard (Astec), RMA and Performance Explorer.

Such soft benchmarking measures do not adjust for a myriad of issues including: different asset allocation policies and investment structures, active versus passive, equities versus fixed income, separate versus commingled funds, lending restrictions, depth of borrower pool, statutory limitations, regulatory requirements, ERISA versus non-ERISA, collateral restrictions, negotiated revenue splits, etc.

How does your fund utilize securities lending income?



Top Securities Lending Issues and Concerns

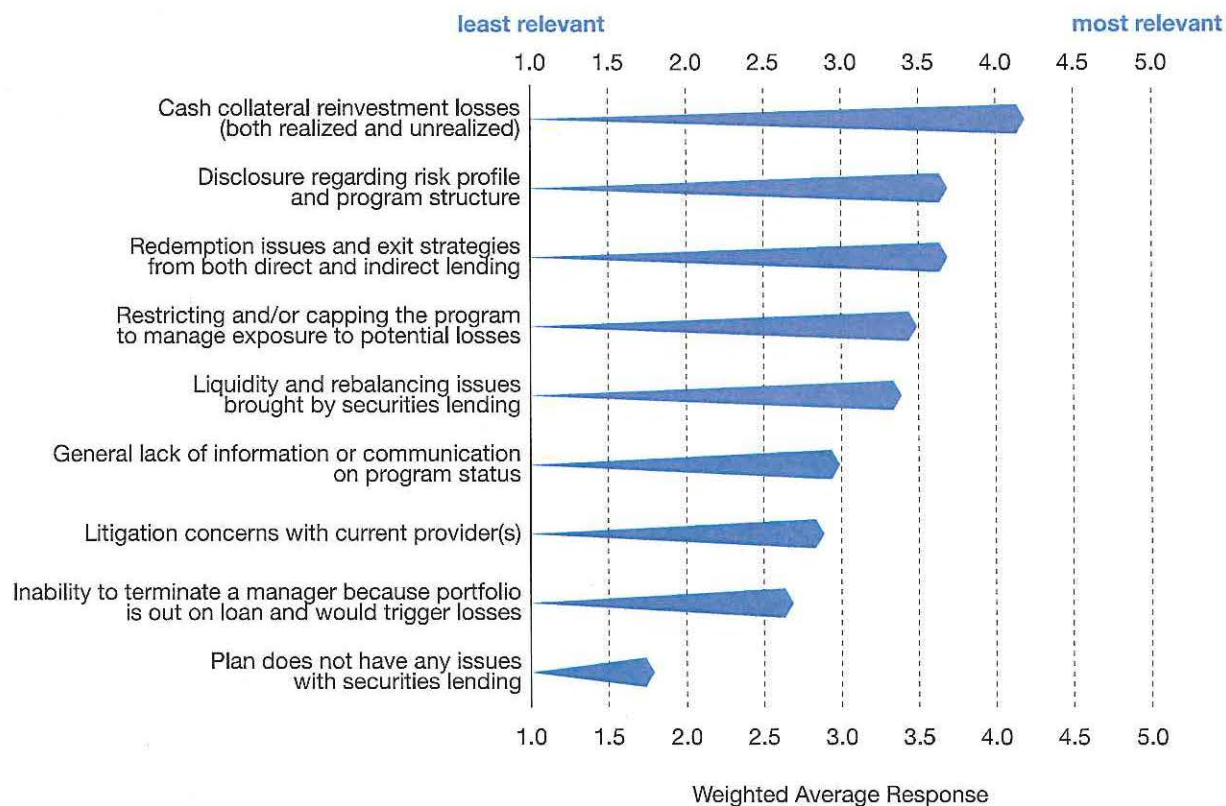
Respondent firms were asked to rank a number of issues or concerns based on relevance to their securities lending program. Few funds (14%)—all under \$9 billion with “advanced” knowledge of securities lending—reported no issues or concerns with their securities lending programs. The small percentage of funds reporting no issues is not surprising given the widespread losses in cash collateral pools experienced by many funds during the second half of 2008.

Cash collateral reinvestment losses—both realized and unrealized—ranked as the greatest area of concern with over three-quarters (76%) of respondents ranking it relevant or very relevant. Disclosure regarding the risk profile and program structure, along with redemption issues and exit strategies (from both direct and indirect lending), also ranked highly as relevant concerns or issues to survey participants.

Conversely, litigation concerns and the inability to terminate a manager because the portfolio was out on loan and would trigger losses were less relevant but still of interest to respondent firms.

By fund type, corporate funds’ greatest concerns related to cash collateral reinvestment losses, redemption issues and exit strategies, restricting and/or capping their programs to manage exposure to potential losses and disclosure regarding risk profile and program structure. By fund size, large and mega funds reported more issues with their securities lending programs, the most relevant being cash collateral reinvestment losses.

Rank the following current issues as they relate to your securities lending program (1= very relevant and 5 = not relevant).



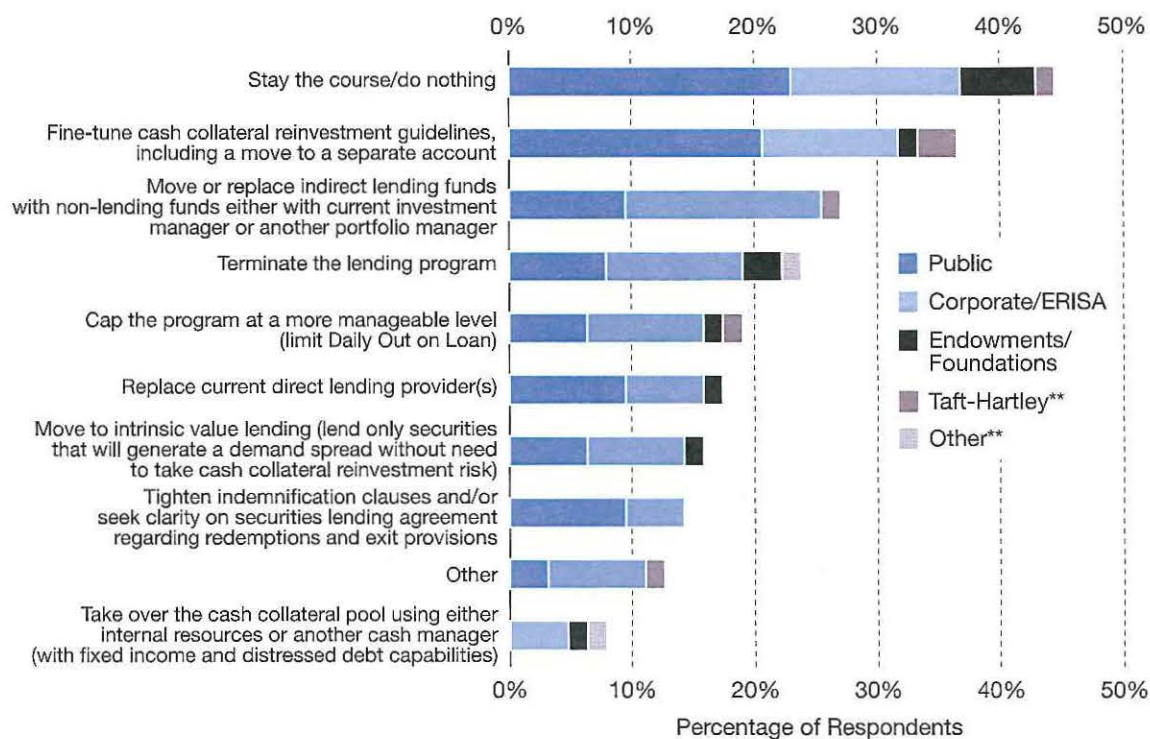
Expected Changes and Future Considerations

Looking ahead, we asked respondents to identify any changes they are contemplating with regard to their securities lending programs. While fewer than half (44%) indicated they might not make any changes to their program, nearly one-quarter (24%) indicated they may terminate their securities lending program.

Across respondents that are considering changes, the most common anticipated change is fine-tuning cash collateral reinvestment guidelines, including weighing the merits of a separate account versus a commingled account structure for cash collateral reinvestment.

More than one-quarter (27%) of participants may move or replace current funds that allow for securities lending with non-lending fund equivalents. Approximately two out of 10 respondents indicate they might cap the program at a more manageable level. Few respondents (8%) indicate they would consider taking over the cash collateral pool internally or through another cash manager. This is because securities lending has an asset/liability component wherein the reinvestment of cash collateral cannot be disengaged from the lending itself. An internal or external cash manager would have to be mindful of the “gap,” which is to say manage asset/liability risk, in addition to managing liquidity, credit and interest rate risks. This could be risky and difficult for those who are not trained on the asset/liability component and requires additional resources.

Indicate any changes you are contemplating with regard to your securities lending program.*



Notable observations by fund size and type include:

- Mega and large funds are most interested in fine-tuning cash collateral reinvestment guidelines at 67% of their respective respondent pools. Mega funds are also more interested in replacing current direct lending provider(s) and moving to intrinsic value lending.
- Mid-sized funds are the least likely to stay the course or to take over the cash collateral pool.
- Sixty percent of small funds indicate they are likely to stay the course. Since they often have indirect-only lending programs within investment manager commingled funds, they have less control over their programs.
- Specific to DC plans, 64% are contemplating moving or replacing indirect lending funds with non-lending funds. For DB plans, close to half (48%) are considering fine-tuning cash collateral reinvestment guidelines.

* Multiple responses were allowed

** Please note small sample size (5 responses).



Securities Lending Controlled Unwinds

Nearly half (48%) of respondent firms indicate they are going through a “work out” (controlled unwind)—or managing down to a more controlled level—their securities lending program and cash collateral pool. While there was little variation to this statistic by fund size, by fund type corporate funds are the most likely to be going through a controlled unwind (67% of respondents) while endowments and foundations are the least likely (22%).

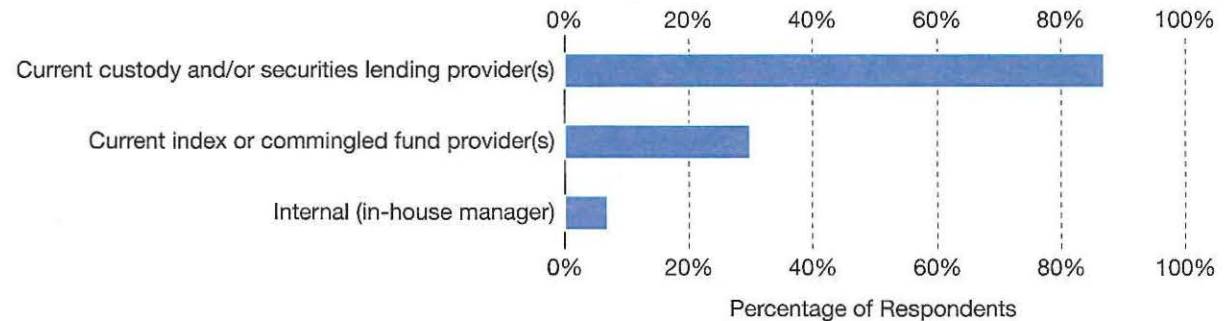
For those who are undergoing a controlled unwind, the majority (87%) indicated that their current custodian and/or securities lending provider(s) is implementing the solution. Thirty percent of all respondents indicated their current index or commingled fund provider would implement the solution, most common among mega funds. Only two firms (7%) responded that in-house resources would implement the solution, one of them with the assistance of both current index/commingled fund providers and custody/securities lending providers.

Work out solutions vary by fund size, type and magnitude of losses, and by exit gates or redemption provisions of the fund.

Are you going through a “work out” (controlled unwind) or managing down to a more controlled level the securities lending program and the cash collateral pool?



If yes, who is implementing the work out solution?*



* Multiple responses were allowed

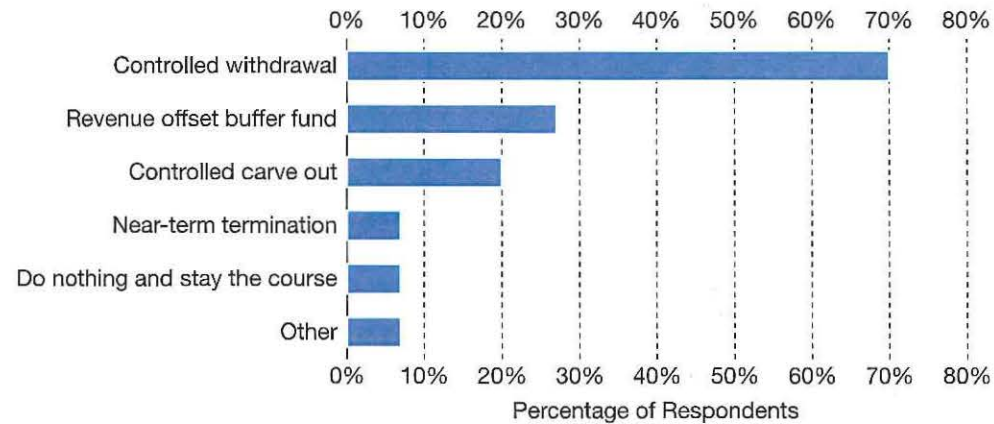
Securities Lending Controlled Unwinds (continued)

Among survey participants, the three most common strategies being used within the work out solution are controlled withdrawals (redemptions without triggering losses) at 70%, revenue offset buffer funds (using securities lending revenue to offset realized losses) at 30% and controlled carve outs (by taking delivery of securities or a corresponding unit of ownership of the collateral pool) at 20%. Follow-up discussions with those using controlled withdrawals reveal they are doing so for rebalancing purposes, to raise cash for liquidity and to lower the fund's risk profile.

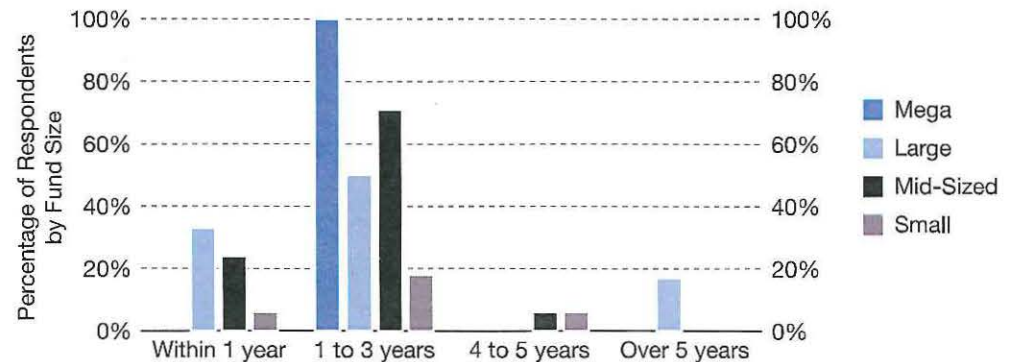
Near-term termination (regardless of potential losses), doing nothing/staying the course and "other" responses are less prevalent at 7% of respondents each. "Other" responses include taking a vertical slice of the commingled collateral and putting it into a separate account.

While nearly one-quarter (23%) of respondents were optimistic that the controlled unwind would occur within a year, the majority (67%) projected it would take one to three years to complete. The remaining 7% and 3% project four to five years and over five years, respectively.

Which of the following strategies are being utilized within the work out solution?*



If so, what is the timeframe for the work out?



* Multiple responses were allowed

Caps on Lending Activity

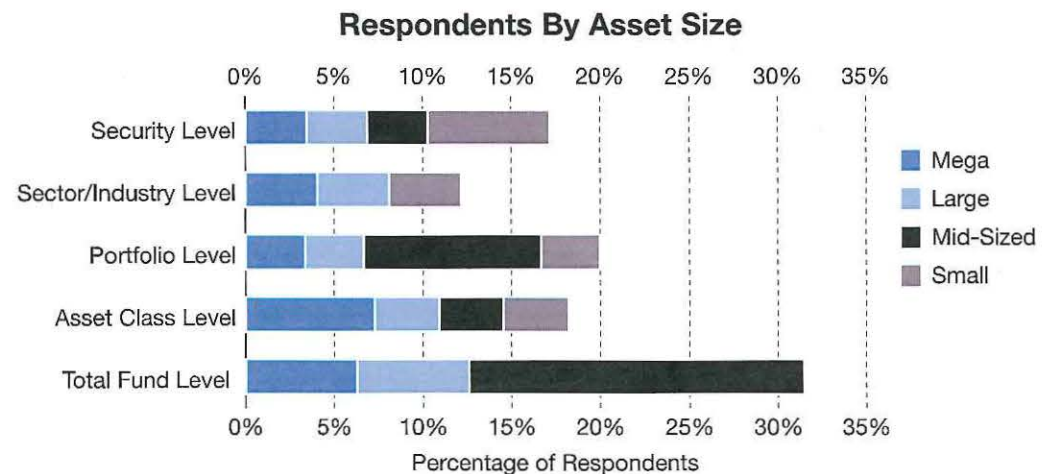
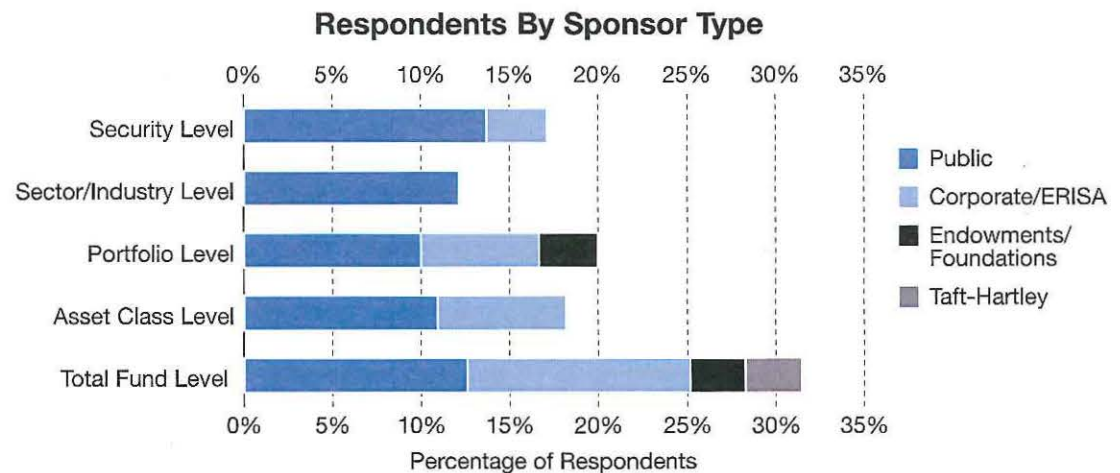
The majority of respondents do not intend to restrict allowable lending at the security, sector/industry, portfolio, asset class or total fund levels. Follow-up conversations with participants reveal that many had not considered caps or restrictions.

Restrictions at the total fund level were most common (over 30%) across funds that intend to restrict allowable lending. Some organizations are restricting lending in some funds and not in others, and look at the individual manager, the mandate and the guidelines before making restriction decisions.

Public funds are more likely to restrict allowable lending at the security and sector/industry levels than other fund types. Fewer corporate/ERISA funds intend to restrict allowable lending at any level than other fund types. Endowments and foundations were most likely to restrict lending at the portfolio, asset class and total fund levels.

While more likely to restrict allowable lending at the security level than other fund sizes, small funds reported the least intent to restrict lending at other levels. On the contrary, mid-sized funds showed the least inclination to restrict at the security level and the strongest intentions to restrict at the total fund level (40% of mid-sized respondents).

Specific to restrictions or caps on lending activity, indicate if you intend to restrict allowable lending in any of the following areas.



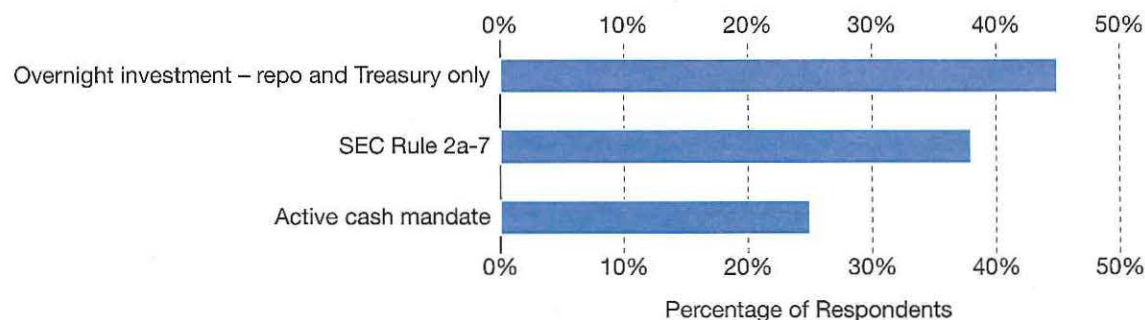
Cash Collateral Reinvestment Guidelines

Specific to cash collateral reinvestments, survey participants were asked which guidelines they intend to use. The top responses were: 1) Overnight investment—repo and Treasury-only with a 1-day duration (45%); 2) SEC Rule 2a-7 (38%), which was most frequently cited among mega funds; and 3) active cash mandate/short duration (25%). Follow-up conversations with participants reveal the SEC Rule 2a-7 guidelines are often used as a maximum risk parameter and that some funds frequently maintain more conservative guidelines.

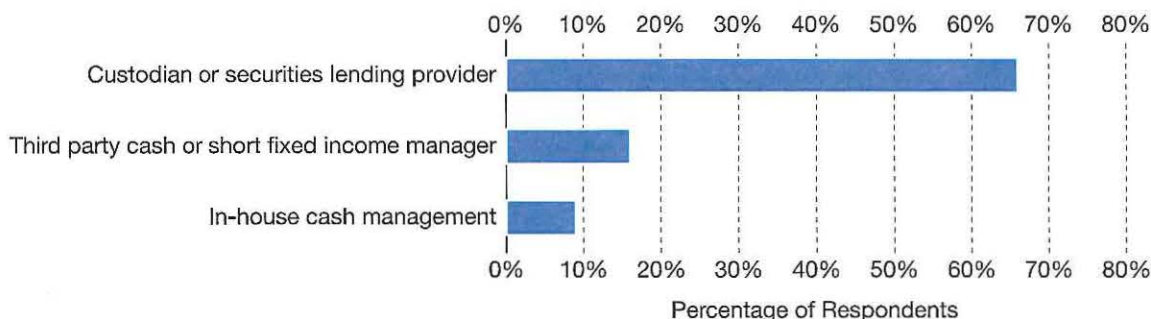
To manage the cash collateral within these guidelines, the majority of respondents (66%) will use their existing custodian or securities lending provider(s); 16% will use a third party cash or short fixed income manager and 9% will use in-house cash management. Most respondents using internal cash management also use a custodian/securities lending provider or third party manager.

By fund type, it is notable that among endowment and foundations one-third reported that the custodian or securities lending provider would manage the cash collateral and one-third reported they would pursue other alternatives, including in-house cash management.

Indicate any of the following guidelines you intend to use specific to cash collateral reinvestments.*



Who will manage the cash collateral specific to the investment guidelines above?*



Notable observations by fund size:

- Mega funds report greater use of custodians or securities lending providers (80%) and in-house cash management (20%) than other fund sizes.
- Large funds also report greater use of custodians or securities lending providers (80%) than smaller funds. Forty percent of large funds will use third party cash or short fixed income managers.
- The use of cash collateral managers is less common among small funds. Among those that do, 36% use custodians or securities lending providers while none of the small respondent firms use third party cash or short fixed income managers to manage the cash collateral.

* Multiple responses were allowed



The Ideal Securities Lending Program – Future Trends

We asked respondents what their likelihood of implementation would be for certain intrinsic value-oriented approaches if they were to design a program from scratch.

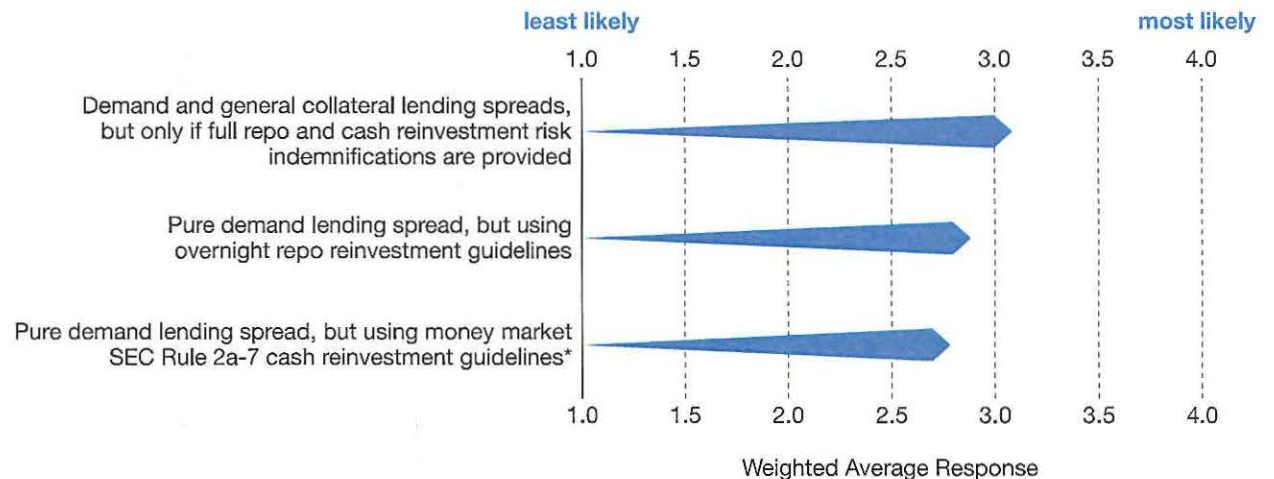
The tightness of observations for each of the three approaches seems to be contingent on the size, type and risk profile of the plan. Results show a slightly higher level of interest in demand and general collateral lending spreads, but only if full repo and cash reinvestment risk indemnifications are provided. The next most popular response was a pure demand lending spread, but using overnight repo reinvestment guidelines.

Public funds report they are slightly more likely to implement a pure demand lending spread, but using overnight repo reinvestment guidelines. Corporate and Taft-Hartley funds were most likely to implement demand and general collateral lending spreads if full repo and cash reinvestment risk indemnifications were provided. However, among all fund types, Taft-Hartley funds expressed the least amount of interest in a pure demand lending spread using money market SEC Rule 2a-7 cash reinvestment guidelines approach.

By size, small funds were least interested in a pure demand lending spread using overnight repo reinvestment guidelines approach while mega and large funds showed greater interest in this approach.

Other fund specific responses include a strictly non-cash collateral program (U.S. Treasuries), non-cash collateral lending with risk indemnification, pure demand lending but using government money market funds only for cash collateral, index funds and no involvement in a securities lending program.

If you could design your securities lending program from scratch, rate your level of interest in the following intrinsic value-oriented approaches in terms of likelihood of implementation (1=most likely, 4 = least likely).



* The application of SEC Rule 2a-7 guidelines should not increase the underlying risk profile of the asset class, portfolios or securities that are out on loan. In a rapidly rising interest rate environment, SEC Rule 2a-7 guidelines may not be immune to losses due to the gap between the loan and the reinvestment. Since current interest rates are near zero, there is a high probability that a rapid rising interest environment can materialize over the next few years. If this happens the securities lending program would be subjected to interest rate risk and could lead to losses.

Throughout the survey participants provided qualitative comments on positive and negative perceptions and experiences with securities lending. Following are selected excerpts.

Selected respondent quotes on the following topics:

Limiting conflicts of interest:

- “[We are concerned with the] appearance of a potential conflict-of-interest in the current securities lending revenue sharing structure, where the securities lending provider shares in the investment revenues generated by the collateral pool whose investments they control. Yet, they share none of the investment risks.”
-

Benchmarking concerns:

- “We are interested in benchmarking our program, but very little information on how to do this is available.”
-

Communication with lending agents:

- “[We are concerned with] understanding the lending agent’s sell policy.”
- “[Our lending agent] has done a terrible job communicating the Lehman loss event. That triggered numerous other questions from me about how the program works, what risk exposure we may have and how to mitigate that risk going forward. Most of the questions are still not answered with any specificity. After seven months, I am still trying to get numerical answers to collateral and earnings questions and have not executed amendments to the securities lending agreements for Lehman or otherwise.”

Qualitative Survey Commentary (continued)

Some respondents expressed concerns with:

- “Capital market changes—including Fed actions to restore credit markets, attitudes and perceptions about securities lending and whether it benefits the beneficial owner to lend.”
 - “Tradeoffs between the pros of establishing a separate collateral pool versus the lack of liquidity during manager terminations/changes in a pool with only one client.”
 - “Efficient management of the collateral pool in a rising interest rate environment.”
 - “Lack of control over securities lending in commingled products (indirect lending).”
 - “Inability of most securities lending business models to temporarily stop lending all together when risk is greater than reward.”
 - “Hidden investment risk.”
-

Forward-looking comments:

- “[If we were to design a securities lending program from scratch, we would] have 100% of revenue go to the plan sponsor. [We] would pay an annual flat fee and small transaction fee to the custodian. The majority of the assets would be managed outside of the custodian. We would try to limit conflicts of interest.”
- “We’ve always been an intrinsic lender, so far our program is working to our satisfaction so we will stay the course with current agents and program structure.”
- “[We plan to] unbundle lending services from cash collateral reinvestment services.”
- “[We plan to] stay the course and monitor the collateral vehicle more closely.”

- ▶ **Agency Lending Model** – The lending of securities by a fund or plan sponsor through an agent (usually contracted as a custody lending agent and/or third party lending provider). The lending agent is responsible for counterparty risk assessment and negotiating terms and conditions including rebate rates and spreads.
- ▶ **Auction-based Lending** – Securities are lent via an auction process with the intent of extracting the maximum intrinsic value of securities through an agent and/or principal program, including opportunities presented in the reinvestment process. The motivation is to build (or package) a portfolio of securities that is in demand and extract the maximum intrinsic value through an auction process.
- ▶ **Controlled Carve Out** – This is akin to controlled withdrawal and usually is employed by large institutional investors. The intent is to take a slice of the cash collateral pool (in-kinds or unit of ownership) for better risk oversight, management or opportunistic disposition to minimize current and future losses.
- ▶ **Controlled Withdrawal** – This is also known as a staged withdrawal or controlled unwind. The purpose is to reduce the risk profile of the program and minimize current and future losses.
- ▶ **Direct Lending** – Funds in separate account portfolios lend via their custodian and/or third party lending agent. This is done through an agency lending model.
- ▶ **Indirect Lending** – Funds in a portfolio are lent through collective vehicles including index funds, commingled funds, mutual funds, target date funds, etc. This is typically conducted through an agency lending model.
- ▶ **Intrinsic Value Lending** – The intrinsic value approach focuses on the inherent positive spread from the demand characteristics of a security or portfolio that is in high demand (also known as “special”) and has less or zero reliance on the collateral reinvestment spread often attributed to general collateral (or not-in-demand securities).
- ▶ **Near-Term Termination** – This is also called a short fuse termination or complete exit from securities lending. This strategy is only deployed after careful evaluation of the risk/reward trade-off of terminating a program and the resulting impact of losses and exit penalties that would be triggered or realized.
- ▶ **Principal (Internal) Lending** – The fund or plan sponsor lends to borrowers without the need for a middleman or lending agent. The fund or plan sponsor is responsible for counterparty risk assessment and negotiating terms and conditions including rebate rates and spreads.
- ▶ **Revenue Offset Buffer Fund** – The parking of securities lending revenues in a cash reserve to pay for current and future realized losses emanating from the cash collateral reinvestment pool.

Disclaimer

The impact of the credit and liquidity crisis prompted numerous organizations to evaluate the risk profile of their respective securities lending programs. The fluidity of the situation and the complexity of the issues facing securities lending today require both patience and thoughtful evaluation of any action taken by a plan/fund sponsor.

Institutional investors or funds taking a conservative stance cannot be criticized for prioritizing risk management before revenues when it comes to securities lending. Fund and plan sponsors should understand the risks inherent in securities lending:

Borrower Risk: The risk that the borrower will not return the securities due to insolvency.

Operational Negligence: The risk that an agent fails to mark to market, follow-up on delivery instructions, maintain collateralization levels and post corporate actions and income, including all economic benefits of ownership except for proxy voting.

Trade Settlement Risk: The risk that an investor sells a security that is out on loan, that the loaned security is not returned by the borrower and that a trade fails or the seller is charged with an overdraft fee, including opportunity costs of a failed trade.

Country Risk: The risks associated with investing in a foreign country. These risks include political risk, exchange rate risk, economic risk, sovereign risk and transfer risk, which is the risk of capital being locked up or frozen by government action.

Currency Risk: The risk that the collateral posted by a borrower involving non-U.S. securities or cross collateralization of loaned securities would be insufficient because of daily fluctuations in currency values.

Collateral Reinvestment Risk: The risk that the investment of the cash collateral will not earn a sufficient return to cover the agreed upon rebate rate due to interest rate risk, liquidity risk and credit risk.

More than 70 fund and plan sponsor organizations participated in Callan's Securities Lending Survey for U.S. Tax-Exempt Institutional Investors in May 2009. Unless otherwise noted, all data contained in this report was taken from the responses and follow-up discussions with respondents. Just like any other investments, past performance does not guarantee future results. Securities lending is not and never will be risk free.

Author Biographies



Virgilio "Bo" Abesamis, III is a Senior Vice President and Manager of the Master Trust, Global Custody and Securities Lending Group. Bo joined Callan Associates in 1987 and is a shareholder of the firm. Initially, Bo worked in the Capital Markets Research Group with responsibilities involving asset/liability modeling, manager structure, benchmark and database reviews, style analysis, and research.

Bo previously managed the Specialty Performance Measurement Group at Callan Associates with an emphasis on analytics involving non-traditional asset classes, namely international, alternative investments, and real estate. He also assisted in the development of Callan's International Consulting Services Group and Defined Contribution Consulting Services Group.

Bo earned a B.S. degree in Accounting and Finance from Ateneo de Manila, Philippines, and an M.B.A. with a double major in Finance and International Business from the University of San Francisco.



Inga B. Sweet is a Senior Vice President and Manager of Callan's Published Research Group. She is responsible for overseeing the development of white papers, statistical surveys and quarterly periodicals created by Callan's general and research consultants for clients and distributed by the Callan Investments Institute. She also conducts the analysis and is the author of the Style, Trend, Analysis and Research (STAR) reports. She is a shareholder of the firm.

Inga joined Callan Associates in 1991 as an analyst in the International Consulting Services group, and until 1998, was responsible for manager research, analysis and manager structure work. From 1998 through 2007, she held a several positions within the Institutional Consulting Group where she provided consulting and research services to investment manager clients.

Inga graduated from George Washington University with a B.A. in International Relations.



Anna S. Wagner is a Research Analyst in the Published Research Group. Anna is responsible for generating research and collaborating on the creation and distribution of Callan's industry white papers and newsletters. She also conducts, analyzes and authors Callan surveys, such as the Investment Management Compensation Survey. Her other responsibilities include overseeing multiple quarterly reports and semi-annual or annual projects. Anna joined Callan in August 2006 as a Communications Assistant with the Callan Investments Institute. Prior to joining Callan Associates, Anna was with Vail Resorts, Inc. working in the front office division of Keystone and Breckenridge Resorts.

Anna earned a B.A. in International Business and French from Washington University in St. Louis, MO, and is currently pursuing an M.B.A. at the University of San Francisco.

Callan Associates would like to express our appreciation to the participants who took the time and effort to provide us with this valuable information.



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Founded in 1973, Callan Associates Inc. is one of the largest independently owned investment consulting firms in the country. Headquartered in San Francisco, Calif., the firm provides research, education, decision support, and advice to a broad array of institutional investors through five distinct lines of business: Fund Sponsor Consulting, Independent Adviser Group, Institutional Consulting Group, Callan Investments Institute and the Trust Advisory Group. Callan employs more than 170 people and maintains four regional offices located in Denver, Chicago, Atlanta and Florham Park, N.J. For more information, visit www.callan.com.



ASK THE EXPERT

MARCH 2008

A Conversation with Callan's
Virgilio "Bo" Abesamis
Senior Vice President and
Manager of the Master Trust,
Global Custody and Securities
Lending Group

Interviewed by
Michael J. O'Leary, CFA
Executive Vice President and
Manager of Callan's Denver
Consulting Office

Securities Lending

Mechanics and Risks Revisited



Michael O'Leary (left) and Bo Abesamis

Securities lending has received considerable attention from the investment community. The vast majority of institutional investors lend securities either through stand-alone programs or, in many cases, through mutual funds or collective trusts. Many programs were impacted by the credit crunch, raising questions about the risks associated with what was generally thought to be a low risk program.

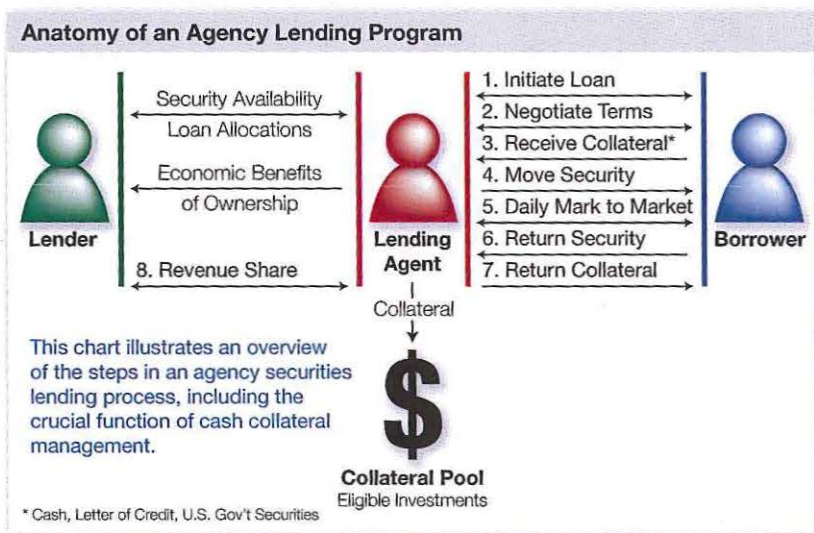
Recently, Michael O'Leary sat down with Bo Abesamis to discuss the principal players, the risks involved and client reactions to the current environment surrounding securities lending.

About Callan Associates

Founded in 1973, Callan Associates Inc. is one of the largest independently owned investment consulting firms in the country. Headquartered in San Francisco, Calif., the firm provides research, education, decision support and advice to a broad array of institutional investors through five distinct lines of business: Fund Sponsor Consulting, Independent Adviser Group, Institutional Consulting Group, Callan Investments Institute and the Trust Advisory Group. Callan employs more than 170 people and maintains four regional offices located in Denver, Chicago, Atlanta and Florham Park, N.J.

O'LEARY: Bo, let's start out with the basics. What is securities lending?

ABESAMIS: Securities lending is a transaction in which the owner of a security agrees to lend the security to a borrower according to negotiated terms. This temporary exchange of securities is between the lender (beneficial owner of securities) and the borrower, usually for other securities or the cash value equivalent (which can be a mixture of both), with an obligation to redeliver a like quantity of the same securities at a future date. Once a security is out-on-loan, the legal title to the security is transferred to the borrower and the loan is secured with collateral. However, the lender retains all economic benefits of ownership and is paid a fee.



Who are the principal players and, on the borrowing side, who needs to borrow securities?

ABESAMIS: The principal players are the borrowers—broker/dealers and banks—and the institutional investors who lend.

Usually, a lending agent is the conduit to the securities lending transaction. Firms may need to temporarily borrow securities when they: (1) Sell securities they have purchased but have not been delivered; (2) Open a "short" position (i.e., sell securities they do not own), either voluntarily to establish a specific position or involuntarily as the result of an obligation as a market-maker to fill a customer buy order; (3) Need to deliver securities they have not yet purchased against an exercise of a derivatives contract (e.g., the exercise of a call option); (4) Want to raise specific collateral, perhaps for another securities lending transaction; or (5) Need to cover a failed transaction in a securities settlement system. Prime brokers who facilitate the borrowing needs of hedge funds account for the majority of the borrowing activity, which is estimated at around 60% of the marketplace.

SECURITIES LENDING BASIC PREMISE

WHY LEND?

Extra revenue (often to cover administrative costs and performance enhancements).

WHAT IS IT?

Owner of a security agrees to lend the security to a borrower according to negotiated terms and the owner is secured with collateral.

WHY BORROW?

To make delivery of securities to avoid fails, and money is not tied in the cash market.

DO YOU OWN WHAT YOU LEND?

No, but you are entitled to the economic benefits of ownership, except for proxy voting.

SECURITIES LENDING AT A GLANCE

Many institutional investors routinely participate in securities lending programs, both directly and/or indirectly. Typically, institutional investors use their custodians to provide direct securities lending services. Institutional investors participate indirectly through a variety of collective investment vehicles (mutual funds, commingled trust funds, etc.) that have the authority to lend fund assets.

Securities lending involves the temporary loan of securities to approved counterparties or borrowers. The borrowers provide eligible collateral (generally cash), and the loans and collateral are marked to market daily. The lender retains all economic ownership rights except the right to vote proxies.

U.S. Government securities, domestic or international equity securities and corporate bonds can all be used in securities lending. Borrowers borrow to facilitate securities transactions (for example, to deliver on short sales or to provide acceptable collateral for futures or options transactions).

Transactions are structured so that they should not affect a manager's ability to sell the security on loan.

There are three primary risks associated with securities lending: operational risks, borrower/counterparty default risk and collateral reinvestment risk. The lending agent often indemnifies the lending fund against losses arising from operational errors and losses due to borrower default.

However, they do not generally indemnify for losses arising from the investment of collateral. The lending fund is responsible for returning the borrower's collateral and providing the agreed upon rebate rate on the collateral. Thus, if the lender earns a lower return on the collateral than the rebate rate, there will be an "investment loss" on the transaction. This risk is minimized by using very high quality, liquid instruments for collateral investment and then carefully managing potential asset liability duration differences. Naturally, highly unusual market conditions can create very challenging environments for lending programs.

In most cases, the lending agent receives a share of the spread (the difference between income earned on the collateral less the rebate rate promised). The proportion varies from client to client based on several factors, but generally 25% to 40% of the income earned goes to the lending agent. The lending agent typically absorbs the operational expenses associated with providing the service.

The institutional investor's net of expense income varies based on market conditions, the nature of the investor's portfolio (size and types of holdings) and the portion of the portfolio on loan. A large institutional portfolio can earn 15 to 17 basis points loaning U.S. Government securities, 17 to 20 basis points loaning U.S. equities and a greater spread loaning international stocks.

One more question pertaining to the players. I'm always amazed that many clients don't recognize that securities lending is generally done within mutual funds and, very frequently, within commingled investment vehicles offered by trust entities. Would you comment on that?

ABESAMIS: Several years ago, I informally studied the number of Callan clients that were participating in securities lending. At that time close to 85% of Callan clients participated in securities lending—about 75% through separate accounts and the remainder through commingled funds or collective trusts. So it is true, Mike, that an investor in an S&P 500 Index collective trust can be actually participating in securities lending often unbeknownst to them.

What do you see as the principal risks involved in a securities lending program from the institutional investor's perspective?

ABESAMIS: There are three main risks: operational risk, borrower/counterparty default risk and collateral reinvestment risk. As we know, cash collateral reinvestment risk was prevalent in the last several months of 2007.

How does the lender (the fund) mitigate operational and borrower default risk?

ABESAMIS: Any accomplished securities lending agent has strong operational controls and systems, and typically indemnifies the lending client against operational risks.

Does the same thing pertain to borrower default?

ABESAMIS: Yes. Borrower default risk indemnification is typically provided by the lending agent to the lender. Borrower default risk indemnification means that if a borrower fails to return the securities, or the borrower goes bankrupt and is unable to return the securities, then the lending agent—by virtue of the provisions of the indemnification clause—should make the client or the plan sponsor whole. So any time a borrower fails to deliver those securities back to the beneficial owner, the lending agent ensures the borrower's posted collateral is sufficient and, if not, covers any shortfall to make the client whole.

Can you briefly describe how the borrowing is collateralized?

ABESAMIS: Before they can borrow securities, the borrower has to post collateral to the lender. For example, for \$100 worth of domestic large cap securities to be lent out, the borrower must provide \$100 worth of collateral plus 2% margin in order to borrow the securities. The collateralization rate depends on the

RISKS

OPERATIONAL RISK – the risk that the lending agent did not administer the program as agreed. This includes the agent's failure to mark to market collateralization levels and to post corporate actions and income, including all economic benefits of ownership except for proxy voting.

BORROWER/COUNTERPARTY DEFAULT RISK – the risk that the borrower fails to return the securities due to insolvency or other reasons. Borrower default also leads to trade settlement risk, which is the risk that an investor sells a security on loan and that the loaned security is not returned by the borrower. Therefore the trade fails or the seller is charged with an overdraft fee.

COLLATERAL REINVESTMENT RISK – the risk of investment loss from the reinvestment of the cash collateral by the lending agent and/or beneficial owner. The real risk is that the investment of the cash collateral will not earn a sufficient return to cover the agreed upon rebate rate because of interest rate, liquidity and/or credit risks.

Before they can borrow securities, the borrower has to post collateral to the lender.

type of securities being lent. For domestic securities the typical collateralization rate is 102%, for international securities it is 105%.

There are two forms of collateral that can be posted to meet that 102% or 105%—cash collateral and non-cash collateral. Cash collateral is usually the U.S. dollar. Consistent with ERISA requirements, non-cash collateral normally takes the form of irrevocable letters of credit and/or U.S. Government bonds/Treasuries. For non-ERISA clients certain other non-cash securities are acceptable. But the main forms are U.S. dollar cash, irrevocable letters of credit and U.S. Government bonds/Treasuries.

With international securities, it is up to the client to determine if they want their cash held in the currency of the underlying security (or what we call same currency collateralization) or in a different currency (cross currency collateralization).

Is collateral marked to market daily to reflect changes in value of the security on loan?

ABESAMIS: Yes. This is a non-negotiable requirement. Failure to do so constitutes operational negligence by the lending agent.



Bo Abesamis

Further, if the loaned security increases in value, the borrower has to post additional collateral and, if it declines in value, the lending agent would be amenable to returning some portion of the collateral.

ABESAMIS: Yes, however, collateralization rates are typically initiated at the origination of the loan. Certain programs could mark daily at the designated level or they could mark at 100%. For example, the initial collateralization would be 102% for borrowed U.S. Treasuries, but for the subsequent mark after the loan is initiated, some of them would mark at 100%. That means that the lending agent will only ask for additional collateral once the market value of the collateral goes below 100%. In certain programs 100% is maintained at both initial and subsequent marks. This is often confusing and should be understood by clients participating in any form of securities lending transaction.

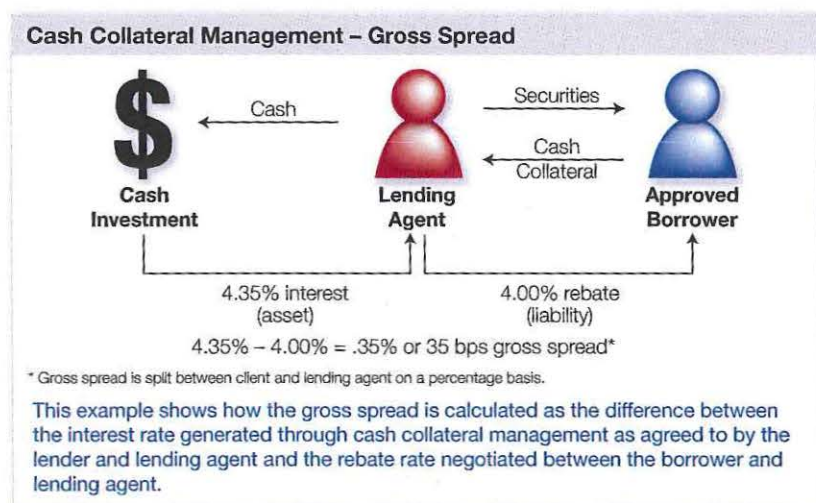
If collateral is the first line of protection to the lender or to the fund, what is the second line of protection?

ABESAMIS: The second line of defense would be the indemnification provided by the lending agent.

Now, moving on to the third level of risk—investment risk—we begin by discussing the investment risk associated with cash collateral. The borrower provides cash equal to 102% or 105% of the value of the security that has been borrowed, and that cash is invested by the lending agent. The borrower will not let the lender invest the cash collateral and keep all the earnings. So this gets us into the rebate rate. Would you describe what it is?

ABESAMIS: The rebate rate is a negotiated rate that the lender must pay the borrower on the cash collateral. It is typically expressed as a rate linked to an index, such as the fed funds rate or LIBOR. For example, you'll hear the rebate rate is fed funds plus 25 (basis points). Therefore, before making any money, the lender needs to earn enough yield to cover the negotiated rebate rate agreed to between the lending agent and the borrower, including the principal value of the collateral (posted by the borrower). Any net earnings generated from the demand spread and the reinvestment spread are shared between the beneficial owner and the lending agent. By the way, if a security is in high demand, a borrower may forgo the rebate rate or even agree to a negative rebate rate. If this happens, the potential revenue of the loan increases significantly to the advantage of the client. For loans made against non-cash collateral, both lender and lending agent need not worry about the rebate rate. The borrower pays the lender and lending agent a premium (or fee) for posting non-cash collateral.

Any net earnings generated from the demand spread and the reinvestment spread are shared between the beneficial owner and the lending agent.



It is imperative that the client, or any beneficial owner, understands how the cash collateral is to be reinvested.

By way of example, what happens if they earn 20 basis points more than the negotiated rebate rate?

ABESAMIS: The extra 20 basis points doesn't all go to the lender. The lending agent would normally have a revenue sharing arrangement with the lender or the beneficial owner. The revenue sharing arrangement (normally called a revenue split) can range from 50/50 to 90/10, where 90% goes to the lender and 10% goes to the lending agent. Typically, the lending agent has to absorb the program's expenses from its share of that gross spread.

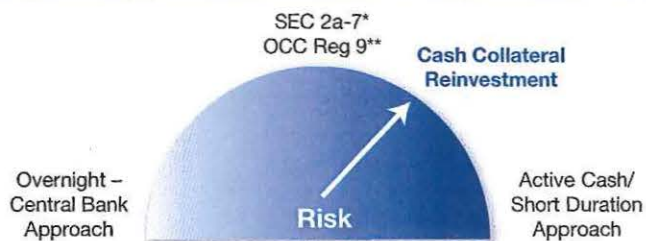
Now suppose that the lending agent investing the collateral invests in a security that defaults. Typically who bears that risk?

ABESAMIS: Collateral reinvestment risk is shouldered by the lender (the beneficial owner or the fund). Therefore, the lender has to cover both the rebate rate and the full principal value of the cash collateral posted by the borrower. Failure to do so results in collateral reinvestment risk. The lending agent typically *does not* indemnify clients for such a risk.

What is the principal investment risk in securities lending?

ABESAMIS: The credit and liquidity risks associated with the investment of the cash collateral. It is imperative that the client, or any beneficial owner, understands how the cash collateral is to be reinvested. There need to be stated policies and guidelines governing the reinvestment of the cash collateral agreed to between the client and the lending agent. Obviously, the lending agent must have the requisite skills to prudently manage the collateral portfolio.

Cash Collateral Reinvestment – Risk Speedometer



The chart illustrates that the average cash collateral reinvestment guidelines of securities lending falls between SEC Rule 2a-7/OCC Reg 9 STIF and active cash/short duration guidelines. Thus, there is a possibility that the securities lending cash collateral pool can sustain losses and not maintain \$1 net asset value.

* SEC RULE 2A-7: SEC Rule 2a-7 governs the eligible securities that money market funds may purchase, maintains an average dollar-weighted maturity of 90 days or less, and prohibits money market funds from purchasing securities that have an effective maturity longer than 13 months. The rule was designed to ensure that money market mutual funds preserve a \$1.00 NAV and don't "break the buck." [SEC = Securities and Exchange Commission]

** OCC REG 9: OCC Reg 9 led to the creation of STIF (short-term investment fund), which is a collective investment vehicle maintained by banks, and is similar to SEC Rule 2a-7. [OCC = Office of the Comptroller of the Currency]

TRUTHS & MISCONCEPTIONS

Misconception: *Anybody can lend.*

Truth: Not all plan sponsors and lending agents can lend securities. Asset size, investment guidelines and regulations can prohibit a plan sponsor from lending securities.

Misconception: *All securities can be lent.*

Truth: Not all securities are lendable. Liquidity and the derivatives market dictate what is lendable.

Misconception: *You still own what you lend.*

Truth: Given the nature of the transaction, the plan sponsor (lender) loses ownership (title), but retains the benefits of ownership (e.g., dividends, corporate actions, interest income, etc.) except for voting proxies.

Misconception: *Securities lending interferes with the decisions of money managers.*

Truth: A well structured program should not interfere with manager decisions as long as loans are recalled on the first indication of sale.

Misconception: *Securities lending is virtually risk free.*

Truth: Risk does not go away. Risk can be minimized if prudent guidelines are in place.

Misconception: *Securities lending generates a lot of money.*

Truth: Revenue generated by securities lending is subject to a number of factors, ranging from market forces to portfolio holdings. Securities lending should be viewed more as an activity that generates supplemental income than a substantial money-making enterprise. Net lending income, as a percentage of the lendable asset base, is very small. However, for a multi-billion dollar portfolio, securities lending can produce millions of dollars of incremental return.

Misconception: *Securities lending is a leveraged transaction.*

Truth: Technically speaking, securities lending effectuates the efficient use of leverage by market participants. However, since the beneficial owner is fully collateralized, leverage is therefore mitigated. Securities lending contributes to market efficiencies. Yet, indiscriminate, negligent and ignorant use of securities lending beyond its intended purpose can lead to market disruptions.

If the cash collateral reinvestment is not able to cover that rapid reset to the new fed funds rate at the higher level, that's when the possibility of a loss from duration mismatch can occur.

Excluding the mega funds, in most cases isn't cash collateral generally invested in collective investment vehicles designed expressly for securities lending programs?

ABESAMIS: Yes, the majority of lending agents invest cash collateral in a collective trust or a commingled fund vehicle dedicated to securities lending. Lending agents typically offer multiple types of cash pools for the reinvestment of cash collateral. The degree of each pool's risk must be carefully considered. While most are conservatively oriented, some assume greater credit, liquidity and/or duration risk. Even if a lending agent has a single very high quality cash pool, it doesn't really eliminate all of the investment risk. The perfect storm we encountered in the last several months of 2007 was a sobering experience.

What are the other sources of investment risk?

ABESAMIS: Within cash collateral reinvestment risk, there is what we call the duration mismatch risk between the duration of the loan relative to the duration or maturity of the cash collateral investment. The duration of the loan, because it resets daily, is one day, but the duration of the investment can be one day to six months or more depending on how the cash collateral is reinvested. So it doesn't take much to see that if the duration of the loan is one day and the duration of the investment averages 30 days, it would lead to a duration mismatch, creating an additional source of risk for the program.

The duration mismatch risk is heightened in a rising interest rate environment and/or if the yield curve is inverted. Recalling the earlier example, the duration of the loan is pegged to the fed funds rate, so the borrower would expect the rebate rate to be fed funds plus 25. So let's say we start at a fed funds rate of 5% plus



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25 and, in an interest rate environment that's going up, we're now at 6% plus 25. If the cash collateral reinvestment is not able to cover that rapid reset to the new fed funds rate at the higher level, that's when the possibility of a loss from duration mismatch can occur.

However, in practice this seldom occurs.

ABESAMIS: Correct. The asset/liability mismatch is generally not a major risk unless the client is using an unusually long duration or illiquid collateral pool. One would expect that, by extending the duration, one would squeeze out incremental returns but also increase the risk of short-term losses owing to rate volatility.

The lending agent is paid a percent of the gross spread as compensation while the client bears the risk of loss. Doesn't that relationship create an inherent potential conflict?

ABESAMIS: In reality, the lending agent is incentivized to generate spreads in order to earn their portion of the revenue. There's an inherent potential conflict if the lending agent does not align with the client's interest. It is imperative that both the lending agent and the lender agree on the risk/reward trade-off. If a lending agent understands the inherent risk appetite of a client, then the incentive should not be an issue. It has been my experience that a client's willingness to accept all forms of investment risk may change with market conditions.

The difference between the agreed upon rebate rate and the investment rate of the collateral varies significantly by type of security on loan, with Treasuries and agencies being in the low to mid-teens (pre-split), domestic equities being maybe just a tad higher and international stocks being more than twice that of domestic equities. Is that a reasonable order of magnitude?

ABESAMIS: Yes. Over the three years ending December 2006, the median spread net of rebate was 16 basis points for U.S. Treasuries and agencies. The median spreads net of rebate for domestic large cap equity and international equity were 23 basis points and 63 basis points, respectively.

Are the splits for mutual funds or collective trusts as generous from the lender's perspective as they seem to be in the institutional separate account world?

ABESAMIS: Typically, the revenue sharing arrangement with collective funds or mutual fund complexes is in the 50/50 to 60/40 range. In the separate account tax-exempt arena, institutional investors who are able to lend their securities have a revenue sharing arrangement that ranges from 60/40 to 90/10, where the aver-

The commingled vehicle allows even small accounts to have some of the benefits of participating in a securities lending program that these investors would not have on a stand-alone basis.

Up until this point, clients have not really factored securities lending into their risk budgeting exercise.

age is between 70/30 and 75/25. Nonetheless, the commingled vehicle allows even small accounts to have some of the benefits of participating in a securities lending program that these investors would not have on a stand-alone basis.

How big does a client have to be for them to have their own customized collateral investment vehicle and not participate in a collective pool?

ABESAMIS: Ideally a client should have average out-on-loan balances of at least \$100 million in order to have its own separate collateral investment account and not participate in a collective pool. But a much larger average daily balance—\$500 million or higher—would be more reasonable.

In the difficult current credit market environment, an ability to understand the risks you are taking is something that's very valuable to clients. Is it typical for lending agents to provide a complete transparency to the collateral pools so that a client can actually see what's in the collateral pool on a real-time basis or a next-day basis?

ABESAMIS: When clients insist, they should be able to see how the cash collateral in the pool is invested on a next-day basis at a minimum. They should be able to have what we call a "peek through" for the program. Now, it's typical to have agents provide hard copies of the cash collateral or a summary of the program on a month-end basis. But clients have the ability to demand a report from their lending agent on a next-day basis and to see how that cash is invested. There are certain programs in the industry where lending agents provide a complete real-time peek through.

In that case, clients who have their portfolios online are given access to the collateral pool from an accounting valuation perspective.

ABESAMIS: Exactly. But that is not typical because a lot of the programs are amortized when they reflect the valuation. So you could have a peek through to the securities at the point in time valuation, but it doesn't necessarily mean that it is the market value at that point in time.

Give us a measure of clients' comfort level—what do we see today? Many seem to be questioning whether securities lending is worth the risk.

ABESAMIS: By virtue of the fact that a lending agent can have huge blocks of securities out-on-loan and is charged to reinvest large amounts of cash collateral on any given day, the lending agent can be the single largest investment manager of a client. Up until this point, clients have not really factored securities lending into their risk budgeting exercise. However, when something goes wrong in a

program that is expected to generate incremental revenue at very low risk, it is just normal to question its value. As a result of the current environment and losses incurred, clients' comfort levels are changing and some are indeed questioning the ongoing risk/reward trade-off of their securities lending programs. There is no free lunch with securities lending. I do believe that a program focused on risk management is far superior to a revenue-driven program.

As we look back on 20 plus years of clients actually participating in securities lending programs, have there been losses? What's the incidence and the magnitude of them? And are we currently in an environment where we will see losses?

ABESAMIS: Over the last 20 plus years that Callan has been monitoring and advising clients on their securities lending programs, we have seldom seen plans realize any losses. There have been very few losses arising from actual collateral investment defaults. Back in 1994, some plans quickly terminated their programs and suffered small losses associated with the forced sale of collateral investments at inopportune times.

I haven't seen losses due to operational negligence, as programs out there have really followed the guidelines that were set by the industry and by regulatory bodies.

There were instances of borrower default, but overall borrower default has not really been problematic. It's the events with cash collateral that we have experienced in 2007 and now has overflowed to 2008—probably to a certain extent a credit and liquidity crisis—that have caused losses. When liquidity and credit markets are stressed, programs may be confronted with potential losses, particularly if forced to liquidate collateral investments quickly.

I encourage fund sponsors to avoid a knee jerk reaction should they experience losses. First and foremost, clients should sit down with their consultant and with their lending agent to understand the program. How does it look given the current credit and liquidity crisis? Can a less aggressive set of collateral investment guidelines be adopted? Those options should be addressed with the lending agent. If changes are adopted, they should ideally be made to new loans such that current collateral investments are not subject to forced sales in an illiquid environment. Finally, if clients terminate their lending programs, change custodians or even fire managers with securities out-on-loan, it is critical that the current lending program be unwound in an orderly manner.

Thank you very much, Bo.

If clients terminate their lending programs, change custodians or even fire managers with securities out-on-loan, it is critical that the current lending program be unwound in an orderly manner.

Glossary

BORROWER/COUNTERPARTY DEFAULT RISK – The failure by a borrower to return securities on demand or upon recall. The default can arise from financial difficulty or bankruptcy.

COLLATERAL – Security for a loan in the form of assets with monetary value. The creditor holds either the asset itself or title to it until the loan is repaid.

COLLATERAL REINVESTMENT RISK – The risk associated with the reinvestment loss in the cash securities in which the lending agent and/or beneficial owner choose to reinvest the cash collateral. The real risk is that the investment of the cash collateral will not earn a sufficient return to cover the agreed upon rebate rate because of interest rate, liquidity and/or credit risks.

DURATION MISMATCH RISK – Risk known to occur when the interest rate sensitivity of the asset (cash collateral reinvestment) is longer or shorter than the interest rate sensitivity of the liabilities (loan).

FED FUNDS RATE – The rate of interest charged for an overnight loan from one bank to another of excess reserves, that is, cash and deposits in excess of the reserves it is required to have on hand. Because the interest rate for such loans depends largely on supply and demand, it is regarded as a very important barometer of monetary conditions at any given time.

GROSS SPREAD – The difference between the yield or return generated by the cash collateral and the negotiated rebate paid on a securities loan (or, in the case of loans vs. non-cash collateral, the premium). The gross spread is the sum of the demand spread and the collateral reinvestment spread.

INDEMNIFICATION – An agreement to compensate for damage or loss.

LENDING AGENT – An entity that undertakes a securities loan and negotiates the terms with borrowers on behalf of the owner of the securities that are out-on-loan.

MARGIN – The amount or percentage by which the collateral value exceeds the value of the securities that are on loan.

MARKING TO MARKET – The daily process of adjusting the value of a portfolio to reflect daily changes in the market prices of the assets held in the portfolio.

MATCHED BOOK – Within the context of a securities lending transaction, the duration of the liability of the loan is synchronized and matched to the duration of the cash collateral reinvestment.

OPEN LOAN – A securities loan with no fixed maturity date.

OPERATIONAL RISKS – The risk that the lending agent did not administer the program as agreed. This includes the failure of the agent to mark to market collateralization levels, and to post corporate actions and income including all economic benefits of ownership except for proxy voting.

PROXY – A written form that is given by shareholders to record their vote or to authorize someone else to vote in their place at a shareholder's meeting. Shareholders or investment managers typically receive proxy notification specific to a pending vote.

REBATE RATE – The negotiated interest rate that a securities lender pays the borrower on cash collateral. The negotiated interest rate or rebate rate is determined by the scarcity value of a security or demand for a specific security in the marketplace.

RECALL – The ability to receive a security without fail that is out-on-loan to complete a sale transaction or to exercise a proxy vote.

TERM LOAN – A security loan with a fixed maturity date.

TRADE SETTLEMENT RISK – The risk that an investor sells a security that is out-on-loan and that the loaned security is not returned by the borrower, and that a trade fails or the seller is charged with an overdraft fee.

Biographies



Virgilio "Bo" Abesamis III

Senior Vice President and Manager of the Master Trust, Global Custody and Securities Lending Group

Bo joined Callan Associates in 1987. Bo is a shareholder of the firm. Initially, Bo worked in the Capital Markets

Research Group with responsibilities involving asset/liability modeling, manager structure, benchmark and database reviews, style analysis and research. Bo previously managed the Specialty Performance Measurement Group at Callan Associates with an emphasis on analytics involving non-traditional asset classes, namely international, alternative investments and real estate. He also assisted in the development of Callan's International Consulting Services Group and Defined Contribution Consulting Services Group. Bo earned a B.S. degree in Accounting and Finance from Ateneo de Manila, Philippines, and an M.B.A. with a double major in Finance and International Business from the University of San Francisco.



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Executive Vice President and Manager of the Denver Consulting Office

Michael joined Callan in 1984 in the firm's Chicago office as a senior consultant. He established the firm's Denver

office in 1990. Michael is a shareholder of the firm. Prior to joining Callan, Michael worked for 13 years for major Trust companies in Chicago and Hartford, Connecticut. Michael works directly with a number of the firm's major public and private accounts by providing a complete range of investment consulting services. He has extensive personal experience in asset allocation analysis, manager structure analysis, manager selection, performance evaluation, securities lending, and defined contribution plan design and evaluation. He speaks frequently at client conferences and to professional groups. Michael earned a bachelor's degree from Fordham University.

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 275 and 279

[Release No. IA-2968; File No. S7-09-09]

RIN 3235-AK32

Custody of Funds or Securities of Clients by Investment Advisers

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is adopting amendments to the custody and recordkeeping rules under the Investment Advisers Act of 1940 and related forms. The amendments are designed to provide additional safeguards under the Advisers Act when a registered adviser has custody of client funds or securities by requiring such an adviser, among other things: to undergo an annual surprise examination by an independent public accountant to verify client assets; to have the qualified custodian maintaining client funds and securities send account statements directly to the advisory clients; and unless client assets are maintained by an independent custodian (*i.e.*, a custodian that is not the adviser itself or a related person), to obtain, or receive from a related person, a report of the internal controls relating to the custody of those assets from an independent public accountant that is registered with and subject to regular inspection by the Public Company Accounting Oversight Board. Finally, the amended custody rule and forms will provide the Commission and the public with better information about the custodial practices of registered investment advisers.

DATES: Effective Date March 12, 2010

Compliance Dates: An investment adviser required to obtain a surprise examination must

enter into a written agreement with an independent public accountant that provides that the first examination will take place by December 31, 2010. An investment adviser also required to obtain or receive an internal control report because it or a related person maintains client assets as a qualified custodian must obtain or receive an internal control report within six months of the effective date. Section III of this Release contains additional information on the effective and compliance dates.

FOR FURTHER INFORMATION CONTACT: Vivien Liu, Senior Counsel, Melissa A. Rovers, Senior Counsel, Daniel S. Kahl, Branch Chief, or Sarah A. Bessin, Assistant Director, at (202) 551-6787 or <IArules@sec.gov>, Office of Investment Adviser Regulation, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (“Commission”) is adopting amendments to rule 204-2 [17 CFR 275.204-2], rule 206(4)-2 [17 CFR 275.206(4)-2] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] (the “Advisers Act” or “Act”), to Form ADV [17 CFR 279.1], and to Form ADV-E [17 CFR 279.8].

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I. BACKGROUND

Earlier this year we began a comprehensive review of our rules regarding the safekeeping of investor assets in connection with our bringing several fraud cases involving investment advisers and broker-dealers.¹ As part of this effort, we proposed amendments to rule 206(4)-2, the rule under the Advisers Act that governs an adviser's custody of client funds and securities ("client assets").² Our staff is currently reviewing potential recommendations to enhance the oversight of broker-dealer custody of customer

¹ Since the beginning of this year, the Commission has brought several enforcement actions against investment advisers and broker-dealers alleging fraudulent conduct, including misappropriation or other misuse of investor assets. *See* cases cited in footnote 11 of *Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Act Release No. 2876 (May 20, 2009) [74 FR 25354 (May 27, 2009)] (the "Proposing Release"). In addition to these actions, we have brought several others more recently alleging similar types of misconduct. *See, e.g., In re Stratum Wealth Management, LLC and Charles B. Ganz*, Advisers Act Release No. 2930 (Sept. 29, 2009)(settled action in which Commission alleged a registered investment adviser, through its sole owner and chairman, misappropriated over \$400,000 from a client account during the course of nearly a year to pay for his personal expenses and falsified client account statements, among other things); *SEC v. Titan Wealth Management, LLC, et al.*, Litigation Release No. 21184 (Aug. 26, 2009)(complaint alleges a registered investment adviser misappropriated 80% of investor funds for personal use, to make Ponzi payments to certain investors or transfers to others); *In the Matter of Paul W. Oliver, Jr.*, Advisers Act Release No. 2903 (Jul. 17, 2009)(settled action in which Commission alleged a registered investment adviser's chairman aided and abetted misappropriations of more than \$23 million in client funds by the investment adviser's co-founder and president); *SEC v. Weitzman*, Litigation Release No. 21078 (June 10, 2009)(settled action in which Commission's complaint alleged registered investment adviser's co-founder and principal stole more than \$6 million in investor funds for his own personal use and falsified client account statements). *See also SEC v. Frederick J. Barton, Barton Asset Management, LLC, and TwinSpan Capital Management, LLC*, Litigation Release No. 21016 (Apr. 29, 2009)(default judgment entered against registered investment adviser and its direct and indirect majority owner for diverting approximately \$493,100 of offering proceeds for personal use and for misappropriating \$685,000 from one advisory client and \$970,000 from another); *SEC v. Crossroads Financial Planning, Inc., et al.*, Litigation Release No. 20996 (Apr. 10, 2009)(complaint alleges registered investment adviser, through its president, chief operating officer and principal owner, misappropriated at least \$2.3 million of client assets).

² We use the term "client assets" solely for ease of reference in this Release; it does not modify the scope of client funds or securities subject to the rule.

assets. Thus today's adoption represents a first step in the effort to enhance custody protections, with consideration of additional enhancements of the rules governing custody of customer assets by broker-dealers to follow.

The amendments we proposed earlier this year to rule 206(4)-2 were designed to strengthen the existing custodial controls imposed by the rule. Under rule 206(4)-2, advisers, in most cases, must maintain client funds and securities with a "qualified custodian."³ Qualified custodians under the rule include the types of financial institutions to which clients and advisers customarily turn for custodial services, including banks, registered broker-dealers, and registered futures commission merchants.⁴ These institutions' custodial activities are subject to regulation and oversight.⁵ In addition, advisers must have a reasonable belief that the qualified custodian sends account statements directly to advisory clients.⁶ The rule also permits advisers (rather than custodians) to send account statements if the adviser is subject to an annual surprise verification of client assets by an independent public accountant.⁷

The proposed amendments were designed to eliminate certain exemptions in the rule, thus expanding the protections afforded advisory clients by requiring all registered advisers with custody of client assets to be subject to an annual surprise examination,⁸ and requiring that they have a reasonable belief that qualified custodians send account

³ Rule 206(4)-2(a)(1).

⁴ Rule 206(4)-2(c)(3).

⁵ See Proposing Release, at note 4.

⁶ Rule 206(4)-2(a)(3)(i).

⁷ Rule 206(4)-2(a)(3)(ii).

⁸ Proposed rule 206(4)-2(a)(4).

statements *directly* to the clients.⁹ When the adviser or its related person serves as qualified custodian for client assets, the proposed amendments would require that the adviser undergo an annual surprise examination and obtain, or receive from the related person, an internal control report with respect to custody controls, both of which must be performed or prepared by an independent public accountant that is registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board (“PCAOB”).¹⁰ Amendments to Form ADV would require advisers to report current information to us about these custodial arrangements.

We received more than 1,300 comment letters on the proposed amendments. Most were from investment advisers, broker-dealers, banks, and their trade associations that would be affected by the amended rule and which objected to significant parts of our rulemaking initiative.¹¹ Commenters generally expressed their support for our goal of strengthening protections provided to advisory clients under the custody rule. Most urged us to make changes to our proposal particularly as it applies to advisers that have custody solely because of their authority to deduct advisory fees from client accounts. Many suggested that we update our guidance on the elements of the annual surprise examination performed by an independent public accountant.¹²

⁹ Proposed rule 206(4)-2(a)(3). The proposed amendments, however, would not eliminate an exception to the direct delivery requirement currently available to advisers to pooled investment vehicles that are subject to an annual audit and distribute the audited financial statements to investors in the pool. See proposed rule 206(4)-2(b)(3).

¹⁰ Proposed rule 206(4)-2(a)(6)(ii)(B).

¹¹ Other commenters included accountants, law firms, consultants, and investors. Of the 1,300 letters, approximately 1,100 were form letters or substantially similar letters submitted by smaller advisory firms.

¹² The comment letters are available for public inspection and photocopying in the Commission’s Public Reference Room, 100 F Street, NE, Washington, DC (File No. S7-

II. Discussion

We are today adopting amendments to rule 206(4)-2 to strengthen controls over the custody of client assets by registered investment advisers and to encourage the use of independent custodians. We are also adopting related amendments to rule 204-2, Form ADV, and Form ADV-E that will improve our ability to oversee advisers' custody practices. In response to comments, we made several modifications from the proposal. In addition, we are today publishing a companion release to provide guidance for accountants with respect to the surprise examination and internal control report required under rule 206(4)-2.

We believe these amendments, together with the guidance for accountants, will provide for a more robust set of controls over client assets designed to prevent those assets from being lost, misused, misappropriated or subject to advisers' financial reverses. We acknowledge that no set of regulatory requirements we could adopt will prevent all fraudulent activities by advisers or custodians. We believe, however, that this rule, together with our examination program's increased focus on the safekeeping of client assets, will help deter fraudulent conduct, and increase the likelihood that fraudulent conduct will be detected earlier so that client losses will be minimized.

A. Delivery of Account Statements and Notice to Client

As discussed above, rule 206(4)-2 currently requires advisers that have custody, with certain limited exceptions, to maintain client funds or securities with a "qualified custodian," which the adviser must have a reasonable basis for believing sends an

09-09). They are also available on our website at <http://www.sec.gov/comments/s7-09-09/s70909.shtml>.

account statement, at least quarterly, to each client for which the qualified custodian maintains funds or securities.¹³ The requirement is designed so that advisory clients will receive a statement from the qualified custodian that they can compare with any statements (or other information) they receive from their adviser to determine whether account transactions, including deductions to pay advisory fees, are proper.¹⁴

We are adopting, as proposed, an amendment to the rule that eliminates an alternative to the requirement under which an adviser can send quarterly account statements to clients if it undergoes a surprise examination by an independent public accountant at least annually. We believe that direct delivery of account statements by qualified custodians will provide greater assurance of the integrity of account statements received by clients.

Most commenters that addressed this aspect of our proposal supported it as reflective of best practices followed by most advisers.¹⁵ A few commenters objected to the proposal, suggesting that a client's desire for privacy may override the Commission's

¹³ Rule 206(4)-2(a)(1). If the adviser is a general partner of a limited partnership or holds a similar position with another type of pooled investment vehicle, the account statement must be provided to the limited partners or other investors in the pooled investment vehicle. Rule 206(4)-2(a)(3)(iii). For convenience, we will presume in this Release that all advisers to pooled investment vehicles hold such a position.

¹⁴ Rule 206(4)-2(a)(3)(i). The rule provides an exception to this requirement for an adviser to a pooled investment vehicle if the pooled investment vehicle is audited annually by an independent public accountant and distributes the audited financial statements to the investors in the pool. See rule 206(4)-2(b)(3).

¹⁵ Comment letter of Compliance Solution Group (July 24, 2009)("CAS Letter"); comment letter of CFA Institute Centre for Financial Market Integrity (Dec. 11, 2009)("CFA Institute Letter"); comment letter from The Cornell Securities Law Clinic (July 28, 2009)("Cornell Letter"); comment letter from E*Trade Financial Corp. (July 28, 2009)("E*Trade Letter"); comment letter from Investment Adviser Association (July 24, 2009)("IAA Letter"); comment letter from North American Securities Administrators Association, Inc. (Aug. 5, 2009)("NASAA Letter"); comment letter from National Regulatory Services (July 28, 2009)("NRS Letter"); comment letter from Timothy P. Turner (July 27, 2009)("Turner Letter").

goal of investor protection.¹⁶ In light of recent frauds, we believe generally that the protections provided by direct delivery of account statements by custodians are of substantially greater value than the privacy and confidentiality concerns that led us to permit this alternative.¹⁷ Privacy concerns can be addressed through custodial contracts, or other agreements that restrict the custodian's use of confidential information, as one commenter suggested.¹⁸

As proposed, the amended rule requires that an adviser's reasonable belief that the qualified custodian sends account statements directly to clients must be formed by the adviser after "due inquiry."¹⁹ We are not prescribing a single method for forming this belief, as was suggested by one commenter,²⁰ but rather are providing advisers with flexibility to determine how best to meet this requirement. For instance, an adviser could

¹⁶ Comment letter from American Bar Association (Committee on Federal Regulation of Securities)(July 28, 2009)("ABA Letter"); NRS Letter; comment letter from The Private Equity Council (July 28, 2009)("PEC Letter").

¹⁷ *See Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Act Release No. 2176 (Sept. 25, 2003)[68 FR 56692 (Oct. 1, 2003)] ("2003 Adopting Release"), at Section II.C. Qualified custodians may use service providers to deliver their account statements. The rule does not prohibit this practice, so long as the statements are sent to the client directly and not through the adviser. *See* 2003 Adopting Release at n.30.

¹⁸ *See* IAA Letter. In support of its assertion that that a client's desire for privacy could override the Commission's goal of investor protection, the ABA argued that contractual or other alternative means of protecting confidentiality would be insufficient and potentially very costly, although they did not provide support for these assertions. We note, in addition to contractual protections, other privacy protections are relevant in this context. As discussed in the Proposing Release at n.60, a U.S. qualified custodian would, with respect to individual clients who obtain custodial services for their personal, family or household purposes, be subject to the limitations on information sharing in the privacy rules adopted pursuant to Title V of the Gramm-Leach-Bliley Act. *See, e.g.*, 12 CFR Parts 40, 216, 332, 573 (privacy rules adopted by the Office of the Comptroller of the Currency, the Federal Reserve Board, the Office of Thrift Supervision, and the National Credit Union Administration); 17 CFR Parts 160, 248 (privacy rules adopted by the Commodity Futures Trading Commission and the SEC).

¹⁹ Amended rule 206(4)-2(a)(3).

²⁰ Comment letter of Fifth Third Asset Management, Inc. (July 28, 2009)("FTAM Letter").

form a reasonable belief after “due inquiry” if the qualified custodian provides the adviser with a copy of the account statement that was delivered to the client.²¹

Rule 206(4)-2 requires investment advisers to notify their clients promptly upon opening a custodial account on their behalf and when there are changes to the information required in that notification.²² We are amending the rule, as proposed, to require advisers to include a legend in the notice urging clients to compare the account statements they receive from the custodian with those they receive from the adviser.²³ Several commenters asserted that advisers may not (and are not required by rule 206(4)-2 to) send statements separate from the ones the custodian delivers and thus the proposed disclosure could confuse clients.²⁴ We agree and have, therefore, modified this notice requirement so that the cautionary legend must be included *only* if the adviser elects to send its own account statements to clients.²⁵ Finally, we had requested comment on whether to

²¹ This practice is followed by many advisers today. Commenters suggested that we permit advisers to satisfy the requirement of forming a reasonable belief after “due inquiry” by accessing qualified custodian account statements through the custodian’s website. See comment letter from Curian Capital LLC, Financial Wealth Management, Inc, LPL Financial Corporation, and SEI Investments Company (July 28, 2009)(“Curian Letter”). We believe that accessing account statements through the website merely confirms that they are *available*. If an adviser does not take additional steps to determine whether account statements were *sent* to clients, or that clients obtained statements through the website, the adviser would have an inadequate basis for forming a reasonable belief, after due inquiry, that the qualified custodian sends account statements to clients.

²² Rule 206(4)-2(a)(2).

²³ Proposed rule 206(4)-2(a)(2). One commenter suggested not only requiring the legend in the initial notice, as proposed, but also adding a requirement to include the legend as an annual reminder in the annual Form ADV delivery offer or in the annual privacy statement. See comment letter of The National Association of Personal Financial Advisors (July 21, 2009)(“NAPFA Letter”). We would not discourage advisers from adopting such a practice. As described above, we are adopting a regular notice requirement today for advisers.

²⁴ CAS Letter; comment letter from Dechert LLP (July 28, 2009)(“Dechert Letter”); IAA Letter; comment letter from MarketCounsel, LLC (July 28,2009)(“MarketCounsel Letter”); NRS Letter.

²⁵ Amended rule 206(4)-2(a)(2).

require advisers who choose to send statements to also include in those statements the cautionary legend urging clients to compare the information the adviser sends to clients with the information reflected in the qualified custodian's account statements.²⁶ We believe providing regular notice will serve to more effectively remind clients to take steps to protect their assets. Accordingly, we are amending the rule to require those investment advisers, in any subsequent statements they deliver to clients after the initial notice, to urge clients to compare the adviser's statements with the account statements they receive from the custodian.²⁷

B. Annual Surprise Examination of Client Assets

The Commission is adopting the proposed amendment to rule 206(4)-2 to require registered advisers with custody of client assets to undergo a surprise examination (or an audit, if applicable) of those assets by an independent public accountant, except as discussed below.²⁸ We are also adopting several amendments to the custody rule and related forms that will strengthen the utility of the surprise examination as a means of deterring misuse of client assets and will improve our ability to identify potential misuse of those assets. We are revising the guidance we provide to accountants that are engaged to perform these examinations in order to modernize the surprise examination and make it more effective. We believe these changes, discussed below, will improve protection of client assets.

1. Applicability of Surprise Examination

²⁶ See Proposing Release, at Section II.C. We did not receive comment on this particular approach.

²⁷ Amended rule 206(4)-2(a)(2).

²⁸ Amended rule 206(4)-2(a)(4).

We proposed to require that all advisers with custody obtain a surprise examination of client assets by an independent public accountant in order to provide “another set of eyes” on client assets, and thus an additional set of protections against their misappropriation. Because advisers with custody often have authority to access, obtain and, potentially, misuse client funds or securities, we believed the additional review provided by an independent public accountant would help identify problems that clients may not, and thus would provide deterrence against fraudulent conduct by advisers.²⁹

Many commenters opposed the surprise examination requirement, arguing that it would provide little additional protection to client assets when assets are held with an independent qualified custodian that sends account statements directly to clients.³⁰ Almost all advisers that commented raised concerns about the high costs of the surprise examination and many asserted that the costs could drive smaller advisers that typically

²⁹ Some commenters agreed and expressed support of this proposal. *See* comment letter of Ascendant Compliance Management (July 27, 2009)(expressing support with respect to advisers that are registered as broker-dealers (“dual registrants”)); CFA Institute Letter; comment letter of CLS Investments, LLC (July 28, 2009)(“CLS Letter”)(expressing support with respect to dual registrants); comment letter of The Consortium (July 18, 2009) (“Consortium Letter”)(supporting the requirement other than for advisers who have custody solely because of their authority to deduct advisory fees from client accounts); comment letter of First Manhattan Co. (July 28, 2009)(“FMC Letter”)(expressing support with respect to dual registrants); NASAA Letter.

³⁰ *See, e.g.*, ABA Letter; comment letter of Advisor Solution Group (July 28, 2009)(“ASG Letter”); comment letter of Davis Polk & Wardwell LLP (July 28, 2009)(“Davis Polk Letter”); comment letter of Grandfield & Dodd, LLC (July 28, 2009)(“G&D Letter”); Form Letter F; comment letter of Financial Planning Association (July 28, 2009)(“FPA Letter”); IAA Letter; comment letter of Jackson, Grant Investment Advisers, Inc. (July 28, 2009)(“Jackson Letter”); MarketCounsel Letter; NRS Letter; comment letter of Pickard and Djinis LLP (July 28, 2009)(“Pickard Letter”); comment letter of SIFMA Asset Management Group (July 28, 2009)(“SIFMA(AMG) Letter”).

have custody only because of authority to deduct advisory fees out of business,³¹ or, with respect to advisers that serve in capacities such as trustee on a limited basis, would cause them to cease providing such services to their clients.³²

The focus of most commenters, however, was not on the utility of the surprise examination, but whether the proposed requirement should apply to certain advisers and advisory accounts, which we address below.³³ Some urged that if we expand the surprise examination requirement, we should update our guidance to accountants on examination methodology, which dates back to 1966 and requires verification of all client assets, a potentially expensive procedure not required in most audits.³⁴

³¹ See, e.g., comment letter of TD Ameritrade, Inc. (July 24, 2009) (“Ameritrade Letter”); CAS Letter; Cornell Letter; comment letter of Ronald P. Denk (July 3, 2009) (“Denk Letter”); comment letter of Janet Elder (July 1, 2009); Form Letter D; comment letter of Financial Services Institute (July 28, 2009) (“FSI Letter”); G&D Letter; comment letter of Thomas Hamilton (July 23, 2009); IAA letter; comment letter of The International Association of Small Broker Dealers and Advisors (May 27, 2009) (“IASBDA Letter”); comment letter of Carol K. Lampe (July 1, 2009); comment letter of Walter Marbert (July 1, 2009); comment letter of Scott A. McCord (July 1, 2009); NAPFA Letter; comment letter of Don Slabaugh (July 1, 2009); comment letter of Jeff Toadvine (July 1, 2009); comment letter of Anthony W. Welch (July 1, 2009).

³² See *infra* note 38.

³³ Most commenters urged us to except advisers that have custody solely because of deducting advisory fees from the surprise examination requirement. See, e.g., ASG Letter; comment letter of Certified Financial Planner Board of Standards, Inc. (July 28, 2009) (“CFP Board Letter”); comment letter of Center for Capital Markets Competitiveness, Chamber of Commerce (July 28, 2009) (“Chamber of Commerce Letter”); Curian Letter; Dechert Letter; E*Trade Letter; comment letter of GE Asset Management (July 24, 2009) (“GE Asset Letter”); G&D Letter; Form Letters B, F, and G; FPA Letter; IAA Letter; Jackson Letter; comment letter of The Money Management Institute (July 28, 2009) (“MMI Letter”); NRS Letter; SIFMA(AMG) Letter; comment letter of SIFMA Private Client Legal Committee (July 28, 2009) (“SIFMA(PCLC) Letter”); comment letter of Warshaw Burstein Cohen Schlesinger & Kuh, LLP (July 24, 2009) (“Warshaw Letter”).

³⁴ Comment letter of The American Institute of Certified Public Accountants (July 28, 2009) (“AICPA Letter”); comment letter of Center for Audit Quality (July 28, 2009) (“CAQ Letter”); Chamber of Commerce Letter; comment letter of Cohen Fund Audit Services, Ltd. (July 21, 2009) (“Cohen Letter”); Curian Letter; comment letter of Deloitte & Touche LLP (July 28, 2009) (“Deloitte Letter”); comment letter of Ernst & Young (July 28, 2009) (“E&Y Letter”); FPA Letter; FTAM Letter; comment letter of

We believe the surprise examination requirement will deter fraudulent conduct by investment advisers, and that it provides important protections to advisory clients, even when their assets are maintained by an independent qualified custodian.³⁵ If fraud does occur, a surprise examination will increase the likelihood that it is uncovered and thus reduce client losses.³⁶ Therefore, we are requiring advisers with custody of client assets to obtain a surprise examination (or an audit, if applicable in the case of a pooled investment vehicle) of client assets by an independent public accountant, other than as discussed below.³⁷

We acknowledge the concerns raised by commenters with respect to the impact of the surprise examination requirement on smaller advisers whose client assets are maintained by an independent qualified custodian. For this reason, we have directed our

KPMG LLP (July 28, 2009)(“KPMG Letter”); comment letter of Managed Fund Association (July 28, 2009)(“MFA Letter”); MMI Letter; comment letter of McGladrey & Pullen LLP (July 28, 2009)(“M&P Letter”); comment letter of PricewaterhouseCoopers LLP (July 28, 2009)(“PWC Letter”); comment letter of Charles Schwab (July 28, 2009)(“Schwab Letter”); SIFMA(AMG) Letter; SIFMA(PCLC) Letter.

³⁵ We have recently brought enforcement cases in which we alleged advisers misappropriated client assets that were maintained by an independent qualified custodian. See *In re Stratum Wealth Management, LLC and Charles B. Ganz*, Advisers Act Release No. 2930 (Sept. 29, 2009); *In the Matter of Paul W. Oliver, Jr.*, Advisers Act Release No. 2903 (Jul. 17, 2009); *SEC v. Weitzman*, Litigation Release No. 21078 (June 10, 2009); *SEC v. Crossroads Financial Planning, Inc., et al.*, Litigation Release No. 20996 (Apr. 10, 2009).

³⁶ Under the amended rule, the independent public accountant conducting a surprise examination will verify client funds and securities of which an adviser has custody, including those maintained with a qualified custodian and those that are not required to be maintained with a qualified custodian, such as certain privately offered securities and mutual fund shares.

³⁷ Amended rule 206(4)-2(a)(4). An investment adviser required to obtain a surprise examination must enter into a written agreement with an independent public accountant that provides that the first examination will take place by December 31, 2010 or, for advisers that become subject to the rule after the effective date, within six months of becoming subject to the requirement. If the adviser itself maintains client assets as qualified custodian, however, the agreement must provide for the first surprise

staff to evaluate the impact of the surprise examination requirement on smaller advisers that have the authority to obtain possession of client funds or securities and whose client assets are maintained by an independent qualified custodian. We have also asked the staff to evaluate the impact of the surprise exam on these advisers' clients. Following the completion of the first round of surprise examinations of these advisers under the requirements of the amended rule, our staff will conduct a review and provide the Commission with the results of this review, along with any recommendations for amendments necessary to improve the effectiveness of the rule as it applies to these advisers, or address unnecessary burdens on them.

a. Advisers with Limited Custody Due to Fee Deduction

Commenters have persuaded us that the surprise examination will not provide materially greater protection to advisory clients when the adviser has custody of client assets *solely* because of its authority to deduct advisory fees from client accounts.³⁸ The principal risk associated with this limited form of custody is that a fee will be deducted to

examination to occur no later than six months after obtaining the internal control report. *See infra* Section III.B.1.

³⁸ Amended rule 206(4)-2(b)(3). This exception would also be available to such an adviser when the adviser can rely on amended rule 206(4)-2(b)(6). *See infra* Section II.C.2. of this Release. The exception would not be available, however, to an adviser that has custody under the rule for other reasons. Several commenters opposed applying the surprise examination requirement to advisers that serve as trustees for their clients. *See* comment letter of Allegheny Investments (July 28, 2009); Consortium Letter; G&D Letter; IAA Letter; NRS Letter; comment letter of Bruce Siegel (July 28, 2009). Some explained that most advisers that serve as trustees do so as a convenience to existing clients and either do not charge a separate fee or charge only a minimal fee for this service, and that requiring surprise examinations for these advisers will discourage advisers from serving as trustees and result in clients paying higher fees for this service. An adviser acting as trustee typically has significant authority over the assets in the trust, which would likely include the ability to access and, potentially, misuse those assets. We believe that the broad access that trustees typically have to trust assets makes the protections of the surprise examination important for these advisory clients to protect against potential abuse.

which the adviser is not entitled under the advisory contract. The amended rule addresses this risk by enabling the client to monitor the amount of advisory fees deducted by reviewing the account statement which, as discussed above, must be sent directly to the client by the qualified custodian.³⁹ Further, as several commenters noted the surprise examination may not be an effective tool to identify inappropriate fee deductions as it requires the accountant to verify client assets, not determine the accuracy of fees paid.⁴⁰ On balance, we believe that the magnitude of the risks of client losses from overcharging advisory fees does not warrant the costs of obtaining a surprise examination. However, we do believe that appropriate controls should be in place regarding fee deduction, as discussed below.⁴¹

b. Pooled Investment Vehicle Audit

We proposed to require all registered investment advisers with custody of client assets to obtain an annual surprise examination, which included pooled investment vehicles subject to an annual financial statement audit. Several commenters asserted that a surprise examination would be duplicative of the annual financial statement audit and would not materially benefit investors.⁴²

³⁹ Many commenters expressed similar views in their letters. *See* ASG Letter; CFP Board Letter; Dechert Letter; E*Trade Letter; FMC Letter; GE Asset Letter; G&D Letter; Form Letters B, F, and G; IAA Letter; Jackson Letter; MMI Letter; NRS Letter; SIFMA(AMG) Letter; SIFMA(PCLC) Letter; Warshaw Letter.

⁴⁰ ABA Letter; Dechert Letter; FMC Letter; IAA Letter; MMI Letter; Pickard Letter; comment letter of Seward & Kissel LLP (July 29, 2009) (“S&K Letter”).

⁴¹ *See infra* notes 140 and 141 and accompanying text.

⁴² *See* comment letter of Adams Street Partners, LLC (July 28, 2009) (“Adams Street Letter”); Davis Polk Letter; Deloitte Letter; IAA Letter; MFA Letter; comment letter of The Bank of New York Mellon (July 28, 2009) (“Mellon Letter”); comment letter of National Society of Compliance Professionals, Inc. (July 28, 2009) (“NSCP Letter”); comment letter of National Venture Capital Association (July 28, 2009) (“NVCA Letter”); PEC Letter; SIFMA(AMG) Letter; S&K Letter; Warshaw Letter.

During the course of a financial statement audit, the accountant performs procedures comparable to those performed as part of a surprise examination, including verifying the existence of the pooled investment vehicle's funds and securities and obtaining confirmation from investors.⁴³ The financial statement audit also addresses additional matters important to pool investors that are not covered by the surprise examination, such as tests of valuations of pool investments, income, operating expenses, and, if applicable, incentive fees and allocations that accrue to the adviser.⁴⁴

We believe that these and other procedures performed by the accountant during the course of a financial statement audit provide meaningful protections to investors, and that the surprise examination would not significantly add to these protections. Although the annual audit is not required to be performed at a time of the accountant's choosing (as is a surprise examination), we believe other elements of the audit incorporate an element of uncertainty similar to the surprise element of the surprise examination, with corresponding benefits to investors. Specifically, in the course of an annual audit, the auditor will select transactions to test during the period that the adviser will not be able to anticipate.

We have therefore amended the rule to deem an adviser to a pooled investment vehicle that is subject to an annual financial statement audit by an independent public accountant, and that distributes the audited financial statements prepared in accordance

⁴³ See AICPA, *Audit and Accounting Guide*, Investment Companies, (May 1, 2009).

⁴⁴ *Id.*

with generally accepted accounting principles to the pool's investors,⁴⁵ to have satisfied the annual surprise examination requirement ("annual audit provision").⁴⁶

In addition, at the suggestion of several commenters,⁴⁷ we are limiting the rule's recognition of such audits as satisfying the surprise verification requirement to those audits performed by an independent public accountant registered with, and subject to regular inspection by, the PCAOB.⁴⁸ We have greater confidence in the quality of such audits.⁴⁹

We note that under rule 206(4)-2, an adviser to a pooled investment vehicle that distributes to its investors audited financial statements is not required to have a

⁴⁵ Amended rule 206(4)-2(b)(4)(i) requires that the audited financial statements be distributed within 120 days of the end of the pooled investment vehicle's fiscal year. In 2006, our staff issued a letter indicating that it would not recommend enforcement action to the Commission under section 206(4) of the Act or rule 206(4)-2 against an adviser of a fund of funds relying on the annual audit provision of rule 206(4)-2 if the audited financial statements of the fund of funds are distributed to investors in the fund of funds within 180 days of the end of its fiscal year. *See ABA Committee on Private Investment Entities*, SEC Staff Letter (Aug. 10, 2006). The amendments we are adopting today do not affect the views of the staff expressed in that letter.

⁴⁶ Amended rule 206(4)-2(b)(4). We note that an adviser that relies on the annual audit provision must nonetheless undergo an annual surprise examination of non-pooled investment vehicle assets of which it has custody.

⁴⁷ ABA Letter; Adams Street Letter; comment letter of Coalition of Private Investment Companies (July 31, 2009)("CPIC Letter"); MFA Letter.

⁴⁸ Amended rule 206(4)-2(b)(4). The independent public accountant must be registered with, and subject to regular inspection by, the PCAOB as of the commencement of the professional engagement period, and as of each calendar year-end. Several commenters suggested other approaches, including enhancing the audit performed on the pool to include verification of securities (SIFMA(AMG) Letter), requiring an internal control report only instead of both the report and a surprise examination (ABA Letter; PEC Letter), and requiring several specific custody controls for advisers to pooled investment vehicles (CPIC Letter). We have considered the alternative approaches, some of which are beyond the scope of the proposal, and we believe, for the reasons discussed above, that our amendment to this aspect of the rule strikes the right balance.

⁴⁹ *See infra* note 122 and accompanying text.

reasonable belief that a qualified custodian delivers account statements to investors.⁵⁰ As a consequence, investors in pooled investment vehicles do not have the benefit of regularly receiving reports that the assets underlying their investments are properly held. We are therefore concerned that the current protections of the rule may be insufficient, and we have directed our staff to explore ways in which we could remedy this potential shortcoming while respecting the confidential nature of proprietary information.

2. Commission Reporting

We are also adopting a number of rule and form amendments that will result in the Commission and the public receiving greater information about the custody practices of advisers and thus a greater ability to identify potential risks to clients. Under amended rule 206(4)-2, each investment adviser subject to the surprise examination requirement must enter into a written agreement with an independent public accountant to conduct the surprise examination. The agreement must require the accountant, among other things, to notify the Commission within one business day of finding any material discrepancy during the course of the examination, and to submit Form ADV-E to the Commission accompanied by the accountant's certificate within 120 days of the time chosen by the accountant for the surprise examination, stating that the accountant has examined the funds and securities and describing the nature and extent of the examination.⁵¹ The agreement also must provide that, upon resignation or dismissal, the accountant must file

⁵⁰ Rule 206(4)-2(b)(4).

⁵¹ Amended rule 206(4)-2(a)(4)(i) and (ii). The written agreement will also require, in accordance with the current requirements of rule 206(4)-2, the independent public accountant to perform the surprise examination. Advisers must maintain copies of these written agreements under rule 204-2(a)(10). The obligation to maintain the records will apply for five years from the end of the fiscal year during which the last entry was made, the first two years in an appropriate office of the investment adviser. Rule 204-2(e)(1).

within four business days a statement regarding the termination along with Form ADV-E.⁵² Accountants will file Form ADV-E with us electronically, through the Investment Adviser Registration Depository (“IARD”).⁵³ We are adopting these amendments as proposed. The information they provide will assist the Commission’s examination staff and the public in identifying risks raised by the investment adviser’s custodial practices and in determining the frequency and scope of our staff’s examination of an investment adviser.

The new requirement that accountants file Form ADV-E within 120 days of the time chosen by the accountant for the surprise examination is designed to require more timely completion of these examinations. Several commenters suggested that we extend the filing deadline to 180 days, asserting that more complex surprise examinations may take more time.⁵⁴ We note that these commenters’ estimate of the duration of a surprise examination was based on the nature and extent of procedures contemplated under the existing guidance for accountants,⁵⁵ which many asserted was unnecessarily time consuming. As discussed more fully below, our revised guidance for accountants should

⁵² Amended rule 206(4)-2(a)(4)(iii). The written agreement must require that the statement include (i) the date of such termination or removal, and the name, address, and contact information of the accountant, and (ii) an explanation of any problems relating to examination scope or procedure that contributed to such termination. *Id.* One commenter specifically expressed support for these time frames. CFA Institute Letter.

⁵³ Until the IARD system is upgraded to accept Form ADV-E, accountants performing surprise examinations should continue paper filing of Form ADV-E. Advisers will be notified as soon as the IARD system can accept Form ADV-E.

⁵⁴ IAA Letter; M&P Letter; PWC Letter. *See also* Dechert Letter; KPMG Letter; SIFMA(AMG) Letter (advocating for an extension, but not specifying that it be 180 days). One commenter suggested that we shorten it to 45-60 days. CFA Institute Letter.

⁵⁵ *Statement of the Commission describing nature of examination required to be made of all funds and securities held by an investment adviser and the content of related accountant's certificate*, Accounting Series Release No. 103, Investment Advisers Act Release No. 201 (May 26, 1966) (“ASR No. 103”).

address many of these concerns.⁵⁶ As a result, we believe that 120 days will be sufficient for an accountant to complete the examination.

Several commenters suggested we modify the requirement regarding the accountant's filing of a statement upon termination. Some argued that these filings should not be made available to the public,⁵⁷ that they should not be required if the accountant was terminated for innocuous reasons,⁵⁸ and that the adviser should have primary responsibility to report accountant dismissals, so that the accountant would submit a report only if the adviser failed to do so.⁵⁹ We have not revised the requirement in response to these comments. We believe it is important that the public have access to the termination statements to permit clients and prospective clients to assess for themselves the reasons for the termination of an accountant's engagement or an accountant's removal from consideration for being reappointed. Disclosure of a termination, even for apparently innocuous reasons, could provide useful information to advisory clients and to our staff. For example, identifying frequent changes in accountants could put clients and prospective clients on notice to inquire about the reasons for these events. Finally, while advisers are responsible for reporting accountant dismissals on Form ADV, the accountant's statement serves as an independent check on the adviser's filing and, as such, is important to increasing the effectiveness of the surprise examination requirement.

⁵⁶ See Section II.B.4. of this Release.

⁵⁷ E*Trade Letter (arguing more broadly that *no* Form ADV-E filings should be made public, regardless of the reason for filing); IAA Letter; S&K Letter; Turner Letter.

⁵⁸ Davis Polk Letter; E*Trade Letter; IAA Letter.

⁵⁹ KPMG Letter.

3. Privately Offered Securities

We are adopting, as proposed, amendments to rule 206(4)-2 to no longer permit the accountant conducting the annual verification of client assets to forego examining certain privately offered securities, as defined in the rule.⁶⁰ As a result, advisers that maintain custody of privately offered securities on behalf of clients will be subject to the surprise examination requirement.⁶¹

Several commenters supported expanding the rule in this respect.⁶² Others, however, asserted that the risk of fraud or misappropriation is low with respect to privately offered securities because they are not easily transferable, while the costs and practical difficulties of including these securities in a surprise exam may be considerable.⁶³ While privately offered securities may present little risk with respect to transferability, they present significant risks in other regards. First, it is difficult for

⁶⁰ The amended rule retains the current definition of “privately offered securities” as securities that are (i) acquired from the issuer in a transaction or chain of transactions not involving any public offering, (ii) uncertificated, and ownership thereof is recorded only on the books of the issuer or its transfer agent in the name of the client, and (iii) transferable only with prior consent of the issuer or holders of the outstanding securities of the issuer. *See* amended rule 206(4)-2(b)(2).

⁶¹ We received various suggestions from commenters, some conflicting, regarding our approach to privately offered securities. *See* ABA Letter (suggesting that the Commission only subject privately offered securities held by the adviser or by related persons to surprise examinations, arguing that such a limitation would reduce costs and target the assets at greatest risk of misappropriation); MFA Letter (proposing that the Commission affirmatively state that some assets, such as bank loans and swaps, are not securities for purposes of rule 206(4)-2 and are, therefore, not subject to the rule). Others advocated expanding the annual verification requirement. *See* CPIC Letter (suggesting that the custody rule cover all assets held by private funds, not just securities and funds and proposing that all non-traditional assets should be held in the name of the custodian and all cash flows should be required to go through the custodian). We have considered the comments and, for the reasons discussed above, we believe our amendment to this aspect of the rule strikes the right balance with respect to privately offered securities.

⁶² ABA Letter; CFA Institute Letter; CPIC Letter; comment letter of The New York State Society of Certified Public Accountants (July 27, 2009).

⁶³ Davis Polk Letter; MFA Letter; NVCA Letter; PWC Letter.

advisory clients to verify that these assets actually exist because ownership of such securities is recorded only on the issuers' books. Second, clients may have to rely on the information provided by the adviser to confirm their ownership of privately offered securities, as well as the existence of the underlying investment, when the adviser maintains custody of these securities.⁶⁴ Because clients are more dependent on the adviser with respect to the safeguarding of these securities, advisory clients may be exposed to additional risks when their advisers acquire these securities on their behalf. To mitigate these risks and to provide assurance that privately offered securities are properly safeguarded, we believe that it is appropriate to require an independent third-party to verify client ownership with the issuers of the securities by requiring that these securities be subject to the surprise examination requirement under the amended rule.⁶⁵

It is our understanding that many accountants today do verify private securities in the course of a surprise examination, and several commenters requested that we provide guidance as to the procedures that an accountant should undertake with respect to the surprise examination of privately offered securities.⁶⁶ In our companion release, we

⁶⁴ Rule 206(4)-2 does not require advisers, with one limited exception, to maintain these assets with a qualified custodian because of the difficulties raised by recording ownership of the securities only on the books of the issuer. Rule 206(4)-2(b)(2). *See also* 2003 Adopting Release, at Section II.B.

⁶⁵ Under amended rule 206(4)-2 an adviser may maintain custody of privately offered securities without being subject to the requirements that apply to advisers that maintain custody of client assets as qualified custodians set forth in paragraph (a)(6) of the rule, such as the internal control report, because the adviser need not be a qualified custodian to maintain custody of those securities. Amended rule 206(4)-2(b)(2). If, however, the adviser holding the privately offered securities also has custody of other client funds or securities as qualified custodian, the adviser is subject to the requirements set forth in paragraph (a)(6) of the rule.

⁶⁶ MFA Letter; comment letter of The Association of Global Custodians (Aug. 03, 2009)(“AGC Letter”); MarketCounsel Letter; comment letter of Sullivan & Cromwell (July 28, 2009).

provide guidance for accountants regarding conducting a surprise examination of client assets, including privately offered securities.⁶⁷

4. Guidance for Accountants

In the Proposing Release, we requested that commenters address whether, and if so how, we should revise the guidance for accountants that we issued regarding the surprise examination.⁶⁸ Commenters that responded all generally agreed that our existing guidance, which we published in 1966, is inadequate because it neither reflects today's custodial practices nor adequately recognizes certain commonly accepted auditing practices.⁶⁹ In a companion release, we are providing updated guidance for accountants that addresses the surprise examination, as well as the internal control report required under amended rule 206(4)-2 and the relationship between them.⁷⁰ Our guidance discusses the relevant auditing and attestation standards that apply to these engagements, and, among other things, the nature and extent of the accountant's procedures with respect to the surprise examination. The revised guidance for accountants will modernize the procedures for the surprise examination.

⁶⁷ See *infra* note 70 and accompanying text. In the Proposing Release we requested comment on whether we should require the accountant performing the surprise examination to perform testing on the valuation of securities, including privately offered securities. One commenter stated that, although valuation is a very important issue closely related to client assets, it covers an area that goes beyond custody. Dechert Letter. We agree and are therefore not requiring accountants to perform testing of valuation as part of the surprise examination.

⁶⁸ Proposing Release, at Section II.

⁶⁹ AICPA Letter; CAQ Letter; Chamber of Commerce Letter; Cohen Letter; Curian Letter; Deloitte Letter; E&Y Letter; FTAM Letter; KPMG Letter; MFA Letter; MMI Letter; M&P Letter; PWC Letter; Schwab Letter; SIFMA(AMG) Letter; SIFMA(PCLC) Letter.

⁷⁰ See *Commission Guidance Regarding Independent Public Accountant Engagements Performed Pursuant to Rule 206(4)-2 Under the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 2969 (Dec. 30, 2009) ("Accounting Release").

C. Custody by Adviser and Related Person

As amended, rule 206(4)-2 imposes additional requirements when advisory client assets are maintained by the adviser itself or by a related person rather than with an independent qualified custodian. As proposed, the amended rule requires, in addition to the surprise examination discussed above,⁷¹ that when an adviser or its related person serves as a qualified custodian for advisory client funds or securities under the rule, the adviser obtain, or receive from its related person, no less frequently than once each calendar year, a written report, which includes an opinion from an independent public accountant with respect to the adviser's or related person's controls relating to custody of client assets ("internal control report"), such as a Type II SAS 70 report.⁷² The amended rule also requires, in these circumstances, that the accountant issuing the internal control report, as well as the accountant performing the surprise examination, be registered with, and subject to regular inspection by, the PCAOB.⁷³ The adviser must maintain the

⁷¹ See *supra* notes 28-37 and accompanying text. Several commenters asserted that the surprise examination would be duplicative of existing regulatory requirements (*see, e.g.*, comment letter of American Bankers Association (July 28, 2009) ("American Bankers Letter"); comment letter of LPL Financial (July 28, 2009) ("LPL Letter"); Mellon Letter; Schwab Letter; and SIFMA(PCLC) Letter). As we discuss later, the surprise examination requirement is important and not duplicative because it works in concert with the internal control report to protect advisory clients and because there are no existing regulatory requirements specifically focused on risks that may arise in the self or affiliated custody context. See *infra* notes 85-87 and accompanying text. Other commenters agreed that the surprise examination and internal control report are independently valuable and not duplicative (*see* E&Y Letter and NASAA Letter).

⁷² Amended rule 206(4)-2(a)(6)(ii). As discussed in more detail below, other types of reports could also satisfy the internal control report requirement. See *infra* notes 98-100 and accompanying text.

⁷³ Amended rule 206(4)-2(a)(6)(i) and (ii)(C). The Commission's standards for the independence of accountants is set forth in Article 2, Rule 2-01 of Regulation S-X [17 CFR 210.2-01]. See 2003 Adopting Release at n.32. Article 2-01 does not preclude the accountant performing the surprise examination from also preparing the internal control report. The determination, however, of whether an accountant is independent under Article 2-01 includes consideration of all the relevant facts and circumstances.

internal control report in its records and make it available to the Commission staff upon request.⁷⁴

1. Internal Control Report

Related person custody arrangements can present higher risks to advisory clients than maintaining assets with an independent custodian. As we pointed out in the Proposing Release, several of the recent enforcement actions in which we have alleged misappropriation of client assets have involved advisers or related persons that maintained client assets.⁷⁵ We requested comment on whether we should prohibit advisers from advising clients whose assets are maintained with the adviser or a related person.

Some commenters supported requiring an “independent” qualified custodian,⁷⁶ although many commenters opposed the requirement.⁷⁷ Several argued that use of an independent custodian would be an impractical requirement for many types of advisory accounts held by smaller investors with broker-dealers, such as wrap fee accounts, in which a client receives bundled advisory and brokerage services from a single firm (or

⁷⁴ Amended rule 204-2(a)(17)(iii).

⁷⁵ *See supra* note 1.

⁷⁶ *See, e.g.*, NASAA Letter; comment letter of The National Association of Active Investment Managers (July 27, 2009) (“NAAIM Letter”); NVCA Letter; comment letter of Kay Conheady (June 4, 2009); comment letter of Carol Y. Godsave (June 15, 2009); comment letter of Michael A. Pagano (June 26, 2009); comment letter of Robert J. Reed (June 1, 2009); comment letter of Robert N. Veres (June 27, 2009).

⁷⁷ *See, e.g.*, ABA Letter; AGC Letter; CLS Letter; Curian Letter; Davis Polk Letter; Dechert Letter; E*Trade Letter; FPA Letter; comment letter of Lincoln Investment (July 28, 2009); LPL Letter; comment letter of National Planning Holdings, Inc. (July 28, 2009) (“NPH Letter”); Pickard Letter; Schwab Letter; SIFMA(PCLC) Letter; comment letter of L.A. Schnase (July 3, 2009) (“Schnase Letter”); comment letter of State Street Corporation (July 28, 2009).

related firms) regulated as both an investment adviser and a broker-dealer.⁷⁸ It is common for institutional clients to maintain assets in a custodial account, often with a bank that is unaffiliated with the client's adviser. We are concerned, however, that requiring an independent custodian could make unavailable many advisory accounts popular with smaller investors, which are today maintained by the adviser or its affiliated brokerage firm or bank. Therefore, we are not amending the rule to require use of an independent custodian, although we encourage the use of custodians independent of the adviser to maintain client assets as a best practice whenever feasible.

To address the custodial risks associated with an affiliated custodial relationship, we proposed requiring, in addition to the surprise examination, an adviser to obtain, or receive from its related person, an annual internal control report, which would include an opinion from an independent public accountant with respect to the adviser's or related person's custody controls. We were concerned that the surprise examination alone would not adequately address custodial risks associated with self or related person custody because the independent public accountant seeking to verify client assets would rely, in part, on custodial reports issued by the adviser or the related person.

Several commenters expressed their support for the proposed internal control report requirement.⁷⁹ Two stated that our approach appropriately targets the frauds we are concerned about.⁸⁰ One large custodian urged us to require all qualified custodians to

⁷⁸ ABA Letter; Curian Letter; Davis Polk Letter; E*Trade Letter; Pickard Letter; Schnase Letter; Schwab Letter; SIFMA(PCLC) Letter.

⁷⁹ AICPA Letter; CFP Board Letter; Cornell Letter; comment letter of Diamant Asset Management, Inc. (July 20, 2009); E&Y Letter; FMC Letter; IAA Letter; NASAA Letter; NPH Letter; Pickard Letter; comment letter of T. Rowe Price Associates, Inc. (July 28, 2009)("T. Rowe Letter").

⁸⁰ CFP Board Letter; IAA Letter.

obtain an internal control report.⁸¹ Another agreed with our assessment that when the adviser or its related person acts as qualified custodian, there is increased risk to clients because the adviser may “misappropriate assets as a result of collusion with [its] affiliated custodians.”⁸² Other commenters, including those representing banks and broker-dealers, however, objected to the internal control report requirement, arguing that qualified custodians are already subject to extensive regulatory oversight and that the additional requirement would be duplicative of existing legal and regulatory requirements.⁸³ They argued that we would be imposing an unnecessary additional regulatory burden on affected custodians.

The internal control report requirement we are adopting today will provide important additional safeguards for client assets maintained with the adviser or a related person. As discussed in more detail below, the adviser must obtain or receive an internal control report that demonstrates that it, or its related person, has established appropriate custodial controls.⁸⁴ As we noted in the Proposing Release, the internal control report can significantly strengthen the utility of the surprise examination when the adviser or a related person acts as qualified custodian for client assets because it provides a basis for the independent public accountant performing the surprise examination to obtain additional comfort that the confirmations received from the related custodian are

⁸¹ Schwab Letter.

⁸² ABA Letter.

⁸³ LPL Letter; MMI Letter; NSCP Letter; comment letter of Pershing LLC (July 28, 2009) (“Pershing Letter”); SIFMA(PCLC) Letter; American Bankers Letter; comment letter of J.P. Morgan (Aug. 26, 2009).

⁸⁴ Amended rule 206(4)-2(a)(6). An investment adviser subject to this requirement must obtain or receive an initial internal control report within six months of becoming subject to the requirement. See *infra* Section III.B.2. of this Release.

reliable.⁸⁵ The requirement to obtain an internal control report therefore serves both to inform the surprise examination process and may itself act as a deterrent to fraud by advisers that may consider misappropriating client assets directly or through a related person.⁸⁶

We have carefully considered commenters' concerns about regulatory duplication in designing the internal control report requirement. We are adopting this requirement because there is no existing regulatory requirement applicable to investment advisers or other entities, such as broker-dealers and banks, that serve as qualified custodians that we believe is specifically focused on internal control risks that may arise in the affiliated custody context. We have, however, developed our guidance for accountants to permit accountants, when preparing an internal control report, to rely on their own relevant audit work performed for other purposes, including audit work performed to meet existing regulatory requirements, which should increase efficiencies in the audit process and help address commenters' concerns about duplication.⁸⁷

We do not believe that the internal control report requirement will be unduly burdensome. A qualified custodian would only have to obtain an internal control report if it maintains the funds or securities of its own advisory clients or those of advisory clients of related persons. As one securities industry commenter noted, custodians often provide Type II SAS 70 reports to clients who demand a rigorous evaluation of internal

⁸⁵ Proposing Release, at Section II.B.2.

⁸⁶ *See id.*

⁸⁷ For example, accountants for broker-dealers perform a variety of procedures as part of a broker-dealer's financial statement audit and to satisfy related requirements under the Securities Exchange Act of 1934 ("Exchange Act"), including reconciliation procedures required for broker-dealers under the Exchange Act. *See infra* note 95.

control as a condition of obtaining their business.⁸⁸ A related person custodian therefore may be able to use a Type II SAS 70 report it is already obtaining and providing to other clients to satisfy the rule's requirement, and may also be able to use the same internal control report to satisfy the rule's requirement for several related advisers whose clients use the custodian.

The elements of the required internal control report are set forth in the companion release we are issuing today, which includes guidance for accountants regarding the overall objectives and scope of the internal control examination.⁸⁹ The internal control report must include the accountant's opinion as to whether the qualified custodian's internal controls have been placed in operation as of a specific date, and are suitably designed, and are operating effectively to meet control objectives related to custodial services, including the safeguarding of funds and securities of advisory clients during the year.⁹⁰ In order for the accountant to be able to form this opinion, the internal control report should address control objectives and associated controls related to the areas of client account setup and maintenance, authorization and processing of client transactions, security maintenance and setup, processing of income and corporate action transactions, reconciliation of funds and security positions to depositories and other unaffiliated custodians, and client reporting.⁹¹

We have revised the amended rule to state that, for the internal control report to satisfy the rule's requirements, the independent public accountant preparing the report

⁸⁸ SIFMA(AMG) Letter (noting that obtaining such a report is an "industry best practice").

⁸⁹ See Accounting Release.

⁹⁰ Amended rule 206(4)-2(a)(6)(ii)(A).

⁹¹ See Accounting Release.

must verify that the client funds and securities are reconciled to a custodian other than the adviser or its related person.⁹² Reconciliation of custodial records to depositories is a key control objective of the internal control report, which will report on, among other things, tests of controls designed to meet this specific objective.⁹³ Internal control reports regarding custody, such as Type II SAS 70 reports, however, may not necessarily include specific procedures performed by the accountant that are designed to verify the reconciliation of funds and securities of unaffiliated custodians. Verification with unaffiliated custodians serves as a critical check on potential collusion when the adviser or its related person acts as custodian. The accountant preparing the internal control report is in the best position to perform this check because the accountant will have access to the information necessary to verify assets when testing controls over the custodian's reconciliation processes. For this reason, we are requiring this verification to be performed in connection with, and reported in, the internal control report.

As described in our guidance for accountants, the accountant's verification that client funds and securities are reconciled to an unaffiliated custodian (*e.g.*, the Depository Trust Corporation) can be accomplished in one of two ways.⁹⁴ The accountant may either obtain direct confirmation, on a test basis, with unaffiliated custodians or perform other procedures designed to verify that the data used in reconciliations performed by the qualified custodian is obtained from unaffiliated custodians and is unaltered.⁹⁵

⁹² Amended rule 206(4)-2(a)(6)(ii)(B).

⁹³ See Proposing Release at Section II.B.2.

⁹⁴ See Accounting Release.

⁹⁵ In meeting this requirement, the accountant can also incorporate its own work performed pursuant to other regulatory requirements, such as requirements under the Exchange Act. Under rule 17a-13 under the Exchange Act, most brokers and dealers are required to conduct a securities count at least once each calendar quarter, which includes, among

We noted several specific control objectives in the Proposing Release that we suggested might be included in the scope of an internal control report prepared under the proposed rule.⁹⁶ Some commenters urged that we establish minimum control objectives that need to be addressed as part of the internal control report as a means of ensuring consistency in practice.⁹⁷ In response to these comments, we are identifying certain minimum control objectives within our revised guidance for accountants.

We are not requiring that a specific type of internal control report be provided under the rule as long as the objectives noted above are addressed. This flexibility should permit accountants of qualified custodians to leverage audit work they have performed to satisfy existing regulatory requirements to which these custodians are subject, or work currently performed as part of internal control reports prepared to meet client demand. In the Proposing Release, we indicated that a Type II SAS 70 report would be sufficient to satisfy the requirements of the internal control report.⁹⁸ As we noted in our guidance for accountants, a report issued in connection with an examination of internal control conducted in accordance with AT Section 601, *Compliance Attestation* ("AT 601") under

other things, a physical examination and count of all securities held, verification (through confirmation or other form of outside documentation) of all securities deposited or otherwise subject to the broker-dealer's control or direction, and reconciliation of the results of such count and verification to the broker-dealer's records. Under rule 17a-5, the broker-dealer's independent accountant provides a supplemental report on internal control which addresses, among other things, the broker-dealer's compliance with rule 17a-13. See Rules 17a-13 and 17a-5 under the Exchange Act [17 CFR Parts 240.17a-13 and 17a-5].

⁹⁶ See Proposing Release, at Section II.B.2.

⁹⁷ See, e.g., AICPA Letter; Deloitte Letter.

⁹⁸ See Proposing Release, at Section II.B.2.

the standards of the American Institute of Certified Public Accountants⁹⁹ would also be sufficient, provided that such examination meets the objectives set forth in our guidance.¹⁰⁰

2. Related Persons

We are amending rule 206(4)-2, as proposed, to provide that an adviser has custody of any client securities or funds that are directly or indirectly held by a “related person” in connection with advisory services provided by the adviser to its clients.¹⁰¹ A related person is defined by the rule as a person directly or indirectly controlling or controlled by the adviser and any person under common control with the adviser.¹⁰²

We received some support for this proposal.¹⁰³ Several commenters urged us to instead adopt the approach our staff has taken in no-action letters in which the staff expressed the view that custody of client assets by a related person would not be attributed to the adviser if the related person was operationally separate.¹⁰⁴ Those letters expressed our staff’s views regarding the scope of the custody rule which, at that time, did not explicitly

⁹⁹ AT 601 provides guidance to accountants for engagements related to either a firm’s compliance with the requirements of particular laws or rules, or the effectiveness of the firm’s internal controls over compliance with those particular requirements.

¹⁰⁰ We have made technical changes to the description of the internal control report in amended rule 206(4)-2(a)(6)(ii)(A) to reflect that our adopted rule permits use of internal control reports other than the Type II SAS 70.

¹⁰¹ Amended rule 206(4)-2(d)(2) (defining “custody”).

¹⁰² Amended rule 206(4)-2(d)(7). For advisers that are part of multi-service financial organizations, for example, such related person custodians may include broker-dealers and banks.

¹⁰³ See CFA Institute Letter; Cornell Letter; FPA Letter; NAAIM Letter.

¹⁰⁴ See, e.g., IAA Letter; Mellon Letter; MMI Letter; NRS Letter; Pershing Letter. Several other commenters suggested similar approaches, including revising the definition of custody based on the factors the staff considered in these no-action letters (T. Rowe Letter), and not considering firms under common control to be deemed related persons under the rule (IAA Letter; Pickard Letter; Schnase Letter; SIFMA(PCLC) Letter). We are not adopting either of these approaches for the same reasons as explained above.

address the applicability of the rule to an entity related to the adviser as parent company, sister company or wholly-owned subsidiary that holds or has access to client assets.¹⁰⁵

We believe that the authority or influence an adviser may have over such related persons presents sufficient risks as a result of a related person's ability to obtain client assets, that we should treat the adviser itself as having custody over the client assets.¹⁰⁶ Therefore, we are adopting the amendment as proposed.¹⁰⁷

We are, however, addressing commenters' concerns in a different way by providing a limited exception from the surprise examination requirements in circumstances when the adviser is deemed to have custody solely as a result of a related person having custody.¹⁰⁸ The exception is available to an adviser that is (i) deemed to have custody solely as a result of certain of its related persons holding client assets, and (ii) "operationally independent" of the custodian.¹⁰⁹

As discussed above, a key premise of our approach to the custody rule is that client assets may be at greater risk when they are maintained by a related person of the investment adviser. As commenters suggested, however, firms under common ownership

¹⁰⁵ See, e.g., *Crocker Investment Management Corp.*, SEC Staff Letter (Apr. 14, 1978) ("*Crocker*").

¹⁰⁶ See Proposing Release, Section II.B.1. We note that under rule 206(4)-2, as amended, only client assets held by a related person "in connection with advisory services" provided by the adviser would be attributable to the adviser. See rule 206(4)-2(d)(2). Consequently, an adviser will not be deemed to have custody of client assets held with a qualified custodian that is a related person of the adviser if the adviser does not provide advice with respect to such assets.

¹⁰⁷ Amended rule 206(4)-2. In light of our amended definition of custody, our staff is withdrawing several no-action letters to the extent such letters are inconsistent with this definition, including *Crocker* and *Pictet et Cie*, SEC Staff Letter (Jun. 22, 1980). Advisers, including those firms that have relied on these letters in the past, must comply with the amended rule.

¹⁰⁸ Amended rule 206(4)-2(b)(6).

¹⁰⁹ *Id.*

that are operationally independent of each other present substantially lower client custodial risks than those that are not because misuse of client assets would tend to require collusion among employees, not significantly different than would be necessary to engage in similar misconduct between unaffiliated organizations.¹¹⁰

Under the amended rule, a related person that holds, or has authority to obtain possession of, advisory client assets would be presumed not to be operationally independent of the adviser unless the adviser can meet the rule's conditions, which are similar to the factors that our staff has used to evaluate whether an adviser has custody of client funds and securities indirectly under the rule as a consequence of the custody of a related person,¹¹¹ and no other circumstances exist that can reasonably be expected to compromise the operational independence of the related person.¹¹² An adviser that is able to satisfy these conditions and overcome the presumption that it is not operationally independent of its related person would not have to obtain a surprise examination of client assets held by a related person, including a related person that is a qualified

¹¹⁰ MMI Letter; Davis Polk Letter. This conclusion is implicit in our staff's no-action letter upon which the staff has relied to determine whether an adviser indirectly has custody of client assets when its related person does. See *Crocker*, *supra* note 105.

¹¹¹ Amended rule 206(4)-2(d)(5) (defining "operationally independent"). The conditions set out in the rule are: (i) client assets in the custody of the related person are not subject to claims of the adviser's creditors; (ii) advisory personnel do not have custody or possession of, or direct or indirect access to client assets of which the related person has custody, or the power to control the disposition of such client assets to third parties for the benefit of the adviser or its related persons, or otherwise have the opportunity to misappropriate such client assets; (iii) advisory personnel and personnel of the related person who have access to advisory client assets are not under common supervision; and (iv) advisory personnel do not hold any position with the related person or share premises with the related person. We would not consider a related person that shared management persons with the adviser, including an owner that was actively involved in the management of the two firms, to be operationally independent.

¹¹² For example, the management of the adviser and related person could be controlled by persons with close familial relationships such as spouses, siblings, or parents and adult children.

custodian. The adviser would, however, have to comply with the other provisions of the rule (unless an exception is available), including notifying the client where the assets are maintained, forming a reasonable belief after due inquiry that the qualified custodian sends the client account statements, and obtaining an internal control report from a related person that is a qualified custodian.¹¹³ We believe that the conditions set out in the rule appropriately accomplish our objective of identifying advisers that are not operationally independent and thus present sufficient custodial risks that the adviser should be subject to a surprise examination.

We emphasize that an adviser that has custody due to reasons in addition to, or other than, a related person having custody *cannot* rebut the presumption contained in the rule. Thus, for example, an adviser that has custody because it serves as a trustee with respect to client assets held in an account at a broker-dealer that is a related person could not rely on the exception from the surprise examination on the grounds that the broker-dealer was operationally independent and that the factors discussed above were met.¹¹⁴ Such an adviser would be subject to the surprise examination requirement *and* would have to receive an internal control report from the related person qualified custodian.¹¹⁵

¹¹³ We believe these safeguards remain important because even when an adviser has demonstrated that a related person is operationally independent, the risks to client assets raised by common control may be greater than if client assets were maintained by an independent custodian.

¹¹⁴ We have also amended the rule so that the exception from the surprise examination requirement with respect to client assets of advisers that have custody as a result of their ability to deduct advisory fees from client assets applies to such advisers when their client assets are held by a custodian that is not a related person of the adviser as well as when the adviser can rely on amended rule 206(4)-2(b)(6). *See* amended rule 206(4)-2(b)(3). For the reasons described above, when the related person custodian is operationally independent, we do not believe the custodial risks raised warrant the costs of obtaining a surprise examination.

¹¹⁵ Under the rule, an adviser whose client assets are maintained by a related person qualified custodian that is not operationally independent from the adviser, must

We are also amending rule 204-2 to require an adviser whose client assets are held by a related person but does not undergo a surprise examination to make and keep a memorandum describing the relationship with the related person in connection with advisory services the adviser provides to clients and including an explanation of the adviser's basis for determining that it has overcome the presumption that it is not operationally independent of the related person with respect to the related person's custody of client assets.¹¹⁶

3. PCAOB Registration and Inspection

Under the amendments, the surprise examination and internal control report required when the adviser or its related person serves as qualified custodian for client assets may be satisfied only when performed or prepared by an independent public accountant that is registered with, and subject to regular inspection by, the PCAOB.¹¹⁷ We have greater confidence in the quality of the surprise examination and the internal control report when prepared by an independent public accountant that is registered with, and subject to regular inspection by, the PCAOB.

Many commenters supported this requirement, agreeing with us that PCAOB registration would provide an important quality check on the independent accountants

obtain a surprise examination of those assets as if it held the assets itself and were required to obtain a surprise examination with respect to those assets. As a result, for example, a broker-dealer that is also a qualified custodian of its client's advisory assets could not avoid obtaining a surprise examination by creating an operationally integrated subsidiary to provide investment advice.

¹¹⁶ See amended rule 204-2(b)(5).

¹¹⁷ Amended rule 206(4)-2(a)(6). The independent public accountant must be registered with, and subject to regular inspection by, the PCAOB as of the commencement of the professional engagement period, and as of each calendar year-end.

performing these services.¹¹⁸ Two of those commenters asserted that PCAOB registration would serve to discourage accounting fraud in the higher risk situation posed by an adviser or its related person maintaining client assets.¹¹⁹ Commenters opposing the requirement expressed concern that the PCAOB's authority is limited to inspecting accountants with respect to audits of public issuers, which does not include the surprise examinations and internal control reports meeting the requirements of rule 206(4)-2.¹²⁰ One commenter urged us to exempt offshore advisers from this requirement, asserting that some foreign countries do not have enough accountants registered with the PCAOB to support a competitive marketplace for their services.¹²¹

We acknowledge that the PCAOB does not currently inspect auditor engagements required solely as a result of rule 206(4)-2. We nonetheless believe a requirement that excludes accountants that are not registered with and examined by the PCAOB will provide greater confidence in the quality of the independent public accountant and complement the enhanced controls under the rule that apply when client assets are not maintained by an independent qualified custodian and in audits of certain pooled investment vehicles.¹²² While PCAOB inspection is focused on public company audit engagements, we believe that requiring that the accountant not only be registered with the

¹¹⁸ Surprise exam and internal control report – E&Y Letter; NAAIM Letter; internal control report only – CPIC Letter; IAA Letter; Pickard Letter; NASAA Letter; surprise examination only – ABA Letter; Curian Letter; FPA Letter; Turner Letter.

¹¹⁹ CPIC Letter; FPA Letter.

¹²⁰ CAS Letter; CAQ Letter; Chamber of Commerce Letter; FTAM Letter.

¹²¹ ABA Letter.

¹²² The PCAOB performs regular inspections with respect to any registered public accounting firm that, during any of the three prior calendar years, issued an audit report with respect to at least one issuer. Under the amended rule, an adviser's use of an independent public accountant that is registered with the PCAOB but not subject to regular inspection would *not* satisfy the rule's requirements. See PCAOB rule 4003.

PCAOB but subject to its inspection can provide indirect benefits regarding the quality of the accountant's other engagements.

We recognize that there may be fewer PCAOB-registered and inspected independent public accountants in certain foreign jurisdictions. Based on discussions with accounting firms, however, we do not expect advisers will have significant difficulty in finding a local auditor that is eligible under the rule. Many PCAOB-registered independent public accountants currently have practices in those jurisdictions in which most offshore advisers and funds are domiciled.¹²³ In addition, some accounting firms have international practices, which may ameliorate concerns regarding offshore availability. Finally, we will continue to monitor the situation as the rule is implemented and consider any issues that may arise.

D. Liquidation Audit

As proposed, the amended rule requires that advisers to pooled investment vehicles that distribute the pool's audited financial statements to investors under the rule's annual audit provision must, in addition to obtaining an annual audit, obtain a final audit of the pool's financial statements upon liquidation of the pool and distribute the financial statements to pool investors promptly after the completion of the audit.¹²⁴ This

¹²³ See http://www.pcaobus.org/Registration/Registered_Firms_by_Location.pdf. We also note that our staff has issued a letter indicating that it would not recommend enforcement action to the Commission under section 206(4) of the Advisers Act or rule 206(4)-2 under the Act against offshore advisers to offshore pooled investment vehicles if those advisers did not comply with certain substantive rules under the Advisers Act, including the custody rule. See *ABA Subcommittee on Private Investment Entities*, SEC Staff Letter (Aug. 10, 2006). The amendments we are adopting today do not affect the views of the staff expressed in that letter.

¹²⁴ Amended rule 206(4)-2(b)(4). Each such set of audited financial statements must be prepared in accordance with generally accepted accounting principles.

amendment is designed to assure that the proceeds of the liquidation are appropriately accounted for so that pool investors can take timely steps to protect their rights.

One commenter thought that liquidation audits should not be required as the costs outweigh the benefits.¹²⁵ We disagree. We believe that a liquidation audit is an important control to protect assets at a time they may be particularly vulnerable to misappropriation.

E. Pooled Investment Vehicles

The custody rule's application to investment advisers to pooled investment vehicles will change in several aspects as a result of the amendments we are adopting today. Because a detailed discussion of each of these changes appears throughout multiple different sections of this Release, we are providing a centralized summary here.

Under amended rule 206(4)-2, advisers to pooled investment vehicles may be deemed to comply with the surprise verification requirements of the rule by obtaining an audit of the pool and delivering the audited financial statements to pool investors within 120 days of the pool's fiscal year-end.¹²⁶ The audit must be conducted by an accounting firm registered with, and subject to regular inspection by, the PCAOB.¹²⁷ If the pooled investment vehicle does not distribute audited financial statements to its investors, the adviser must obtain an annual surprise examination and must have a reasonable basis, after due inquiry, for believing that the qualified custodian sends an account statement of the pooled investment vehicle to its investors in order to comply with the custody rule.¹²⁸

¹²⁵ S&K Letter.

¹²⁶ Amended rule 206(4)-2(b)(4). *See supra* note 45.

¹²⁷ Amended rule 206(4)-2(b)(4)(ii).

¹²⁸ Amended rule 206(4)-2(b)(4).

The rule requires the accounting firm performing the surprise examination to verify privately offered securities, along with other funds and securities, held by a pool that is not subject to a financial statement audit.¹²⁹ Regardless of whether an adviser to a pooled investment vehicle obtains a surprise examination or satisfies that requirement by obtaining an audit, if the pooled investment vehicle's assets are maintained with a qualified custodian that is either the adviser to the pool or a related person of the adviser, the adviser to the pool would have to obtain, or receive from the related person, an internal control report.¹³⁰ Finally, the rule requires advisers to pools complying with the rule by distributing audited financial statements to investors to also obtain an audit upon liquidation of the pool when the liquidation occurs prior to the fund's fiscal year-end.¹³¹

F. Delivery to Related Persons

The Commission is adopting a new provision in rule 206(4)-2 that would preclude advisers from using layers of pooled investment vehicles to avoid meaningful application of the protections of the Rule. Specifically, we are adding a new paragraph (c), which provides that sending an account statement (paragraph (a)(5)) or distributing audited financial statements (paragraph (b)(4)) will not meet the requirements of the rule if all of the investors in a pooled investment vehicle to which the statements are sent are themselves pooled investment vehicles that are related persons of the adviser.

¹²⁹ Section II.B.3. of this Release. Accounting firms that perform surprise examinations under the amended rule are required to report material deficiencies to our staff and also report on Form ADV-E the termination of an engagement as well as the results of the surprise examination.

¹³⁰ See paragraphs (a)(6), and (b)(4) of amended rule 206(4)-2. This applies only where the use of a qualified custodian is required by the rule.

¹³¹ Amended rule 206(4)-2(b)(4)(iii).

Investment advisers to pooled investment vehicles may from time to time use special purpose vehicles (SPVs) to facilitate investments in certain securities by one or more pooled investment vehicles that the advisers manage. These SPVs are typically established or controlled by the investment adviser or its related persons who often serve as general partners of limited partnerships (or managing members of limited liability companies, or persons who hold comparable positions for another type of pooled investment vehicle). Therefore, a literal application of the rule could result in account statements and financial statements designed to permit investors to protect their interests being sent to the adviser itself, rather than to the parties the rule was designed to protect.¹³²

To comply with the rule, as amended, the investment adviser could either treat the SPV as a separate client, in which case the adviser will have custody of the SPV's assets, or treat the SPV's assets as assets of the pooled investment vehicles of which it has custody indirectly. If the adviser treats the SPV as a separate client, rule 206(4)-2 requires the adviser to comply separately with the custody rule's audited financial statement distribution or account statement and surprise examination requirements (*e.g.*, distribute audited financial statements of the SPV pursuant to the requirements of rule 206(4)-2). Accordingly, advisers should distribute the audited financial statements or account statements of the SPV to the beneficial owners of the pooled investment vehicles. If, however, the adviser treats the SPV's assets as assets of the pooled investment vehicles of which it has custody indirectly, such assets must be considered within the

¹³² In certain circumstances, the use of SPVs could constitute a violation of section 208(d) of the Act, which prohibits an investment adviser, "indirectly, or through or by any other person, to do any act or thing which it would be unlawful for such person to do directly under" the Act or any of our rules.

scope of the pooled investment vehicle's financial statement audit or surprise examination.

G. Compliance Policies and Procedures

Rule 206(4)-7 under the Advisers Act requires registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules.¹³³ As we stated in 2003 when we adopted that rule, these policies and procedures must address, among other things, the safeguarding of client assets from conversion or inappropriate use by advisory personnel.¹³⁴ We believe that an adviser's maintenance of strong policies and procedures, in addition to the measures we are adopting today, is an essential component of a comprehensive approach to addressing the potential risks raised by an adviser's custody of client assets. We are therefore taking this opportunity to provide guidance regarding the types of policies and procedures relating to safekeeping of client assets that advisers should consider including in their compliance programs.

Compliance with rule 206(4)-7 requires an adviser with custody to adopt controls over access to client assets that are reasonably designed to prevent misappropriation or misuse of client assets, develop systems or procedures to assure prompt detection of any misuse, and take appropriate action if any misuse does occur.¹³⁵ Commenters on our Proposing Release suggested several policies and procedures that advisers should

¹³³ 17 CFR 275.206(4)-7.

¹³⁴ *Compliance Programs of Investment Companies and Investment Advisers*, Investment Advisers Act Release No. 2204 (Dec. 17, 2003) [68 FR 74714 (Dec. 24, 2003)] ("Compliance Rule Release"), at Section II.A.1.

¹³⁵ *See id.*

consider adopting in order to comply with rule 206(4)-7,¹³⁶ many of which we have incorporated into this guidance.

Advisers with custody of client assets should consider the value of instituting the following policies and procedures as part of their compliance programs:¹³⁷

- conducting background and credit checks on employees of the investment adviser who will have access (or could acquire access) to client assets to determine whether it would be appropriate for those employees to have such access;
- requiring the authorization of more than one employee before the movement of assets within, and withdrawals or transfers from, a client's account, as well as before changes to account ownership information;
- limiting the number of employees who are permitted to interact with custodians with respect to client assets and rotating them on a periodic basis; and
- if the adviser also serves as a qualified custodian for client assets, segregating the duties of its advisory personnel from those of custodial personnel to make

¹³⁶ See, e.g., Comment letter of Investment Adviser Association (March 6, 2009); CPIC Letter.

¹³⁷ In addition to these policies and procedures, an adviser should consider: (i) policies and procedures to establish that it has a basis for its reasonable belief that qualified custodians send account statements to advisory clients; and (ii) if the adviser has overcome the presumption that it is not operationally independent of its related person under amended rule 206(4)-2(d)(5), policies and procedures reasonably designed to ensure that it continues to overcome the presumption set forth in that provision as long as it continues to rely on the provision. See *supra* Sections II.A and II.C.2. of this Release.

it difficult for any one person to misuse client assets without being detected.¹³⁸

Advisers should consider including in their policies and procedures a requirement that any problems be brought to the immediate attention of the management of the adviser. Advisers also should consider developing policies regarding the ability of individual employees to acquire custody of client assets, because their custody may be attributable to the firm, which will thereby acquire responsibility for those assets under the rule. Many firms preclude employees from acquiring custody by prohibiting them from, for example, becoming trustees for client assets or obtaining powers of attorney for clients separate and apart from the advisory firm.¹³⁹ Advisers that permit employees to serve in capacities whereby the firm acquires custody of client assets should take steps to assure themselves that their employees' custodial practices conform to the firm's policies and procedures, and that the adviser's chief compliance officer ("CCO") has access to sufficient information to enforce those policies and procedures.

The adviser's custody of client assets presents elevated compliance risks for the adviser and its clients. Advisers and their CCOs therefore must accord these risks appropriate attention in the adviser's compliance program. Accordingly, the adviser should consider developing procedures by which the CCO periodically tests the

¹³⁸ An adviser utilizing a segregation of duties approach should also consider having different personnel authorize custodial transfers from client accounts than those who reconcile client account balances at the adviser with the custodian's records of client transactions and holdings.

¹³⁹ When a supervised person of an adviser serves as the executor, conservator or trustee for an estate, conservatorship or personal trust solely because the supervised person has been appointed in these capacities as a result of family or personal relationship with the decedent, beneficiary or grantor (and not as a result of employment with the adviser), we would not view the adviser to have custody of the funds or securities of the estate, conservatorship, or trust. See 2003 Adopting Release at n.15.

effectiveness of the firm's controls over the safekeeping of client assets. For example, the CCO could periodically test the reconciliation of account statements prepared by advisers with account statements as reported by qualified custodians. In addition, the CCO could compare, on a sample basis, client addresses obtained from the clients' qualified custodians to which the custodian sends client statements, with client addresses maintained by the adviser, to look for inconsistencies or patterns that suggest possible manipulation of address information as a means for concealing misappropriation from these accounts by advisory personnel.

Advisers that have custody as a result of their authority to deduct advisory fees directly from client accounts held at a qualified custodian should have policies and procedures in place that address the risk that the adviser or its personnel could deduct fees to which the adviser is not entitled under the terms of the advisory contract, which would violate the contract and which may constitute fraud under the Advisers Act. The adviser's policies and procedures should take into account how and when clients will be billed; be reasonably designed to ensure that the amount of assets under management on which the fee is billed is accurate and has been reconciled with the assets under management reflected on statements of the client's qualified custodian; and be reasonably designed to ensure that clients are billed accurately in accordance with the terms of their advisory contracts.¹⁴⁰ Examples of policies and procedures such an adviser should consider include:¹⁴¹

¹⁴⁰ Our staff has taken the view that, under some arrangements, clients may pay advisory fees deducted directly from assets held in their advisory accounts without causing the adviser to have custody of those assets and being subject to the custody rule. Under these arrangements, a client will instruct its qualified custodian as its agent to determine the amount of the advisory fee and to remit the amount of the fee to the adviser. Our staff therefore takes the view, under these circumstances, that the adviser has no access to the

- periodic testing on a sample basis of fee calculations for client accounts to determine their accuracy;
- testing of the overall reasonableness of the amount of fees deducted from all client accounts for a period of time based on the adviser's aggregate assets under management; and
- segregating duties between those personnel responsible for processing billing invoices or listings of fees due from clients that are provided to and used by custodians to deduct fees from clients' accounts and those personnel responsible for reviewing the invoices and listings for accuracy, as well as the employees responsible for reconciling those invoices and listings with deposits of advisory fees by the custodians into the adviser's proprietary bank account to confirm that accurate fee amounts were deducted.

Because different controls may be appropriate for different advisers in designing effective compliance programs, we are not suggesting a single set of policies and procedures. As we noted in 2003 when we adopted rule 206(4)-7, we recognize that advisers are too varied in their operations and size for such an approach to work.¹⁴² Policies and procedures that are appropriate for a 500 employee firm that also operates as a broker-dealer will be unlikely to work (or be necessary) for a five person firm that provides asset allocation advice. Advisers with only a few employees may, for example, find segregation of duties impractical, but for advisers with a large number of employees

client's funds or securities. *See* Staff Responses to Questions About Amended Custody Rule, at Section III. Fee Deduction, Question III.3, available at http://www.sec.gov/divisions/investment/custody_faq.htm.

¹⁴¹ Some of these suggestions came from commenters. *See, e.g.*, CPIC Letter.

¹⁴² Compliance Rule Release, at Section II.A.1.

such a control may be highly effective. Advisers to pooled investment vehicles should consider whether these practices, or others, should cover investor accounts in the pool, for example, to prevent an employee from misappropriating assets from the pool by processing false investor withdrawals. We have therefore provided the guidance set out above primarily in the form of examples; we expect advisers to tailor their custody policies and procedures to fit both the size and the particular risks that are raised by their business model.

H. Amendments to Form ADV

We are adopting several amendments to Part 1A and Schedule D of Form ADV. The amendments require registered advisers to report to us more detailed information about their custody practices in their registration form and to update the information. The information will enhance our ability to identify compliance risks associated with custody of client assets.¹⁴³ The amendments primarily affect only those advisers that have custody of client assets under rule 206(4)-2.

Item 7. We are adopting the amendments to Item 7 and Section 7.A. of Schedule D that we proposed to require each adviser to report *all* related persons who are broker-dealers and to identify which, if any, serve as qualified custodians with respect to the

¹⁴³ These revisions respond in part to concerns raised by the Government Accountability Office in its August 2007 report on our examination program, which concluded that our examination staff should continue to assess and refine the risk algorithm to enhance the risk assessment process, which would include the identification and collection of additional data through Form ADV. See United States Government Accountability Office, *Securities and Exchange Commission; Steps Being Taken to Make Examination Program More Risk-Based and Transparent* (August 2007), available at <http://www.gao.gov/new.items/d071053.pdf>.

adviser's clients' funds or securities.¹⁴⁴ We did not receive comments on these proposed amendments. We also are amending Section 7.A. of Schedule D to require an adviser to report whether it has determined that it has overcome the presumption that it is not operationally independent from a related person broker-dealer qualified custodian, and thus is not required to obtain a surprise examination for the clients' assets maintained at that custodian.

Item 9. We are adopting amendments to Item 9 to require each registered adviser to report to us: (i) whether the adviser or a related person has custody of client assets, and if so, both the total U.S. dollar amount of those assets as well as the number of clients for whose accounts the adviser or its related person has custody;¹⁴⁵ (ii) if the adviser, or a related person, acts as an adviser to a pooled investment vehicle, whether (a) the pool is audited, and (b) the qualified custodians send account statements to pool investors;¹⁴⁶ (iii) whether an independent public accountant conducts an annual surprise examination of client assets;¹⁴⁷ and (iv) whether an independent public accountant prepares an internal control report with respect to the adviser or its related person;¹⁴⁸ and (v) whether the

¹⁴⁴ The item had *required* an adviser to identify on Schedule D of Form ADV each related person that is an investment adviser, but made reporting of the names of related person broker-dealers *optional*.

¹⁴⁵ Items 9.A. and 9.B of Part 1A of Form ADV.

¹⁴⁶ Item 9.C.(1) and (2) of Part 1A of Form ADV.

¹⁴⁷ Item 9.C.(3) of Part 1A of Form ADV.

¹⁴⁸ Item 9.C.(4) of Part 1A of Form ADV. Two commenters suggested that we eliminate the requirements in Item 9.C. that require an adviser to disclose the actions taken by the adviser's qualified custodian and accountant pursuant to the proposed custody rule (as well as corresponding portions of Schedule D), stating that advisers cannot guarantee third-party actions and that reporting compliance with aspects of the custody rule is an inappropriate use of Form ADV. *See* IAA Letter; MMI Letter. These items do not require an adviser to guarantee actions of third parties, but merely require the adviser to report on obligations it has (*e.g.*, to form a reasonable belief) under the revised custody rule, which if not met would result in the adviser's violation of the rule.

adviser or a related person serves as qualified custodian for the adviser's clients.¹⁴⁹ In addition, we are amending Schedule D to require that advisers (i) identify and provide certain information about the accountants that perform audits or surprise examinations and that prepare internal control reports;¹⁵⁰ and (ii) to identify related persons, such as banks, that serve as qualified custodians with respect to their clients' funds or securities, but are not otherwise reported in Item 7. We also are amending Schedule D to require an adviser to report whether it has determined that it has overcome the presumption that it is not operationally independent from a related person qualified custodian, and thus is not required to obtain a surprise examination for the clients' assets maintained at that custodian.¹⁵¹

Several commenters generally supported these amendments to Form ADV, and many requested clarification or modification to parts of the form.¹⁵² In response to several commenters' requests for clarification or modification of Item 9,¹⁵³ we have added an instruction to clarify that an adviser must separately report the amount of assets of which it has custody, excluding those assets maintained by a related person qualified

¹⁴⁹ Item 9.D. of Part 1A of Form ADV.

¹⁵⁰ In addition to providing the accountant's name and address, advisers must indicate whether the accountant is registered with and subject to regular inspection by the PCAOB. Advisers must also indicate whether the accountant's report contained an unqualified opinion. Section 9.C. of Schedule D to Part 1A of Form ADV. One commenter stated that we should not require advisers to report whether the accountants they, or their related persons, engage are registered with and subject to inspection by the PCAOB because this information is readily available on the PCAOB's website. *See* AICPA Letter. An adviser, or related person custodian, would have to collect this information in the course of retaining an accountant to perform the necessary engagements to comply with the revised custody rule, and we expect that accountants would make these representations to their clients. As a result, reporting this information should not be burdensome to advisers.

¹⁵¹ Section 9.D. of Schedule D to Part 1A of Form ADV.

¹⁵² Cornell Letter; IAA Letter; MMI Letter; NRS Letter; Turner Letter.

custodian, and the amount of assets of which a related person has custody, including when the related person serves as a qualified custodian.¹⁵⁴

I. Amendments to Form ADV-E

We are adopting, as proposed, three amendments to the instructions to Form ADV-E. First, we have amended the form instructions to require that the form and the accompanying accountant's examination certificate be filed electronically with the Commission through the IARD.¹⁵⁵ Advisers will, however, continue to file form ADV on paper until the IARD system begins accepting electronic filings of Form ADV-E, which we expect to occur sometime in late 2010. Investment advisers will be notified at that time. The second and third amendments we are adopting conform Form ADV-E instructions to amended rule 206(4)-(2), which, as discussed above, requires that (i) the surprise examination certificate must be filed within 120 days of the time chosen by the accountant for the surprise examination,¹⁵⁶ and (ii) a termination statement be filed by an accountant within four business days of its resignation, dismissal, or removal.¹⁵⁷

¹⁵³ IAA Letter; NSCP Letter; ASG Letter; CAS Letter.

¹⁵⁴ We also are revising an existing instruction to Item 9.A. to specify that in addition to advisers that have custody *only* because they have authority to deduct fees that if they also have custody because a related person maintains client assets but the adviser has overcome the presumption of not being operationally independent they may continue to answer "no" to Item 9.A. Advisers must report information about these custody arrangements in Item 9.B.

It will be several months before FINRA, which operates the IARD for us, completes reprogramming the IARD to implement this change to Item 9. In the interim, advisers registered with the Commission should provide responses following the amended instruction.

¹⁵⁵ Instruction 3(a) to Form ADV-E. Several comments supported electronic filing and the amendments to Form ADV-E generally. See Cornell Letter; IAA Letter; Turner Letter.

¹⁵⁶ Instruction 3(i) to Form ADV-E.

¹⁵⁷ Instruction 3(ii) to Form ADV-E. Commenters suggested that we revise the timing of the filing and that we do not make the filing available to the public. We have addressed these

J. Required Records

We also are adopting amendments, as proposed, to rule 204-2 to require an adviser to maintain a copy of (i) the internal control report that such adviser is required to obtain or receive from its related person, pursuant to amended rule 206(4)-2(a)(6), and (ii) the memorandum describing the basis upon which the adviser determined that the presumption that any related person is not operationally independent, pursuant to amended rule 206(4)-2(d)(5), has been overcome, for five years from the end of the fiscal year in which, as applicable, the internal control report or memorandum is finalized. Requiring an adviser to retain a copy of these items will provide our examiners with important information about the safeguards in place at an adviser or related person that maintains client assets. Information from these records will also assist our staff in assessing custody-related risks at a particular adviser.

III. EFFECTIVE AND COMPLIANCE DATES

A. Effective Date

The effective date of the amendments to rules 206(4)-2, 204-2, and Forms ADV and ADV-E is March 12, 2010.

B. Compliance Dates and Related Rule Amendments

Advisers registered with us must comply with amended rules 206(4)-2, 204-2, and Forms ADV and ADV-E, as amended, on and after March 12, 2010, the effective date of these amendments, except as described below.

Immediately upon the effective date advisers that have custody of client assets must promptly upon opening a custodial account on a client's behalf, and following any

comments in Section II.B.2 of this Release. *See supra* notes 54 and 57 and accompanying text.

changes to the custodial account information, as specified in rule 206(4)-2(a)(2) send a notification to the client, including a legend urging the client to compare the account statements the client receives from the custodian with those the client receives from the adviser. Such legend should also be included in any account statements that advisers send to these clients after they are required to send the notification discussed above. In addition, immediately upon the effective date, each adviser that has custody of client assets must have a reasonable belief (except with respect to pooled investment vehicles the financial statements of which are audited and delivered to investors) that a qualified custodian sends account statements directly to clients at least quarterly, in accordance with rule 206(4)-2(a)(3). We believe 60 days is sufficient for advisers to comply with the amended rule regarding the three requirements described above because they are modifications to the existing rule requirements.

Compliance dates for other provisions of amended rules 206(4)-2, 204-2, and Forms ADV and ADV-E are described below.¹⁵⁸

1. Surprise Examinations

An investment adviser required to obtain a surprise examination must enter into a written agreement with an independent public accountant that provides that the first examination will take place by December 31, 2010 or, for advisers that become subject to the rule after the effective date, within six months of becoming subject to the

¹⁵⁸ Some commenters requested that we delay the compliance date by 12 - 24 months from the effective date of the rule. See Curian Letter; CAQ Letter; Dechert Letter; Deloitte Letter; E&Y Letter; KPMG Letter; PWC Letter. In determining the compliance dates for the amended rules and forms, we balanced the urgency of enhancing investor protection afforded under the Advisers Act, the need to provide sufficient time for advisers to comply with the requirements under the amended rules, and the extent of changes we made from the proposal on which the commenters' requests were based.

requirement.¹⁵⁹ If the adviser itself maintains client assets as qualified custodian, however, the agreement must provide for the first surprise examination to occur no later than six months after obtaining the internal control report.¹⁶⁰ We believe these compliance dates will provide sufficient time for an adviser to hire an independent public accountant for purposes of the surprise examination and for the accountant to perform the surprise examination.

2. Internal Control Reports

An investment adviser also required to obtain or receive an internal control report because it or a related person maintains client assets as a qualified custodian must obtain or receive an internal control report within six months of becoming subject to the requirement. As noted above, an adviser obtaining an internal control report because it (rather than a related person) also serves as a qualified custodian of its clients' assets (e.g., a broker-dealer) need not undergo a surprise examination until six months after obtaining the internal control report.

3. Audits of Pooled Investment Vehicles

An investment adviser to a pooled investment vehicle may rely on the annual audit provision if the adviser (or a related person) becomes contractually obligated to obtain an audit of the financial statements of the pooled investment vehicle for fiscal

¹⁵⁹ An adviser could first become subject to the surprise examination requirement by, for example, registering with the Commission or accepting custody of a client's assets.

¹⁶⁰ An independent public accountant conducting a surprise examination on an adviser that also serves as the qualified custodian for its clients (*i.e.*, self custody) would have to verify the existence of client assets with the adviser itself. Because of the added assurance of having an internal control report, we believe that investors would be better served if the first round of surprise examinations is conducted with the benefit of the internal control report. An adviser with multiple related persons that serve as qualified custodians must undergo a surprise examination within six months of receiving the last internal control report it is required to receive.

years beginning on or after January 1, 2010 by an independent public accountant registered with, and subject to regular inspection by, the PCAOB.

4. Forms ADV and ADV-E

Investment advisers registered with us must provide responses to the revised Form ADV in their first annual amendment after January 1, 2011.¹⁶¹ Until the IARD system is upgraded to accept Form ADV-E, accountants performing surprise examinations should continue paper filing of Form ADV-E. Investment advisers will be notified as soon as the IARD system can accept filings of Form ADV-E.¹⁶²

IV. PAPERWORK REDUCTION ACT

Certain provisions of rule 206(4)-2, Form ADV, and Form ADV-E that we are amending today contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).¹⁶³ In the Proposing Release, the Commission published notice soliciting comment on the collection of information requirements. The Commission submitted the collection of information requirements to the Office of Management and Budget (“OMB”) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11 under control numbers 3235-0241, 3235-0049, and 3235-0361, respectively. The titles for the collections of information are “Rule 206(4)-2, Custody of Funds or Securities of Clients by Investment Advisers,” “Form ADV,” and “Form ADV-E, cover sheet for each certificate of accounting of client securities and

¹⁶¹ Based on discussions with our contractor, we anticipate that IARD will reflect the changes to Form ADV we are adopting today and accept electronic filing of Form ADV-E in the fourth quarter of 2010. Form ADV-Es filed with us on paper before electronic filing will be available upon request through the Commission’s Public Reference Room, 100 F Street, NE, Washington, DC 20549.

¹⁶² We urge advisers in the meantime to confirm that their email contact information on Form ADV is correct and to update the information promptly if necessary.

funds in the custody of an investment adviser,” under the Advisers Act.¹⁶⁴ An agency may not sponsor, or conduct, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

The collections of information under rule 206(4)-2 are necessary to ensure that clients’ funds and securities in the custody of advisers are safeguarded, and information contained in the collections is used by staff of the Commission in its enforcement, regulatory, and examination programs. The respondents are investment advisers registered with us that have custody of client funds and securities (“client assets”). The collections of information under Form ADV are necessary for use by staff of the Commission in its examination and oversight program, and some advisory clients also may find them useful. The respondents are investment advisers seeking to register with the Commission or to update their registrations. The collections of information under Form ADV-E are necessary for use by staff of the Commission in its examination and oversight program, and some advisory clients also may find them useful. The respondents are investment advisers registered with us that have custody of client assets and are subject to an annual surprise examination requirement under rule 206(4)-2. All responses required by the rule are mandatory. With the exception of an accountant’s

¹⁶³ 44 U.S.C. 3501.

¹⁶⁴ We also are adopting amendments to rule 204-2 that require approximately 337 advisers to maintain the internal control reports they obtain, or receive from related persons, and if these advisers have determined that the presumption that a related person is operationally independent has been overcome, a memorandum describing the basis upon which that determination was made. In addition, rule 204-2(a)(10) already requires an adviser to maintain all written agreements relating to its business as such, which would require an adviser to maintain the written agreement concerning the surprise examination required by the amended rule. The current approved collection of information burden for rule 204-2 is 1,945,109 hours and has an estimated cost of \$13,551,390 under OMB control number 3235-0278. The two new retention requirements and the additional written

notification of any material discrepancies identified in a surprise examination pursuant to rule 206(4)-2(a)(4)(ii), responses provided to the Commission are not kept confidential.

A. Rule 206(4)-2

The Commission is adopting amendments to the custody rule under the Advisers Act. The amendments are designed to provide additional safeguards under the Advisers Act when a registered adviser has custody of client funds or securities by requiring such an adviser, among other things: (i) to undergo an annual surprise examination by an independent public accountant to verify client assets; (ii) to have a reasonable basis after due inquiry, for believing that the qualified custodian maintaining client funds and securities sends account statements directly to the advisory clients; and (iii) unless client assets are maintained by an independent custodian (*i.e.*, a custodian that is not the adviser itself or a related person) to obtain or receive a report of the internal controls relating to the custody of those assets from an independent public accountant that is registered with and subject to regular inspection by the PCAOB.

The amendments to rule 206(4)-2 that we are adopting today differ from our proposed amendments in three respects that affect our Paperwork Reduction Act analysis. First, we are providing an exception to the surprise examination requirement for advisers that have custody because they have authority to deduct advisory fees from client accounts and advisers that have custody solely because a related person holds the adviser's client assets and the related person is operationally independent of the adviser.¹⁶⁵ Second, advisers to pooled investment vehicles that are subject to an annual

agreements that will be maintained as a result of more surprise examinations will result in a negligible increase to the currently approved burden for rule 204-2.

¹⁶⁵ Amended rule 206(4)-2(b)(3) and amended rule 206(4)-2(b)(6).

audit and that distribute audited financial statements to investors in the pools are deemed to comply with the surprise examination requirement as long as the accountant performing the annual audit is registered with, and subject to regular inspection by, the PCAOB.¹⁶⁶ Third, if an adviser sends account statements to its clients, it must not only insert a legend in the required notice to clients upon opening accounts on their behalf, but must also insert the legend in subsequent account statements sent to those clients urging the client to compare the account statements from the custodian with those from the adviser.¹⁶⁷

We requested comment on the Paperwork Reduction Act analysis contained in the Proposing Release. A number of commenters expressed concerns that the paperwork burdens associated with our proposed amendments to rule 206(4)-2 were understated.¹⁶⁸ In response to these comments as well as the differences in the amendments we are adopting from those we proposed, as described above, and the guidance for accountants published in a companion release,¹⁶⁹ we have adjusted our Paperwork Reduction Act estimates as discussed below.

Annual surprise examination. The current approved annual burden for rule 206(4)-2 is 415,303 hours, 21,803 of which relate to the requirement to obtain a surprise examination and the delivery of quarterly account statements by the adviser. We estimated in the Proposing Release that 9,575 advisers registered with the Commission

¹⁶⁶ Amended rule 206(4)-2(b)(4).

¹⁶⁷ Amended rule 206(4)-2(a)(2).

¹⁶⁸ See, e.g., ASG Letter; MMI Letter; Schwab Letter. These commenters did not provide empirical data that is relevant to our estimates of burden hours in this Paperwork Reduction Act analysis, but did provide cost estimates that we have considered in Section V of this Release.

¹⁶⁹ See Accounting Release.

would be subject to the surprise examination.¹⁷⁰ As noted above, the amended rule we are adopting today excludes certain advisers with custody from the requirement to undergo an annual surprise examination and deems certain advisers to audited pooled investment vehicles to have complied with the requirement.¹⁷¹ Advisers that have custody for other reasons, however, such as because they or their related person serves as the qualified custodian for client assets, or because they serve as the trustee of a client trust, must undergo an annual surprise examination.¹⁷² As a result, we now estimate that 1,859 advisers will be subject to the surprise examination requirement under the amended rule 206(4)-2.¹⁷³

¹⁷⁰ Based on Form ADVs filed as of February 2009. See the Proposing Release at n.77 for explanation of our estimate.

¹⁷¹ Amended rule 206(4)-2(b)(3) (exception from surprise examination for advisers that have custody because they have authority to deduct fees from client accounts) and amended rule 206(4)-2(b)(4) (deems advisers to audited pooled investment vehicles that distribute audited financial statements to pool investors to comply with the surprise examination requirement if the audit is conducted by a public accountant registered with, and subject to regular inspection by, the PCAOB). See *supra* Section II.B.1 of this Release.

¹⁷² Under amended rule 206(4)-2 an adviser has custody if its related person has custody of its client assets. Amended rule 206(4)-2(d)(2). A related person is defined as a person directly or indirectly controlling or controlled by the adviser, and any person under common control with the adviser. Amended rule 206(4)-2(d)(7).

¹⁷³ Based on Form ADVs filed as of November 2, 2009 (unless indicated otherwise, all data we use in this release were as of November 2, 2009), there were 3,689 advisers that answered "yes" to Form ADV, Part 1A Items 9.A or 9.B (indicating that they or a related person has custody of client assets. This excludes advisers that have custody solely because they have authority to deduct fees from clients' accounts). We exclude from this number (i) 38 of these advisers that only have clients that are investment companies (Item 5.D(4)); (ii) 703 (or 90%, which is based on staff observation that the vast majority of pooled investment vehicles are subject to an annual audit) of the 781 of these advisers that only have clients that are pooled investment vehicles (Items 5.D(6) or 5.D(4)); (iii) 1,030 (or 80%) of the 1,288 advisers that have some clients that are pooled investment vehicles (10% of which is based on the number of advisers (from IARD data) that have both pooled investment vehicle clients and non-pooled investment vehicle clients that will not have to undergo a surprise examination because they do not have custody under the rule of the non-pooled investment vehicle client assets that would require a surprise examination and 10% of which is based on an estimate of the pooled investment vehicles that are subject to an annual audit). We further estimate that of the 396 advisers we estimate that are currently using related person qualified custodians, 59 (or 15%) will

For purposes of estimating the collection of information burden we have divided the estimated 1,859 advisers into 3 subgroups. First, we estimate that 337 advisers have custody because (i) they serve as qualified custodians for their clients and are also broker-dealers, banks or futures commission merchants,¹⁷⁴ or (ii) they have a related person that serves as qualified custodian for clients in connection with advisory services the adviser provides to the clients.¹⁷⁵ We estimate that these advisers will be subject to an annual surprise examination with respect to 100 percent of their clients (or 2,315 clients per adviser) based on the assumption that all of their clients maintain custodial accounts with the adviser or related person.¹⁷⁶ We estimate that each adviser will spend an average of 0.02 hours for each client to create a client contact list for the independent public

choose to use independent qualified custodians and, as a result, will no longer retain custody of client assets under the rule that would require these advisers to undergo the surprise examination. *See infra* note 282 for explanation of this estimate. $(3,689 - 38 - 703 - 1,030 - 59 = 1,859)$.

¹⁷⁴ We estimate that 91 investment advisers that are also banks, registered broker-dealers or futures commission merchants would custody client assets as a qualified custodian under the rule.

¹⁷⁵ Based on IARD data, we also estimate that 305 investment advisers have a related person bank, registered broker-dealer or futures commission merchant that is a qualified custodian for advisory client assets. 91 (advisers that are also banks or broker-dealers) + 305 (advisers using related persons as custodians) = 396 . $396 - 59$ (advisers that will stop using related persons as custodians) = 337 (*see supra* note 173 for explanation of 59 advisers removed).

¹⁷⁶ In the Proposing Release, we estimated that each adviser had, on average, 1,092 clients. *See* Proposing Release at n.79. That estimate was based on the average number of clients of all advisers registered with us (excluding the two largest firms). We now base our estimate on IARD data of all the advisers that will be subject to the surprise examination under the amended rule (also excluding these two largest firms). This new estimate excludes from the calculation about 6,000 advisers that have custody solely because of deducting fees, which tend to have fewer clients. As a result the estimated average number of clients for the advisers that will be subject to the surprise examination under the amended rule is increased.

accountant. The estimated total annual aggregate burden with respect to the surprise examination requirement for this group of advisers is 15,603 hours.¹⁷⁷

A second group of advisers, estimated at 1,315,¹⁷⁸ are those that have custody because they have broad authority to access client assets held at an independent qualified custodian, such as through a power of attorney or acting as a trustee for a client's trust. Based on our staff's experience, advisers that have access to client assets through a power of attorney, acting as trustee, or similar legal authority typically do not have access to all of their client accounts, but rather only to a small percentage of their client accounts pursuant to these special arrangements. We estimate that these advisers will be subject to an annual surprise examination with respect to 5 percent of their clients (or 116 clients per adviser)¹⁷⁹ who have these types of arrangements with the adviser. We estimate that each adviser will spend an average of 0.02 hours for each client to create a client contact list for the independent public accountant. The estimated total annual aggregate burden

¹⁷⁷ 337 advisers x 2,315 (average number of clients subject to the surprise examination requirement) x 0.02 hour = 15,603 hours. As addressed later, some of these advisers will not have to obtain a surprise examination as a result of the exception to the surprise examination requirement under amended rule 206(4)-2(b)(6) for an adviser that has custody because of its related person's custody of client assets and that can overcome the presumption that it is not operationally independent of the related person custodian. See *infra* note 283. We do not have data or another resource to provide an estimate of the number of advisers that use related person custodians that will be able to overcome the presumption. This estimated annual hour burden may, as a result, overestimate the collection of information requirement as advisers that have overcome the presumption will not have to create client contact lists.

¹⁷⁸ This estimate is based on the total number of advisers subject to surprise examinations less those described above in the first group (custody as a result of serving as, or having related person serving as qualified custodians) and below in the third group (advisers to pooled investment vehicles) 1,859 - 337 - 207 = 1,315. See *infra* note 182 and accompanying text.

¹⁷⁹ Based on the IARD data, we estimate that the average number of clients of advisers subject to the surprise examination requirement is 2,315. (2,315 x 5% = 116).

with respect to the surprise examination requirement for this group of advisers is 3,051 hours.¹⁸⁰

A third group of advisers, estimated at 207,¹⁸¹ provide advice to pooled investment vehicles that are not undergoing an annual audit, and therefore will be subject to the surprise examination with respect to 100 percent of their pooled investment vehicle clients (which we estimate to be 5 funds and 250 investors per adviser providing advisory services exclusively to pooled investment vehicles, and 2 funds and 100 investors per adviser not providing advisory services exclusively to pooled investment vehicles).¹⁸² We estimate that the advisers to these pooled investment vehicles will spend 1 hour for the pool and 0.02 hours for each investor in the pool to create a contact list for the independent public accountant, for an estimated total annual burden with respect to the surprise examination requirement for these advisers of 1,296 hours.¹⁸³ These estimates bring the total annual aggregate burden with respect to the surprise examination

¹⁸⁰ $1,315 \times 116 \times 0.02 = 3,051$.

¹⁸¹ Based on IARD data, we estimate that there are 781 advisers that provide advisory services exclusively to pooled investment vehicles. *See supra* note 173. We further estimate, based on our staff's experience, that only ten percent of advisers to pooled investment vehicles will be subject to an annual surprise examination because the pooled investment vehicles they advise do not undergo an annual audit. We further estimate, based upon staff experience, that ten percent of the 1,288 advisers that provide services not exclusively to pooled investment vehicles will be subject to an annual surprise examination because the pooled investment vehicles they advise do not undergo an annual audit. $(781 \times 10\%) + (1,288 \times 10\%) = 78 + 129 = 207$.

¹⁸² The number of funds per adviser is estimated based on the information we collected from Item 5.C. of Form ADV filed by advisers that provide advisory services only to pooled investment vehicles. The estimate of 250 investors per adviser is a staff estimate used in the currently approved collection of information burden.

¹⁸³ $[(78 \times 5) + (78 \times 250 \times 0.02)] + [(129 \times 2) + (129 \times 100 \times 0.02)] = [390 + 390] + [258 + 258] = 1,296$.

requirement for all three groups of advisers to 19,950 hours.¹⁸⁴ This estimate does not include the collection of information discussed below relating to the written agreement required by paragraph (a)(4) of the rule.

Written agreement with accountant. Consistent with the proposal, amended rule 206(4)-2 requires that an adviser subject to the surprise examination requirement must enter into a written agreement with the independent public accountant engaged to conduct the surprise examination and specify certain duties to be performed by the independent public accountant.¹⁸⁵ As stated in the Proposing Release, we believe that written agreements are commonplace and reflect industry practice when a person retains the services of a professional such as an accountant, and they are typically prepared by the independent public accountant in advance. We therefore estimate that each adviser will spend 0.25 hour to add the required provisions to the written agreement, with an aggregate of 465 hours for all advisers subject to surprise examinations.¹⁸⁶ Therefore the total annual burden in connection with the surprise examination is estimated at 20,415 hours under the amended rule.¹⁸⁷

Audited pooled investment vehicles. The rule currently excepts, and the amended rule continues to except, advisers to pooled investment vehicles from having a qualified custodian send quarterly account statements to the investors in a pool if it is audited annually by an independent public accountant and the audited financial statements are distributed to the investors in the pool. The currently approved annual burden in

¹⁸⁴ $1,296 + 15,603 + 3,051 = 19,950$. By contrast, our estimate in the Proposing Release for the surprise examination as proposed was 177,242 hours.

¹⁸⁵ Amended rule 206(4)-2(a)(4).

¹⁸⁶ $1,859 \times 0.25 = 465$.

¹⁸⁷ $19,950 + 465 = 20,415$.

connection with the required distribution of audited financial statements is 393,500 hours.¹⁸⁸ As explained in the Proposing Release, we overestimated the burden for this delivery requirement in the past.¹⁸⁹ The collection of information burden imposed on an adviser relating to the mailing of audited financial statements to each investor in a pool that it manages should be minimal, as the financial statements could be included with account statements or other mailings. We estimate, consistent with the estimate in the proposing release, that the average burden for advisers to mail audited financial statements to investors in the pool is 1 minute per investor.¹⁹⁰ Under our revised estimate of the number of advisers to audited pooled investment vehicles,¹⁹¹ we estimate that the aggregate annual hour burden in connection with the distribution of audited financial statements is 4,861 hours.¹⁹²

¹⁸⁸ We estimated that 3,148 advisers to pooled investment vehicles were subject to this information collection under the current rule. We further estimated that each adviser had, on average, 250 investors in the funds it advises, and that each adviser spent 0.5 hours per investor annually for delivering audited financial statements to its 250 investors. $3,148 \times 250 \times 0.5 = 393,500$.

¹⁸⁹ We previously estimated that an adviser would spend 0.5 hours per investor sending investors audited financial statements. This estimate incorrectly included time for preparation of the audited financial statements, which after the audit should have been readily available to the adviser for distribution.

¹⁹⁰ Proposing Release at n. 94.

¹⁹¹ Based on IARD data, 2,069 advisers with custody of client assets provided advice to pooled investment vehicles as of November 2, 2009. Of these 2,069 advisers, we estimate that 781 advisers will each on average provide advice to five pooled investment vehicles that have a total of 250 investors. $5 \text{ (pools)} \times 50 \text{ (investors)} = 250$. We estimate that of these 781 advisers, 703 (or 90%) will have their pooled investment vehicles audited and distribute the audited financial statements to the investors in the pool. We further estimate that of the remaining 1,288 advisers, on average, each provides advice to two pooled investment vehicles that have a total of 100 investors. $2 \text{ (pools)} \times 50 \text{ (investors)} = 100$. We estimate that of these 1,288 advisers, 1,159 (or 90%) will have their pooled investment vehicles audited and will distribute the audited financial statements to the investors in the pool.

¹⁹² $[(703 \times 250 \times 1)/60] + [(1,159 \times 100 \times 1)/60] = 2,929 + 1,932 = 4,861$.

The amended rule requires that an adviser to a pooled investment vehicle that is relying on the annual audit provision must have the pool audited and distribute the audited financial statements to the investors in the pool promptly after completion of the audit if the fund liquidates at a time other than its fiscal year-end. We estimate that 5 percent of pooled investment vehicles are liquidated annually at a time other than their fiscal year-end, which results in an additional burden of 243 hours per year.¹⁹³ As a result, the total annual hour burden in connection with the distribution of audited financial statements in connection with annual audit and liquidation audit under the amended rule is estimated to be 5,104 hours.¹⁹⁴

Notice to clients. The amended rule also requires each adviser, if the adviser sends account statements in addition to those sent by the custodian, to add a legend in its notification to clients upon opening a custodial account on their behalf, and in any subsequent account statements it sends to those clients, urging them to compare the account statements from the qualified custodian to those from the adviser.¹⁹⁵ Although the legend requirement is new, it will be placed in a notification that is currently required to be sent to clients at specified times. We believe that the increase in this collection of information burden, if any, is negligible. We estimate that 80 percent of the 2,986 advisers would be subject to this collection of information,¹⁹⁶ and that each adviser will

¹⁹³ 4,861 (total burden hours relating to distribution of audited financials) x 0.05 = 243.

¹⁹⁴ 4,861 + 243 = 5,104.

¹⁹⁵ Amended rule 206(4)-2(a)(2).

¹⁹⁶ We understand that advisers having custody solely because of deducting fees do not typically open custodial accounts on behalf of their clients. Excluding those advisers and 703 advisers to audited pooled investment vehicles to which the notice requirement does not apply, we estimate that 2,986 advisers may be subject to this information collection (advisers that answered "yes" to Item 9A. or B. of Part 1A. of Form ADV). *See supra* note 173 and accompanying text. Based on our staff's observation, we further estimate

on average open a new custodial account for 5% of its clients per year, either because the adviser has new clients that request that the adviser open an account on their behalf, or because the adviser selects a new custodian and moves its existing clients' accounts to that custodian. We further estimate that the adviser will spend 10 minutes per client drafting and sending the notice. The total hour burden relating to this requirement is estimated at 41,724 hours per year.¹⁹⁷

Based on the above estimates, we anticipate that the estimated total information collection burden under amended rule 206(4)-2 would be 67,243 hours.¹⁹⁸ This represents a decrease of 348,060 hours from the currently approved burden,¹⁹⁹ primarily due to our change of methodology in estimating the collection of information with respect to distribution of audited financial statements to investors in pooled investment vehicles.²⁰⁰

Annual aggregate cost. The currently approved collection of information for the custody rule includes an aggregate accounting fee of \$281,000. Based on the amendments we are adopting today, we estimate a total annual aggregate accounting fee of \$122,965,000.²⁰¹ The increase in estimated aggregated cost is attributable to an increase in the number of advisers that will be subject to the surprise examination, an increase in the estimated cost for the surprise examination, and the estimated cost for an

that clients of 80% of these advisers will receive account statements from their advisers in addition to the account statements from the qualified custodian. $[0.8 \times 2,986 = 2,389]$

¹⁹⁷ $[(2,986 \times 0.8 \times 2,096 \text{ (average number of clients for the advisers with custody of client assets)} \times 0.05) \times 10] / 60 = 41,724 \text{ hours.}$

¹⁹⁸ $20,415 \text{ (surprise examination)} + 5,104 \text{ (distribution of audited financial statements)} + 41,724 \text{ (notice to clients)} = 67,243.$

¹⁹⁹ $415,303 - 67,243 = 348,060 \text{ hours.}$

²⁰⁰ See *supra* note 188 and accompanying text.

adviser to obtain, or to receive from its related persons, an internal control report when the adviser or related person serves as qualified custodian for the adviser's clients' assets.

In the Proposing Release, we estimated that advisers subject to the surprise examination would on average pay an accounting fee of \$8,100 annually.²⁰² Many commenters asserted that this estimate was too low.²⁰³ In revising our estimates, we have considered the commenters' estimates,²⁰⁴ engaged in further discussions with industry participants and accounting firms, including accounting firms that are registered with, and subject to regular inspection by, the PCAOB, and considered the cost implications for the surprise examination of certain aspects of our guidance for accountants that we are issuing today.²⁰⁵ We now estimate that of the 1,859 advisers subject to the surprise examination requirement, 337 advisers will be subject to the surprise examination with respect to 100 percent of their clients and will each spend an average of \$125,000 annually,²⁰⁶ 262 medium sized advisers will be subject to the surprise examination

²⁰¹ See *infra* note 211 and accompanying text

²⁰² See Proposing Release at n.102 and accompanying text.

²⁰³ See *infra* notes 276 to 278 and accompanying text.

²⁰⁴ We note that commenters based their cost estimates for surprise examinations on the current guidance for accountants, which requires verification of 100% of client assets. We believe that these estimates would have been significantly lower if they had reflected the modernized procedures for the surprise examination described in the guidance for accountants issued in a companion release. See Accounting Release.

²⁰⁵ *Id.*

²⁰⁶ As stated in *infra* note 282, we estimate, based on IARD data, that there will be 396 advisers that do not currently use an independent qualified custodian and will be subject to the surprise examination with respect to 100% of their clients. We expect 15% of these advisers will choose to use independent custodians instead of incurring these costs to comply with the rule. $(396 \times 85\%) = 337$.

We note that the costs of reporting to the Commission (i) regarding "material discrepancy" pursuant to amended rule 206(4)-2(a)(4)(ii) and (ii) upon termination of engagement pursuant to amended rule 206(4)-2(a)(4)(iii) are included in the estimated accounting fees.

requirement with respect to 5% of their clients and will each spend an average of \$20,000 annually, and 1,260 small sized advisers will be subject to the surprise examination requirement with respect to 5% of their clients and will each spend an average of \$10,000 annually, with an aggregate annual accounting fee of \$59,965,000 for all advisers subject to the surprise examination.²⁰⁷

We understand that the cost to prepare an internal control report relating to custody will vary based on the size and services offered by the qualified custodian. We estimated in the Proposing Release that, on average, an internal control report would cost approximately \$250,000 per year for each adviser subject to the requirement.²⁰⁸ We

²⁰⁷ $(337 \times \$125,000) + (262 \times \$20,000) + (1,260 \times \$10,000) = \$42,125,000 + \$5,240,000 + \$12,600,000 = \$59,965,000$. See *infra* notes 282 to 286 and accompanying text for explanation of the estimated amounts. We also note that we may have overestimated the costs for the surprise examination for advisers that have custody because a related person has custody of client assets in connection with advisory services. As we have indicated, as a result of the exception to the surprise examination requirement under amended rule 206(4)-2(b)(6) for an adviser that has custody because of its related person's custody of client assets and that can overcome the presumption that it is not operationally independent of the related person custodian, some of the 337 advisers may not have to obtain a surprise examination. Those advisers that overcome the presumption may, however, incur outside legal expenses to assist with that determination. See *infra* note 283.

²⁰⁸ One commenter, the Chamber of Commerce, generally stated that the Commission's estimate of \$250,000 was too low, but did not provide alternative data. See the Chamber of Commerce Letter. Another commenter, Securities Industry and Financial Markets Association, however, concurred with our cost estimate of \$250,000. See SIFMA(PCLC) Letter. A third commenter, Managed Funds Association, estimated that the internal control report of a hedge fund adviser would cost approximately \$500,000 and over \$1 million in some cases. See MFA Letter. We understand that advisers to pooled investment vehicles typically do not maintain client assets as qualified custodians and, as a result few advisers to pooled investment vehicles would have to obtain an internal control report. Rather, it is more likely that the internal control report would be for a related person broker-dealer, which costs we believe are accurately reflected in the comment letter sent by the Securities Industry and Financial Markets Association. See SIFMA(PCLC) Letter. After further consultation with several accounting firms that have experience in preparing Type II SAS 70 reports, including accounting firms that are registered with the PCAOB, we believe our estimate of \$250,000 is reasonable. Moreover, we are not requiring that a specific type of internal control report be provided under the rule as long as the objectives noted above are addressed. This flexibility should permit accountants of qualified custodians to leverage audit work they have performed to

estimate that under amended rule 206(4)-2, 252 advisers will be subject to the requirement of obtaining or receiving an internal control report.²⁰⁹ Therefore the total cost attributable to this requirement will be \$63,000,000.²¹⁰ The total estimated accounting fee under the amended rule 206(4)-2 is therefore estimated at \$122,965,000.²¹¹

One-time computer system programming costs. As stated above, the amended rule would require an adviser that has an obligation under the rule to provide a notice to clients upon opening a new account on behalf of the client or changes to such account and that sends account statements to its client to include in the account statement a legend urging the client to compare its account statement with those sent by the qualified custodian. We expect that the requirement would cause advisers that are subject to the notice requirement and that send account statements to clients to reprogram their computer system to include the legend in account statements to clients. We estimate that half of the advisers that are subject to the rule or 1,195 advisers will hire a computer programmer to modify their computer system to automatically add the legend to client

satisfy existing regulatory requirements to which these custodians are subject, which may reduce the costs for advisers to comply with the internal control report requirement.

²⁰⁹ Of the 337 advisers (*see supra* note 206 for this estimate) that will be subject to both the surprise examination and internal control report requirement, we further estimate, based on consultation with several accounting firms, that 10% of these advisers already obtain an internal control report for purposes other than the custody rule. In addition, we believe that some related persons may serve as the qualified custodian for more than one affiliated adviser. We estimate that this will reduce the number of required internal control reports by an additional 15%. *See infra* notes 289 and 290 and accompanying text for explanation of this estimate. $337 - (337 \times 10\%) - (337 \times 15\%) = 337 - 34 - 51 = 252$.

²¹⁰ $\$250,000 \times 252 = \$63,000,000$. *See supra* note 207 and *infra* notes 275 to 292 and accompanying text for explanation of our estimate of costs of the internal control report.

²¹¹ $\$59,965,000$ (accounting fee for surprise examination) + $\$63,000,000$ (accounting fee for internal control report) = $\$122,965,000$.

account statements at an average cost of \$1,000 each.²¹² We believe the other half routinely use off-the-shelf software to provide client account statements and will bear little or no direct costs because we expect the software vendors will not pass the reprogramming costs on to their customers (*i.e.* the advisers) due to a very low per unit cost. Based on the above estimates, we believe that the total one-time computer system programming cost would be \$1,195,000 for the advisers subject to this requirement.²¹³

PCAOB registration. For an investment adviser to rely on the provision in amended rule 206(4)-2 that deems pooled investment vehicles to have satisfied the surprise examination requirement if audited financial statements are distributed to investors in the pool, the accountant that audits the pooled investment vehicle's financial statements must be registered with, and subject to regular inspection by, the PCAOB.²¹⁴ We acknowledge that not all pooled investment vehicle audits are performed by accountants meeting the PCAOB requirement as this is a new requirement. However, our staff has reviewed several third-party databases that contain the identity of accountants that perform these audits, and substantially all the pools that identified accountants were audited by PCAOB registered and inspected firms or their affiliates.²¹⁵ Moreover, a representative of venture capital firms stated that the "vast majority" of venture capital funds are audited and, as far as it could determine, all venture capital fund audits are conducted by PCAOB registered accounting firms that are subject to PCAOB

²¹² As stated above, we estimated that there will be 2,389 advisers subject to this requirement. *See supra* note 196 and accompanying text. $2,389/2 = 1,195$.

²¹³ $1,195 \times \$1,000 = \$1,195,000$. *See infra* note 294 for explanation of the estimate.

²¹⁴ Amended rule 206(4)-2(b)(4).

²¹⁵ These databases do not distinguish between funds managed by registered advisers from those managed by exempt advisers (who would not be subject to the rule).

inspection.²¹⁶ As a result, we do not believe there will be a substantial dislocation of pooled investment vehicle auditors as a result of the amended rule. For those pools that will have to change accounting firms, we do not believe based on discussions with accountants that there will be additional costs to retain an accounting firm registered with, and subject to inspection by, the PCAOB, as accountants that perform these financial statement audits are likely to be with national accounting firms or accounting firms that specialize in auditing pooled investment vehicles and that charge equivalent fees to accountants registered with, and subject to inspection by, the PCAOB.²¹⁷

B. Form ADV

In connection with our proposed amendments to Form ADV, we submitted cost and burden estimates of the collection of information requirements to the Office of Management and Budget (“OMB”). We estimated that these amendments would increase the annual information collection burden in connection with Form ADV from 22.25 hours to 22.50 hour for each adviser.²¹⁸ The total information collection burden resulting from the amendments would be 3,068 hours.²¹⁹ We solicited comment in the Proposing Release on our estimates, but did not receive comments. We do not believe that the

²¹⁶ NVCA Letter.

²¹⁷ Two commenters expressed concerns about costs with respect to the requirement of PCAOB registration for accountants performing surprise examinations and preparing internal control reports for advisers that serve, or have related persons serve, as the qualified custodian for their client assets. *See* Consortium Letter; Chamber of Commerce Letter. These comments, however, were not directed to the costs of engaging PCAOB registered accountants for audits of pooled investment vehicles, and the commenters that did recommend the PCAOB requirement did not indicate there would be increased costs for such a requirement. *See, e.g.*, CPIC Letter, MFA Letter.

²¹⁸ *See* the Proposing Release at n.169 and accompanying text. We received no comments on the estimate and we are keeping the estimate unchanged.

²¹⁹ *See* the Proposing Release at n.170 and accompanying text. We received no comments on the estimate and we are keeping the estimate unchanged.

amendments to Form ADV we are adopting today will result in a collection of information requirement different than what we estimated in the Proposing Release. Therefore, we are not revising our PRA burden and cost estimates submitted to the OMB with respect to Form ADV.

C. Form ADV-E

The currently approved collection of information for Form ADV-E is 9 hours. We estimate that this collection of information will increase to 112 hours based on the amendments.²²⁰ This increase results primarily from an increase in the estimated number of advisers that will be subject to the requirement of completing Form ADV-E under the amended rule 206(4)-2 and the additional collections of information required by the amendments to the rule.²²¹

For the currently approved annual hour burden for Form ADV-E, we estimated that 231 advisers would be subject to the annual surprise examination requirement, including the requirement to complete Form ADV-E, and that each of the advisers would spend approximately 0.05 hour to complete Form ADV-E. We now estimate that 1,859 advisers will be required to undergo an annual surprise examination and complete Form ADV-E, and that the total annual hour burden for Form ADV-E in connection with the surprise examination requirement will therefore increase to 93 hours.²²²

²²⁰ We requested comment on our estimates of the collection of information burden relating to Form ADV-E and received no comment.

²²¹ Form ADV-E is the cover sheet for the required filing with the Commission by the accountant performing the surprise examination pursuant to amended rule 206(4)-2(a)(4)(i) and (iii). The adviser completes Form ADV-E and provides it to the accountant, which results in an estimated hour burden for the advisers.

²²² $1,859 \times 0.05 = 93$.

In addition, amended rule 206(4)-2 requires an adviser subject to the surprise examination to enter into a written agreement with the independent public accountant that specifies the accountant's duties, including filing Form ADV-E upon the termination of its engagement. Based on an assumption that advisers change their independent public accountants every five years on average and an estimate that advisers spend approximately 0.05 hours to complete Form ADV-E, advisers will be required each year to complete Form ADV-E with respect to an accountant's termination with an annual burden of 19 hours.²²³ The total annual hour burden for advisers to complete Form ADV-E in connection with the surprise examination and the termination statement will be 112 hours.²²⁴

V. COST-BENEFIT ANALYSIS

A. Background

The Commission is sensitive to the costs and benefits resulting from its rules. Rule 206(4)-2, the custody rule, seeks to protect clients' funds and securities in the custody of registered advisers from misuse or misappropriation by requiring advisers to maintain their clients' assets with a qualified custodian, such as a broker-dealer or a bank. The custody rule, as amended, requires *all* registered advisers that have custody of client assets to have a reasonable belief, formed after due inquiry, that a qualified custodian sends an account statement directly to each advisory client for which the qualified custodian maintains assets.²²⁵ The amended rule also requires advisers that have custody

²²³ $1,859/5 = 372$. $372 \times 0.05 = 19$.

²²⁴ $93 + (372 \times 0.05) = 93 + 19 = 112$

²²⁵ Amended rule 206(4)-2(a)(3). We have retained the exception from the account statement delivery requirement for certain advisers to pooled investment vehicles. Amended rule 206(4)-2(b)(4).

of client assets to undergo an annual surprise examination by an independent public accountant with the exception of advisers that have custody solely because of their authority to deduct advisory fees from client accounts,²²⁶ and advisers that have custody solely because a related person holds the adviser's client assets and the related person is operationally independent of the adviser.²²⁷ In addition, advisers to pooled investment vehicles are deemed to comply with the surprise examination requirement if the pools are subject to an annual financial statement audit by an independent public accountant that is registered with, and subject to regular inspection by, the PCAOB, and if the audited financial statements are delivered to the pool's investors.²²⁸

We are also adopting amendments to the rule to impose additional requirements when advisory client assets are maintained by the adviser itself or by a related person rather than with an independent qualified custodian. The amended rule requires, in addition to the surprise examination discussed above,²²⁹ that the adviser obtain, or receive from its related person, no less frequently than once each calendar year, a written report, which includes an opinion from an independent public accountant with respect to the adviser's or related person's controls relating to custody of client assets, such as a Type II SAS 70 report.²³⁰ The amended rule also requires, in these circumstances, that the independent public accountant issuing the internal control report, as well as the

²²⁶ Amended rule 206(4)-2(b)(3). This exception would also be available to such an adviser when the adviser can rely on amended rule 206(4)-2(b)(6). See Section II.C.2. of this Release. The exception would not be available, however, to an adviser that has custody under the rule for other reasons.

²²⁷ Amended rule 206(4)-2(b)(6).

²²⁸ Amended rule 206(4)-2(b)(4).

²²⁹ Amended rule 206(4)-2(a)(6).

independent public accountant performing the surprise examination, be registered with, and subject to regular inspection by, the PCAOB.²³¹ The adviser must maintain the internal control report in its records and make it available to the Commission or staff upon request.²³²

Finally, we are adopting several amendments to Form ADV and Form ADV-E. The amendments to Form ADV require registered advisers to report to us more detailed information about their custody practices. The amendments to Form ADV-E require that the form and the accompanying accountant's examination certificate, or statement upon termination, be filed electronically with the Commission through the IARD and conform Form ADV-E instructions to amended rule 206(4)-(2).

In the Proposing Release, we requested comment and empirical data regarding the costs and benefits of the amendments. Most of the 1,300 commenters expressed their support for our goal of strengthening protections provided to advisory clients under the custody rule. One opined that the benefits of the proposed additional safeguards to investors whose assets are held in custodial accounts outweigh the costs to advisers.²³³ Many, however, generally expressed concern about the costs, particularly to small advisers, of our proposal as it would have applied to advisers that have custody solely because of their authority to deduct advisory fees from client accounts.²³⁴ As noted

²³⁰ Amended rule 206(4)-2(a)(6)(ii). As discussed in the costs section below, other types of reports could also satisfy the internal control report requirement.

²³¹ Amended rule 206(4)-2(a)(6)(i) and (ii)(C).

²³² Amended rule 204-2(a)(17)(iii).

²³³ CFA Institute Letter.

²³⁴ Of the 1,300 comment letters, approximately 1,100 were form letters or substantially similar letters submitted by smaller advisory firms that, in part, generally expressed

above, we have provided an exception from the surprise examination requirement for these advisers. Several commenters provided comments on the costs and benefits in the Proposing Release, which we address below.

B. Benefits

Improved protection for advisory clients. The rule and form amendments we are adopting today are designed to strengthen controls over the custody of client assets by registered investment advisers and to encourage the use of independent custodians. They will also improve our ability to oversee advisers' custody practices and, together with the guidance for independent public accountants that we are issuing, may prevent client assets from being lost, misused, misappropriated or subject to advisers' financial reverses. The benefits to investors are difficult to quantify, and commenters did not submit empirical data on potential benefits. We believe, however, that these benefits will be substantial, including, generally, increased confidence investors will have when obtaining advisory services from registered investment advisers. In addition, we believe the amendments to the rule could, to a limited extent, promote efficiency and capital formation as a result of such increased investor confidence. In particular, increased investor confidence could lead to more efficient allocation of investor assets, which could result in an increase in the assets under management of investment advisers and, depending on how those assets are invested, a potential increase in the availability of capital.

As described above, the amended custody rule requires investment advisers registered with us that have custody of client assets, subject to certain exceptions, to

concerns regarding the costs of the proposal as it related to the surprise examination for advisers with custody solely due to authority to withdraw advisory fees.

obtain a surprise examination of client assets by an independent public accountant. As a result, advisers that have custody because, for example, they or their related person serves as qualified custodian for client assets, or because they serve as trustee of a client trust or have a power of attorney over client affairs, must undergo an annual surprise examination.²³⁵ The surprise examination requirement should significantly contribute to deterring fraudulent conduct by investment advisers because advisers subject to the surprise examination will know their clients' assets are subject to verification at any time, and therefore may be less likely to engage in misconduct. If fraud does occur, the surprise examination requirement will increase the likelihood that fraudulent conduct will be detected earlier so that client losses will be minimized.²³⁶ The additional review provided by an independent public accountant will also benefit advisory clients because it may help identify problems that clients may not be in the position to uncover through the review of account statements. We estimate that the rule will require 1,859 advisers²³⁷ to obtain an annual surprise examination, and as a result provide the benefits identified above with respect to 956,237 clients.²³⁸

As amended, rule 206(4)-2 requires, in addition to the surprise examination discussed above, that when an adviser or its related person serves as a qualified custodian for advisory client assets, the adviser obtain, or receive from its related person, no less

²³⁵ See Section II. B of this Release.

²³⁶ The independent public accountant conducting a surprise examination is required to verify client assets of which an adviser has custody, including those maintained with a qualified custodian and those that are not required to be maintained with a qualified custodian, such as certain privately offered securities and mutual fund shares.

²³⁷ See *supra* note 173 and accompanying text for explanation of this estimate.

²³⁸ $[337 \text{ (advisers)} \times 2,315 \text{ (average number of clients for advisers subject to the surprise examination)}] + (1,522 \times 2,315 \times 0.05 \text{ (percentage of clients whose assets are subject to the surprise examination)}) = 780,155 + 176,172 = 956,237$.

frequently than once each calendar year, a written report, which includes an opinion from an independent public accountant with respect to the adviser's or related person's controls relating to custody of client assets ("internal control report"), such as a Type II SAS 70 report.²³⁹ The amended rule also requires, in these higher risk situations, that the independent public accountant issuing the internal control report, as well as the independent public accountant performing the surprise examination, be registered with, and subject to regular inspection by, the PCAOB.²⁴⁰

The internal control report requirement will provide important benefits to advisory clients by imposing additional safeguards when client assets are maintained with the adviser or a related person. First, the internal control report will indicate whether the qualified custodian (the adviser or its related person) has established appropriate custodial controls by including an accountant's opinion regarding whether the custodian's internal controls are suitably designed and are operating effectively to meet control objectives related to custodial services, including the safeguarding of funds and securities.²⁴¹ Second, to satisfy the rule's requirements, the independent public accountant preparing the internal control report must verify that client assets are reconciled to a custodian other than the adviser or its related person, which will serve as a critical check when the custodian is not independent.²⁴² Third, an internal control report may also significantly strengthen the utility of the surprise examination when the adviser or a related person custodian maintains client assets because the independent public

²³⁹ Amended rule 206(4)-2(a)(6)(ii). As discussed in more detail below, other types of reports could also satisfy the internal control report requirement.

²⁴⁰ Amended rule 206(4)-2(a)(6)(i) and (ii)(C).

²⁴¹ See Accounting Release.

²⁴² Amended rule 206(4)-2(a)(6)(ii)(B).

accountant performing the surprise examination may obtain additional comfort that confirmations received from the qualified custodian in the course of the surprise examination are reliable. Clients of approximately 337 advisers will benefit from the protections provided by the internal control report requirement.²⁴³

As noted above, the amended rule provides a limited exception from the surprise examination requirement in certain circumstances when the adviser is deemed to have custody solely as a result of a related person having custody.²⁴⁴ The exception is available to an adviser that is (i) deemed to have custody solely as a result of certain of its related persons holding client assets, and (ii) “operationally independent” of its related person.²⁴⁵ Advisers that can overcome the presumption that they are not operationally independent of their related person will benefit from the cost savings of not having to obtain a surprise examination under these circumstances.²⁴⁶ Clients may also benefit from this provision in two respects. First, it may encourage advisers with a choice of related person qualified custodians to use those that are operationally independent over those that are not, which may lower custodial risks to clients. Second, while clients will not have the benefit of the surprise examination under these circumstances, they will benefit from the protections of the internal control report that the adviser must receive from a related person that is a qualified custodian.

²⁴³ See *supra* notes 174 and 175 and accompanying text for explanation of the estimated number. Because these advisers serve, or have a related person serve, as the qualified custodian for their client assets, they are subject to the internal control report requirement. Amended rule 206(4)-2(a)(6).

²⁴⁴ Rule 206(4)-2(b)(6).

²⁴⁵ *Id.*

²⁴⁶ We have estimated that each of these surprise examinations would cost an adviser \$125,000. See *infra* notes 282 - 283 and accompanying text.

When the adviser or its related person serves as qualified custodian for client assets, the surprise examination and internal control report must be performed or prepared by an independent public accountant that is registered with, and subject to regular inspection by, the PCAOB.²⁴⁷ We are also amending rule 206(4)-2 to require that in order to be deemed to comply with the surprise examination requirement, advisers to audited pooled investment vehicles must have the pool's annual audited financial statements prepared by an independent public accountant that is registered with, and subject to regular inspection by, the PCAOB and distribute the audited financial statements to the investors in the pool.²⁴⁸ Advisory clients and pool investors will benefit by having greater confidence in the quality of the surprise examination, the internal control report and pooled investment vehicle audits when performed or prepared by an independent public accountant that is registered with, and subject to regular inspection by, the PCAOB. While PCAOB inspection is focused on public company audit engagements, we believe that requiring that the accountant not only be registered with the PCAOB but be subject to its inspection can provide indirect benefits regarding the quality of the accountant's other engagements.

The amendments also eliminate the alternative, currently provided in the rule, under which an adviser with custody can send its own account statements to clients if the adviser is subject to an annual surprise examination. Instead, all advisers with custody are required to have a reasonable belief, after due inquiry, that the qualified custodian sends account statements directly to clients. As a result, we expect that clients of approximately 190 advisory firms that currently send their own account statements to

²⁴⁷ Amended rule 206(4)-2(a)(6)(i) and (ii)(C).

clients will, under the amended rule, receive account statements directly from qualified custodians.²⁴⁹ Where the qualified custodian is independent, this change provides advisory clients confidence that erroneous or unauthorized transactions will be reflected in the account statement. As a result, this change may deter advisers from engaging in fraudulent activities and allow clients to detect any unauthorized activity in their accounts promptly, thereby averting or reducing losses. Clients of these 190 advisers will benefit from this amendment and will start receiving account statements directly from qualified custodians.

The amended rule requires advisers to include a legend in the notice that they are currently required to send to their clients upon opening a custodial account on their clients' behalf if the adviser sends its own account statements to clients and in any subsequent account statements it sends to clients.²⁵⁰ The legend will urge clients to compare the account statements they receive from the custodian with those they receive from the adviser. As discussed above, client review of periodic account statements from the qualified custodian is an important measure that can enable clients to discover improper account transactions or other fraudulent activity. Raising clients' awareness of this safeguard under the custody rule at account opening and with each subsequent account statement sent by the adviser may cause clients to uncover any unauthorized transactions by their advisers in their accounts more promptly, thereby averting or

²⁴⁸ Amended rule 206(4)-2(b)(4).

²⁴⁹ Based on ADV-E filings, there were 190 advisers that underwent surprise examinations during 2008.

²⁵⁰ Amended rule 206(4)-2(a)(2).

reducing losses. We estimate that 250,367 clients would receive notices and subsequent account statements containing this additional information.²⁵¹

Under the amended rule, each adviser that is required to undergo an annual surprise examination must enter into a written agreement with an independent public accountant to perform the surprise examination. The written agreement will require the independent public accountant to, among other things, (i) file Form ADV-E accompanied by a certificate within 120 days of the time chosen by the accountant for the surprise examination stating that it has examined the client assets and describing the nature and extent of the examination, (ii) report to the Commission any material discrepancies discovered in the examination within one business day, and (iii) upon the accountant's termination or dismissal, or removal from consideration for reappointment, file Form ADV-E within 4 business days accompanied by a statement explaining any problems relating to examination scope or procedure that contributed to the resignation, dismissal, removal, or other termination. These filings and reports will provide our staff additional information to assist in establishing advisers' risk profiles for purposes of prioritizing examinations. The rule will result in the electronic filing of Form ADV-E and the accountant statement on the IARD system.²⁵² Clients will benefit from electronic filing of the Form ADV-E because it will allow them to easily access important information

²⁵¹ We estimated that approximately 2,986 advisers open accounts on behalf of their clients. Based on our staff's observation, we further estimate that 80% of these advisers send account statements to their clients. ($2,986 \times 0.8 = 2,389$). We estimate that each year these 2,389 advisers on average open accounts for about 5% of their 2,096 clients (average number of clients of the advisers with custody of client assets) who are either new clients or whose accounts have been transferred to new qualified custodians and that these advisers also send their own account statements to clients. ($2,389 \times (2,096 \times 0.05) = 250,367$).

about the surprise examinations performed on their advisers. We estimate that 4,303,585 advisory clients will benefit from the amendment.²⁵³ Furthermore, the availability to the general public of Form ADV-E information on the Commission's web site may result in additional benefits, including deterring misconduct before it occurs and providing additional information for clients to consider when deciding which investment adviser to select.

We are adopting the amendments to Item 7 and Section 7.A. of Schedule D that we proposed to require each adviser to report *all* related persons who are broker-dealers and to identify which, if any, serve as qualified custodians with respect to the adviser's clients' funds or securities.²⁵⁴ We are also amending Item 9 to require advisers that have custody (or whose related persons have custody) of client assets to provide additional information about their custodial practices under the custody rule. In addition, the revised Schedule D of Form ADV requires an adviser to provide additional details including information about the independent public accountants that perform annual audits, surprise examinations or that prepare internal control reports,²⁵⁵ whether a report prepared by an independent public accountant contains an unqualified opinion,²⁵⁶ and

²⁵² Until the IARD system is upgraded to accept Form ADV-E, accountants performing surprise examinations should continue paper filing of Form ADV-E. Investment advisers will be notified as soon as the IARD system can accept filings of Form ADV-E.

²⁵³ $1,859 \times 2,315$ (average number of clients of the advisers subject to the surprise examination) = 4,303,585.

²⁵⁴ The item had *required* an adviser to identify on Schedule D of Form ADV each related person that is an investment adviser, but made reporting of the names of related person broker-dealers *optional*.

²⁵⁵ Section 9.C. of Schedule D of Form ADV.

²⁵⁶ *Id.*

about any related person that serves as a qualified custodian for the adviser's clients.²⁵⁷

We also are amending Schedule D to require an adviser to report whether it has determined that it has overcome the presumption that it is not operationally independent from a related person qualified custodian, and thus is not required to obtain a surprise examination for the clients' assets maintained at that custodian. These disclosures will provide our staff more information to determine advisers' risk profiles and prepare for examinations. Moreover, this information will be filed electronically when IARD accepts these filings, and as a result the information will be available to the public through the Commission's web site. Clients will benefit directly from these amendments by obtaining more information about their advisers' custodial practices. They may also benefit indirectly because advisers will be incentivized to implement strong controls and practices to avoid receiving a qualified opinion from an independent public accountant.

Finally, under the amended rule, an adviser to pooled investment vehicles that is deemed to comply with the surprise examination requirement and that is excepted from the account statement delivery requirement by having the pooled investment vehicle audited and distributing the audited financial statements to the investors must, in addition to obtaining an annual audit, obtain a final audit of the fund's financial statements upon liquidation of the fund and distribute the financial statements to fund investors promptly after the completion of the audit.²⁵⁸ This amendment provides fund investors the information necessary to protect their rights and to make sure that the proceeds of the liquidation are appropriately accounted for.

²⁵⁷ Section 9.D of Schedule D of Form ADV.

²⁵⁸ Amended rule 206(4)-2(b)(4)(iii).

Improved clarity of the rule. We anticipate that investment advisers will find it easier to understand and comply with the rule as a result of the amendments, which may result in cost savings for advisers. The amendments will improve the clarity of the rule by adding several definitions, including amending the definition of “custody” to address related person custodian situations, and adding definitions of “control” and “related person.”²⁵⁹

C. Costs

Surprise Examination. As noted above, the amended rule we are adopting today excludes certain advisers with custody from the requirement to undergo an annual surprise examination and deems certain others to comply with the requirement.²⁶⁰

Advisers that have custody for other reasons, however, such as because they or their related person serves as the qualified custodian for client assets, or because they serve as the trustee of a client trust, must undergo an annual surprise examination.²⁶¹ As a result, we now estimate that 1,859 advisers will be subject to the surprise examination requirement under amended rule 206(4)-2.²⁶² Reducing that number by the 190 advisers

²⁵⁹ Amended rule 206(4)-2(d).

²⁶⁰ Amended rule 206(4)-2(b)(3) (exception from surprise examination for advisers that have custody because they have authority to deduct fee from client accounts); amended rule 206(4)-2(b)(6) (exception from surprise examination for advisers that have custody solely because a related person holds the adviser’s client assets and the related person is operationally independent of the adviser); and amended rule 206(4)-2(b)(4) (deemed compliance with the surprise examination requirement for advisers to audited pooled investment vehicles that distribute audited financial statements to pool investors if the audit was conducted by an independent public accountant registered with, and subject to regular inspection by, the PCAOB).

²⁶¹ Under amended rule 206(4)-2 an adviser has custody if its related person has custody of its client assets. Amended rule 206(4)-2(d)(2). A related person is defined as a person directly or indirectly controlling or controlled by the adviser, and any person under common control with the adviser. Amended rule 206(4)-2(d)(7).

²⁶² See *supra* note 173.

that already undergo an annual surprise examination under the current rule,²⁶³ we estimate that the amendments will result in approximately 1,669 additional advisers being required to obtain a surprise examination.²⁶⁴

For purposes of the PRA analysis, we estimate that the total annual collection of information burden in connection with the surprise examination, before including the hours spent on conforming written agreements with accountants to the amended rule, will be 19,950 hours.²⁶⁵ Based on this estimate, we anticipate that advisers will incur an aggregate cost of approximately \$1,256,850 per year for these estimated hours.²⁶⁶

Written agreement. As proposed, amended rule 206(4)-2 requires that an adviser subject to the surprise examination requirement must enter into a written agreement with the independent public accountant engaged to conduct the surprise examination and specify certain duties to be performed by the independent public accountant.²⁶⁷ As stated in the Proposing Release, we believe that written agreements are commonplace and reflect industry practice when a person retains the services of a professional such as an independent public accountant, and they are typically prepared by the accountant in advance. Because the amended rule applies to investment advisers (and not accountants) we believe that the burden to add the provisions to the written agreement will be borne by

²⁶³ See *supra* note 249.

²⁶⁴ $1,859 - 190 = 1,669$.

²⁶⁵ See *supra* note 184 accompanying text for explanation of the estimate.

²⁶⁶ We expect that the function of providing lists of clients to the independent public accountant in assisting its examination, totaling 19,950 hours, would be performed by compliance clerks. Data from the *Securities Industry and Financial Markets Association's Office Salaries in the Securities Industry 2008*, modified by Commission staff to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that cost for this position is \$63 per hour. Therefore the total costs would be \$1,256,850.

²⁶⁷ Amended rule 206(4)-2(a)(4).

the adviser. We estimate that each adviser will spend 0.25 hour to add the required provisions to the written agreement, with an aggregate of 465 hours for all advisers subject to surprise examinations.²⁶⁸ Requiring certain additional items to be included in the written agreement will not significantly increase costs for advisers.²⁶⁹ Moreover, we do not believe that the new requirements placed on the independent public accountant by the written agreement (electronic filing of Form ADV-E and termination statement) will materially increase the accounting fees for the surprise examination discussed above.

For purposes of the PRA analysis, we estimate a total annual collection of information burden in connection with the surprise examination of 20,415 hours.²⁷⁰ Based on this estimate, we anticipate that advisers will incur an aggregate cost of approximately \$1,376,820 per year for the total hours their employees spend in complying with the surprise examination requirement.²⁷¹

²⁶⁸ 1,859 x 0.25 = 465.

²⁶⁹ We estimate that it will take each adviser about 0.25 hour to add the required specifications. *See supra* note 186 and accompanying text. Converting the hour burden to costs, each adviser would spend \$64.50. *See infra* note 271.

²⁷⁰ This estimated number includes the hours an adviser spends on providing client lists to the accountant performing the surprise examination and meeting the rule's requirements for the written agreement with the accountant regarding its engagement to perform the surprise examination. 15,603 hours (advisers subject to the surprise exam for 100% of clients to provide client lists) + 3,051 (advisers subject to the surprise exam for advisers with custody of a small portion of their clients to provide client lists) + 1,296 (advisers to pooled investment vehicles that are subject to the surprise examination to provide investor lists) + 465 (written agreement with accountants) = 20,415.

²⁷¹ As we stated above, the total estimated burden hours related to the surprise examination requirement, before including the hours for written agreement with the accountant, are 19,950 hours with an estimated costs of \$1,256,850. *See supra* note 184 for explanation of the estimated hours and *supra* note 266 for explanation of estimated cost. We expect that the function of adding certain duties of the accountant to the written agreement with the accountant, totaling 465 hours, would be performed by compliance managers. Data from the *Securities Industry and Financial Markets Association's Management & Professional Earnings in the Securities Industry 2008*, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for this position is \$258 per

In the Proposing Release, we estimated that there would have been 9,575 advisers subject to the surprise examination and they would each pay, on average, an annual accounting fee of \$8,100 for the surprise examination.²⁷² The estimated total accounting fees for all surprise examinations would therefore have been \$77,557,500.²⁷³ As explained above, the amended rule excepts from the surprise examination requirement, advisers that have custody because of deducting advisory fees, and advisers that have custody solely because a related person holds the adviser's client assets and the related person is operationally independent of the adviser, and it deems advisers to audited pooled investment vehicles to comply with the requirement under certain circumstances,²⁷⁴ reducing our estimated number of advisers subject to the surprise examination requirement from 9,575 to 1,859.²⁷⁵

Several commenters believed that our cost estimates for surprise examination accounting fees were too low.²⁷⁶ Some of them provided their own estimates ranging from an amount close to our estimate (for smaller advisers),²⁷⁷ to over one million dollars for the largest firms.²⁷⁸ We believe that the costs of the surprise examination are lower than the costs suggested by commenters because commenters' estimates were based on

hour. Therefore the total costs would be \$1,376,820 ((19,950 x \$63) + (465 x \$258) = \$1,376,820).

²⁷² See Proposing Release at n.102 and accompanying text.

²⁷³ $9,575 \times \$8,100 = \$77,557,500$.

²⁷⁴ See Section II.C.2. of this Release.

²⁷⁵ See *supra* notes 170 to 173 and accompanying text.

²⁷⁶ See, e.g., FPA Letter (estimated costs of \$15,000 to \$24,000), IAA Letter (estimated costs of \$20,000 to \$300,000).

²⁷⁷ CFP Board Letter (estimating cost of surprise examination from \$5,000 to \$10,000).

²⁷⁸ SIFMA(PCLC) Letter (member survey indicated average cost estimate of \$200,000 with one response of over \$1,000,000).

two critical assumptions that no longer are valid. First, these estimates were generally based on an understanding that the examination would involve verifying 100% of client assets, as is currently required under our existing guidance for accountants.²⁷⁹ The revised guidance for accountants we are issuing, however, among other things, permits accountants to use sampling in the course of the surprise examination.²⁸⁰ Second, many of these estimates are based on an assumption that an adviser would have custody of all of its clients' accounts based on our proposal to require the surprise examination if an adviser had custody because of the authority to deduct advisory fees directly from client accounts. The rule now provides an exception from the surprise examination when fee deduction is the reason the adviser has custody. As a result, many advisers that have custody under the amended rule will have custody with respect to a limited number of client accounts, and the scope of work for the accountant performing the surprise examination will be significantly reduced.

While, for reasons discussed above, we believe commenters' estimates of the cost of surprise examination are too high, they have caused us to reexamine our cost estimates and to determine that it would be more appropriate to categorize advisers into subcategories to estimate surprise exam costs. Instead of a single average cost, we have divided the 1,859 advisers that are subject to the surprise examination requirement into three distinct groups.²⁸¹ We now estimate that 337 advisers either serve as qualified

²⁷⁹ See ASR No. 103.

²⁸⁰ See Accounting Release.

²⁸¹ The revised estimated costs are based on the experience of our staff and discussions with public accounting firms regarding the surprise examination requirement, modern accounting practices, and commenters' estimates.

custodian for their clients or have a related person that serves as qualified custodian.²⁸²

These advisers would likely be subject to the surprise examination with respect to 100 percent of their clients, and as these advisers typically are large advisers with many clients, we estimate they will each spend an average of \$125,000 annually.²⁸³ We estimate that the rest of the advisers will be subject to surprise examination with respect

²⁸² Based on IARD data, we estimated 396 advisers either serve as qualified custodian for their clients or have a related person that serves as qualified custodian. These advisers would likely be subject to the surprise examination with respect to 100 percent of their clients. We expect 15% of these advisers will use independent custodians instead of incurring these costs. This estimate is based on comments that we received about the high costs of the proposed requirements with respect to advisers using a related person as the qualified custodian. We believe that these advisers will do their own analysis of the benefits of continuing using their related persons as qualified custodians. Some of the advisers that maintain client assets with their related person custodians on an incidental basis may decide to use independent qualified custodians instead to avoid the costs of complying with the requirements. $(396 \times 85\%) = 337$.

²⁸³ Several of these large advisers are advisers with thousands of client accounts, while others have significantly fewer client accounts. The largest advisers will likely incur expenses higher than \$125,000. Whereas those with significantly fewer client accounts will likely incur expenses less than \$125,000. Moreover, as a result of the exception to the surprise examination requirement under amended rule 206(4)-2(b)(6) for an adviser that has custody because of its related person's custody of client assets and that can overcome the presumption that it is not operationally independent of the related person custodian, some of these 337 advisers would not have to obtain the surprise examination. We do not have data or another resource to provide an estimate of the number of advisers that use related person custodians that will be able to overcome the presumption. As a result, we are unable to estimate with specificity the reduced costs due to this exception. We do estimate that of the 337 advisers subject to the surprise examination, that 259 (after the 15% reduction noted above) use related person qualified custodians. *See supra* note 175. If 75% of the 259 of these advisers could overcome the presumption, the cost estimates for the surprise examination would be overstated by \$24,281,250 $((259 \times .75) \times \$125,000)$, if one half of them could overcome the presumption the costs would be overstated by \$16,187,500 $((259 \times .5) \times \$125,000)$, or if one quarter of them could overcome the presumption the costs would be overstated by \$8,093,750 $((259 \times .25) \times \$125,000)$. Those advisers that overcome the presumption may, however, incur outside legal expenses to assist with the determination. We estimate that on average, such legal assistance would cost an adviser between \$4,000 (for 10 hours) and \$16,000 (for 40 hours), significantly less than the estimated costs for the surprise examination. The hourly cost estimate of \$400 on average is based on our consultation with advisers and law advisers who regularly assist them in legal and compliance matters.

to 5 percent of their client accounts.²⁸⁴ We have divided these 1,522 advisers into two groups based on their number of clients: 262 medium-sized advisers and 1,260 small-sized advisers.²⁸⁵ We estimate that medium-sized advisers will on average have accounting fees of \$20,000 annually and small-sized advisers will on average have accounting fees of \$10,000 annually for the surprise examination. Therefore the aggregate account fee relating to the surprise examination is estimated at \$59,965,000.²⁸⁶

Internal Control Report. Under amended rule 206(4)-2, if an adviser or a related person serves as a qualified custodian for client assets in connection with advisory services the adviser provides to clients, the adviser must obtain, or receive from the related person, no less frequently than once each calendar year, a written report of the internal controls relating to the custody of those assets from an independent public accountant that is registered with and subject to regular inspection by the PCAOB. We estimate that approximately 337 investment advisers must obtain, or receive from a related person, an internal control report relating to custodial services.²⁸⁷ One securities industry commenter noted that custodians often already provide Type II SAS 70 reports to clients who demand a rigorous evaluation of internal control as a condition of

²⁸⁴ Advisers are required to undergo an annual surprise examination with respect to only those client accounts to which they have access that causes them to have custody, including through a power of attorney, acting as trustee, or similar legal authority. Based on the experience of our staff, we estimate that on average, only 5 percent of client accounts of these advisers will be subject to the surprise examination.

²⁸⁵ Based on responses to Item 5.C of Form ADV, we estimate that the average number of clients for these 1,522 advisers is 806. We determined, for purposes of this analysis, that an adviser with clients more than this average number is a medium size adviser and an adviser with clients less than this average number is a small adviser. $337 + 262 + 1,260 = 1,859$.

²⁸⁶ $(337 \times \$125,000) + (262 \times \$20,000) + (1,260 \times \$10,000) = \$42,125,000 + \$5,240,000 + \$12,600,000 = \$59,965,000$.

²⁸⁷ See *supra* notes 276-278 for explanation of this estimate.

obtaining their business.²⁸⁸ We estimate that 10% of the advisers that must obtain or receive an internal control report will themselves or their related person qualified custodian will already obtain an internal control report for purposes other than the custody rule.²⁸⁹ In addition, a single internal control report will satisfy the rule's requirement for several related advisers if their clients use the same related person as qualified custodian. We estimate that this will reduce the number of required internal control reports by an additional 15%.²⁹⁰ As a result, we estimate that independent public accountants will prepare 252 internal control reports as a result of the rule amendments. Based on discussions with accounting professionals, we understand that the cost to prepare an internal control report relating to custody will vary based on the size and services offered by the qualified custodian, but that on average an internal control report will cost approximately \$250,000 per year,²⁹¹ for total costs attributable to this section of the proposed rule to be \$63,000,000.²⁹² These advisers also will need to maintain the report as a required record. We anticipate that the cost of maintaining these records will be minimal.

Although the amended rule does not require use of an independent custodian, we encourage the use of custodians independent of the adviser to maintain client assets as a best practice whenever feasible. As a result of the amendments and our encouragement, there may be effects on competition if additional advisers (and clients) begin using

²⁸⁸ SIFMA(AMG) Letter.

²⁸⁹ Our estimate of 10% is based on our consultation with accounting firms that have experience in preparing internal control reports. $337 \times 10\% = 34$.

²⁹⁰ Our estimate of 15% is based on the IARD data. $337 \times 15\% = 51$.

²⁹¹ See *supra* note 208 and accompanying text for explanation of this estimate.

²⁹² $\$250,000 \times (337 - 34 - 51) = \$250,000 \times 252 = \$63,000,000$.

independent custodians, which is a common practice of many advisers today, particularly among those that are not themselves, or affiliated with, large financial service firms.

The total cost estimate above may overestimate actual costs incurred for internal control reports because of the factors discussed below. Accountants preparing an internal control report may incorporate relevant audit work performed for other purposes, including audit work performed to meet existing regulatory requirements, which should increase efficiencies in the audit process. These efficiencies are not represented in the estimated costs as the estimates are based on a custodian entering a new engagement for an internal control report. And any report that meets the objectives of the internal control report would be acceptable under the rule. In addition to the Type II SAS 70 report, other reports a qualified custodian already obtains could satisfy the rule's requirements. For instance, a report issued in connection with an attestation conducted in accordance with AT 601 under the standard of the AICPA would be sufficient, provided that such examination meets the objectives set forth in our guidance for accountants.

One-time computer system programming costs. As stated above, the amended rule would require an adviser that has obligation under the rule to provide a notice to clients upon opening a new account on behalf of the client or changes to such account and that sends account statements to its client to include in the account statement a legend urging the clients to compare its account statement with those sent by the qualified custodian. We expect that the requirement would cause advisers that are subject to the notice requirement and that send account statement to clients to reprogram their computer system to include the legend in account statements to clients. We estimate that half of the advisers that are subject to the rule or 1,195 advisers will hire a computer programmer to

modify their computer system to automatically add the legend to client account statements at an average cost of \$1,000 each.²⁹³ We believe the other half routinely use off-the-shelf software to provide client account statements and will bear little or no direct costs because we expect the software vendors will not pass the reprogramming costs on to their customers (*i.e.* the advisers) due to a very low per unit cost. Based on the above estimates, we believe that the total one-time computer system programming cost would be \$1,195,000 for the advisers subject to this requirement.²⁹⁴

PCAOB registration. For an investment adviser to rely on the provision in amended rule 206(4)-2 that deems pooled investment vehicles to have satisfied the surprise examination requirement if audited financial statements are distributed to investors in the pool, the accountant that audits the pooled investment vehicle's financial statements must be registered with, and subject to regular inspection by, the PCAOB.²⁹⁵ We acknowledge that not all pooled investment vehicle audits are performed by accountants meeting the PCAOB requirement as this is a new requirement. However, our staff has reviewed several third-party databases that contain the identity of accountants that perform these audits, and substantially all the pools that identified accountants were

²⁹³ As stated above, we estimated that there will be 2,389 advisers subject to this requirement. *See supra* note 196 and accompanying text. $2,389/2 = 1,195$.

²⁹⁴ $1,195 \times \$1,000 = \$1,195,000$. Data from the *Securities Industry and Financial Markets Association's Management & Professional Earnings in the Securities Industry 2008*, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for this position is \$193 per hour. We further estimate that such reprogramming will take about 5 hours for each adviser. $\$193 \times 5 \text{ hours} = \965 . Based on the above, we estimate that each adviser will spend approximately \$1,000 as reprogramming costs.

²⁹⁵ Amended rule 206(4)-2(b)(4).

audited by PCAOB registered and inspected firms or their affiliates.²⁹⁶ Moreover, a representative of venture capital firms stated that the “vast majority” of venture capital funds are audited and, as far as it could determine, all venture capital fund audits are conducted by PCAOB registered accounting firms that are subject to PCAOB inspection.²⁹⁷ As a result, we do not believe there will be a substantial dislocation of pooled investment vehicle auditors as a result of the amended rule. For those pools that will have to change accounting firms, we do not believe based on discussions with accountants that there will be additional costs to retain an accounting firm registered with, and subject to inspection by, the PCAOB, as accountants that perform these financial statement audits are likely to be with national accounting firms or accounting firms that specialize in auditing pooled investment vehicles and that charge equivalent fees to accountants registered with, and subject to inspection by, the PCAOB.²⁹⁸

Liquidation Audit. The amended rule specifically requires an adviser to a pooled investment vehicle that is relying on the annual audit provision to obtain a final audit if the pool is liquidated at a time other than the end of a fiscal year.²⁹⁹ This requirement will assure that the proceeds of the liquidation are appropriately accounted for. We believe this requirement will not materially increase the costs for advisers to pooled

²⁹⁶ These databases do not distinguish between funds managed by registered advisers from those managed by exempt advisers (who would not be subject to the rule).

²⁹⁷ NVCA Letter.

²⁹⁸ Two commenters expressed concerns about costs with respect to the requirement of PCAOB registration for accountants performing surprise examinations and preparing internal control reports for advisers that serve, or have related person serve, as the qualified custodian for their client assets. See Consortium Letter; Chamber of Commerce Letter. These comments, however, were not directed to the costs of engaging PCAOB registered accountants for audits of pooled investment vehicles, and the commenters that did recommend the PCAOB requirement did not indicate there would be increased costs for such a requirement. See, e.g., CPIC Letter, MFA Letter.

investment vehicles because we believe most of these pooled investment vehicles are subject to contractual obligations with their investors to obtain a liquidation audit.³⁰⁰ For purposes of PRA analysis, we estimate that advisers will spend 243 hours complying with the requirement³⁰¹ and thus will incur an aggregate cost of \$15,309 for all advisers subject to the requirement.³⁰²

Qualified Custodian Account Statements. With the exception of advisers to certain pooled investment vehicles that distribute audited financial statements, the amended rule requires all registered advisers that have custody of client assets to have a reasonable belief, after due inquiry, that the qualified custodian sends account statements directly to their clients at least quarterly. We believe few advisers will have to change their practices to meet the requirement that all clients receive account statements directly from qualified custodians. Most advisers subject to the rule have qualified custodians that deliver account statements directly to clients and already conduct an inquiry of whether the qualified custodian sends account statements to clients.³⁰³ For those advisers that previously had sent account statements directly to clients instead of having the

²⁹⁹ Amended rule 206(4)-2(b)(4)(iii).

³⁰⁰ As discussed above, amended rule 206(4)-2(c) provides that an adviser's sending an account statement (paragraph (a)(5)) or distributing audited financial statements (paragraph (b)(4)) will not meet the requirements of the rule if all of the investors in a pooled investment vehicle to which the statements are sent are themselves pooled investment vehicles that are related persons of the adviser. We do not believe this requirement will impose new costs on advisers under the rule because the application of the rule as required by this new provision was incorporated into our prior cost estimates.

³⁰¹ See *supra* note 193 and accompanying text.

³⁰² 243 x \$63 (hourly wage) = \$15,309. See *supra* note 266 for explanation of advisory employee wage estimate.

³⁰³ Filing data indicates that 190 advisers (other than those that have custody but only have pooled investment vehicle clients that are subject to an annual audit) did not have the qualified custodian send account statements directly to their clients.

qualified custodian send account statements to clients, the costs should not be significant because qualified custodians send account statements to clients in their normal course of business. The requirement that advisers form their reasonable belief after due inquiry similarly should not have significant costs, as we understand that today most advisers receive duplicate copies of client account statements from custodians.

Based on the above analysis, we conclude that the aggregate annual accounting fee to comply with the surprise examination requirement and the internal control report requirement under amended rule 206(4)-2 is estimated at \$122,965,000. In addition, we estimate that the total hours spent by advisory employees to comply with the amendments³⁰⁴ will be 29,003 at a total cost of \$1,917,864³⁰⁵. The total cost estimated for complying with amendments to 206(4)-2 is estimated at \$126,077,864.³⁰⁶

³⁰⁴ The total hours include time spent to produce client contact lists for the accountant performing the surprise examination, add required language in a written agreement with the accountant engaged to perform the surprise examination, prepare a required legend in notices and subsequent statements to clients urging them to compare information contained in the account statements sent by the adviser with those sent by the qualified custodian, and distribute audited financial statements, including those related to liquidation audit, to fund investors. *See* Section IV of this Release for explanation of the estimates.

³⁰⁵ *See supra* notes 270 and 271 and accompanying text for explanation of these estimates. $[(19,950 \text{ (employee hours for surprise examination)} + 243 \text{ (employee hour for distributing audited financials related to liquidation audit)} + 8,345 \text{ (employee hours for adding a legend in the notice to clients)}] \times \$63 + (465 \text{ (employee hours for adding language in written agreements)} \times \$258) = \$1,797,894 + \$119,970 = \$1,917,864.$

We estimated that advisory employees will spend a total of 41,724 hours to comply the notice requirement. The estimated 8,345 hours noted above for adding the legend to the required notice represents 20% of the total hour burden relating to the notice, which is 41,724 hours. $(41,724 \times 0.2) = 8,345.$ *See supra* note 197 for explanation of the estimate.

³⁰⁶ $(\$122,965,000 \text{ (aggregate accounting fees)} + \$1,917,864 \text{ (costs of hours advisory employees spent)} + \$1,195,000 \text{ (cost of one-time computer system programming)}) = \$126,077,864.$

Form ADV. We are adopting substantially as proposed several amendments to Part 1A of Form ADV that are designed to provide us with additional details regarding the custody practices of advisers registered with the Commission, and to provide additional data to assist in our risk-based examination program. For purposes of the PRA analysis, we estimated that these amendments will increase the annual information collection burden in connection with Form ADV from 22.25 hours to 22.50 hour for each adviser.³⁰⁷ The total information collection burden resulting from the amendments would be 3,068 hours.³⁰⁸ Based on this estimate, we anticipate that advisers will incur an aggregate cost of approximately \$193,284 per year for the total hours their employees spend in connection with the amendments to Form ADV.³⁰⁹

Form ADV-E. For purposes of the PRA analysis, we estimate that the collection of information in connection with Form ADV-E will increase from the currently approved 9 hours to 112 hours based on the requirements of the amended rule. This increase results from an increase in the estimated number of advisers that will be subject to the requirement of completing Form ADV-E under the amendments to rule 206(4)-2 and the additional collections of information required by the amendments relating to completing Form ADV-E when an independent public accountant performing the surprise

³⁰⁷ See *supra* note 218 and accompanying text.

³⁰⁸ See *supra* note 219 and accompanying text. We received no comments on the estimate and we are keeping the estimate unchanged.

³⁰⁹ We expect that the function of completing Form ADV would be performed by compliance clerks at a cost of \$63 per hour. The total cost would be \$193,284 (3,068 x \$63 = \$193,284). See *supra* note 266 for explanation of the hourly compliance clerk cost estimate.

examination terminates its engagement. This represents an increase of 103 hours³¹⁰ with an estimated aggregated annual cost of approximately \$7,056.³¹¹

We recognize that there also might be certain costs to investment advisers, advisory clients and others that are not easily quantifiable. For instance, some advisers may choose to only use independent qualified custodians, and as a result, they may lose advisory clients if those clients insist on maintaining their assets with a particular custodian that happens to be a related person of the adviser. Advisory clients that are unwilling to change custodians also may lose the ability to hire an adviser that is related to the custodian if the adviser will only accept clients that use independent custodians. Advisers that chose to only use independent qualified custodians might also lose efficiencies that resulted from self-custody or related person custody arrangements, which could result in increased costs to advisory clients. Additionally, to the extent that advisers discontinue existing relationships with custodians, accountants or other service providers as a result of, or as required by, the amended rule, these service providers may lose revenues and incur other costs.

Based on the above analysis, we estimate that the aggregate costs for complying with the amendments to rule 206(4)-2, rule 204-2, Form ADV, and Form ADV-E will be \$126,278,204.³¹² Of this amount, we estimate that \$1,195,000 is one-time computer

³¹⁰ 112 - 9 = 103. We received no comments on this estimate.

³¹¹ We expect that the function of completing Form ADV-E would be performed by compliance clerks at a cost of \$63 per hour. The total cost would therefore be \$7,056 (112 x \$63 = \$7,056). See *supra* note 266 for explanation of the hourly compliance clerk cost estimate.

³¹² \$126,077,864 (total costs for complying amendments to rule 206(4)-2) + \$193,284 (total costs for complying with amendments to Form ADV) + \$7,056 (total costs for complying with amendments to Form ADV-E) = \$126,278,204

system programming costs related to account statement legends, while the remainder will be recurred on an annual basis.

VI. FINAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared the following Final Regulatory Flexibility Analysis regarding rule 206(4)-2 in accordance with section 3(a) of the Regulatory Flexibility Act.³¹³ We prepared an Initial Regulatory Flexibility Analysis (“IRFA”) in conjunction with the Proposing Release in May 2009. A summary of that IRFA was published with the Proposing Release.³¹⁴

A. Need for the Rule

Rule 206(4)-2, the custody rule, requires registered advisers to maintain their clients’ assets with a qualified custodian, such as a broker-dealer or a bank. To enhance the protections afforded to clients’ assets, we are adopting amendments to the rule to require all registered advisers that have custody of client assets, among other things: (i) to undergo an annual surprise examination by an independent public accountant to verify client assets; (ii) to have a reasonable basis, after due inquiry, for believing that the qualified custodian maintaining client funds and securities sends account statements directly to the advisory clients; and (iii) unless client assets are maintained by an independent custodian (*i.e.*, a custodian that is not the adviser itself or a related person) to obtain, or receive from a related person, a report of the internal controls relating to the custody of those assets from an independent public accountant that is registered with and subject to regular inspection by the PCAOB.

³¹³ 5 U.S.C. 605(b).

³¹⁴ See Proposing Release at Section VI.

We have designed the amendments to enhance the protections afforded to clients when their advisers have custody of client assets. We believe that the surprise examination requirement will deter fraudulent activities by advisers. Moreover, an independent public accountant may identify misuse that clients have not, which would result in the earlier detection of fraudulent activities and reduce resulting client losses.

The amendments adopted today provide that an adviser is deemed to have custody of client assets held by related persons. Related person custody arrangements can present higher risks to advisory clients than those that maintain assets with an independent custodian. We were concerned that the surprise examination alone would not adequately address custodial risks associated with self or related person custody because the independent public accountant seeking to verify client assets would rely on custodial reports issued by the adviser or the related person. To address these risks, we are adopting a requirement that a registered adviser obtain, or receive from its related person, an annual internal control report, which would include an opinion from an independent public accountant with respect to the adviser's or related person's custody controls.

B. Significant Issues Raised by Public Comment

In the Proposing Release, we requested comment on the IRFA. We received a number of comments related to the impact of our proposal on small advisers. They argued that the proposed amendments to the rule, particularly those that would have imposed the surprise examination requirement on advisers that have custody solely because of their authority to deduct advisory fees, would be disproportionately expensive for, and would impose an undue regulatory burden on, smaller firms.³¹⁵

³¹⁵ Mallon P.C. Letter (asserting that the requirement would cost 10 percent of smaller firms' gross income). *See also* CAS Letter; Consortium Letter; Cornell Letter; Form Letter D;

We are sensitive to the burdens our rule amendments will have on small advisers. We believe that the amendments to the custody rule we are adopting today will alleviate many of the commenters' concerns regarding small advisers. In particular, as described above, we have provided an exception from the surprise examination requirement for advisers who have custody because they have authority to deduct advisory fees from client accounts. Moreover, for small advisers still subject to the surprise examination requirement, the revised guidance for accountants modernizes the procedures for surprise examinations, which may reduce the burden on small advisers.³¹⁶

C. Small Entities Subject to Rule

Under Commission rules, for the purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (i) has assets under management having a total value of less than \$25 million; (ii) did not have total assets of \$5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of \$25 million or more, or any person (other than a natural person) that had \$5 million or more on the last day of its most recent fiscal year.³¹⁷

The Commission estimates that as of November 2, 2009 approximately 73 SEC-registered investment advisers that have custody of client assets were small entities that

FSI Letter; IAA Letter; NAPFA Letter; FPA Letter; Denk Letter. Some commenters argued that, at a minimum, it would force most small advisers to eliminate a convenient billing method chosen by many of their clients. ASG Letter; Cornell Letter; Form Letters C and D; FSI Letter; MarketCounsel Letter. Others urged us to consider that this proposal would likely drive many small advisers out of business, and would create a barrier to entry for others. Ameritrade Letter; IASBDA Letter; NAPFA Letter.

³¹⁶ See Accounting Release.

will be subject to the surprise examination requirement under amended rule 206(4)-2(a)(4), and that no more than eight small entity advisers that have custody of client assets will be subject to the requirement of obtaining or receiving an internal control report under amended rule 206(4)-2(a)(6).³¹⁸

D. Projected Reporting, Recordkeeping, and other Compliance Requirements

The rule amendments impose certain reporting, recordkeeping and compliance requirements on advisers, including small advisers. The rule requires advisers that are subject to the surprise examination to complete Form ADV-E and to maintain internal control reports in certain instances. In addition, under the amendments, each adviser that is required to undergo an annual surprise examination must enter into a written agreement with the independent public accountant that performs the surprise examination that specifies certain duties the accountant must perform as part of the surprise examination engagement. Investment advisers, under the proposed rule amendments, must maintain a copy of an internal control report that an adviser is required to obtain, or receive from its related person, for five years from the end of the fiscal year in which the internal control report is finalized.

We estimate that a total of 1,859 advisers will be subject to the surprise examination requirement, of which 337 advisers will be subject to the surprise examination with respect to 100 percent of their clients and will each spend an average of \$125,000 annually,³¹⁹ and 1,522 will be subject to the surprise examination with respect

³¹⁷ 17 CFR 275.0-7(a).

³¹⁸ Based on IARD data.

³¹⁹ See *supra* note 206 and accompanying text for explanation of the estimate.

to 5 percent of their clients. Of the 1,522 advisers, 262 medium-sized advisers will each spend an average of \$20,000 annually,³²⁰ and 1,260 small-sized advisers will each spend an average of \$10,000 annually.³²¹ The advisers subject to the surprise examination that fall into the definition of “small entities” under section 3(a) of the Regulatory Flexibility Act are among the smallest within the small-sized advisers group, with an average of fewer than 6 clients whose accounts would be subject to the surprise examination requirement.³²² As a result, the accounting fees for the surprise examination conducted on the client accounts at these advisers may be lower than our estimated average cost of \$10,000.³²³ As a result, the potential impact of the amendments on these small entities due to the surprise examination requirement should not be substantial.

We also estimate that, on average, an internal control report will cost approximately \$250,000 per year, but would vary based on the size and services offered by the qualified custodian. As stated above, we estimate that no more than eight small entity advisers will be subject to the internal control report requirement, half of which will obtain the report and the other half will receive the report from a related person. We

³²⁰ These advisers report a larger number of clients than the average number of clients for the subset of advisers that are subject to the surprise examination for only a portion (estimated at 5%) of their clients.

³²¹ These advisers report a smaller number of clients than the average number of clients for the subset of advisers that are subject to the surprise examination for only a portion (estimated at 5%) of their clients.

³²² Based on IARD data, we estimate that more than half (43) of the 73 small advisers will be subject to the surprise examination with respect to no more than 6 clients.

³²³ For the four small entity advisers that may be subject to the surprise examination with respect to 100% of their clients, we believe the cost will be significantly less than the \$125,000 annual fee estimated for the 337 advisers. Based on IARD data, we estimate that the average number of clients for these advisers would be 120 rather than the 2,315 we estimate for other advisers that are in the same group. *See supra* note 176 and accompanying text for explanation of our estimate of average number of clients for the 337 advisers.

believe that the cost of an internal control report for the four small entity advisers that must obtain one will be lower than the estimated \$250,000 because of the small scale of their businesses. Alternatively, these advisers may simply advise their clients to select independent qualified custodians so that they will not be subject to the requirement of obtaining an internal control report.

E. Agency Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the rule amendments, the Commission considered the following alternatives: (i) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for such small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the rule, or any part thereof, for such small entities.

Regarding the first and fourth alternatives, we do not believe that differing compliance or reporting requirements or an exemption from coverage of the rule amendments, or any part thereof, for small entities, would be appropriate or consistent with investor protection. Because the protections of the Advisers Act are intended to apply equally to clients of both large and small advisory firms, it would be inconsistent with the purposes of the Act to specify different requirements for small entities under the amendments.

Regarding the second alternative, the amendments clarify when an investment adviser, including a small adviser, has custody. In addition, we are providing updated guidance for accountants that modernize the procedures for the surprise examination and should provide clarification to investment advisers, including small entities, and accountants on certain issues regarding the surprise examination. We also have endeavored to consolidate and simplify the rule, by adding new definitions to the rule.

Regarding the third alternative, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection with respect to custody of client assets by investment advisers.

VII. EFFECTS ON COMPETITION, EFFICIENCY AND CAPITAL FORMATION

We are adopting amendments to rule 204-2, Part 1A of Form ADV and Form ADV-E, in part, pursuant to our authority under Section 204. Section 204 requires the Commission, when engaging in rulemaking pursuant to that authority, to consider whether the rule is “necessary or appropriate in the public interest or for the protection of investors.”³²⁴ Section 202(c)(1) of the Advisers Act requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.³²⁵ In the Proposing Release, we solicited comment on whether, if adopted, the proposed rule and form amendments would promote efficiency, competition and capital

³²⁴ 15 U.S.C. 80b-4(a).

³²⁵ 15 U.S.C. 80b-2(c). We are adopting amendments to rule 206(4)-2 pursuant to our authority set forth in Sections 206(4) and 211(a) of the Advisers Act, neither of which requires us to consider the factors identified in Section 202(c). Analysis of the effects of these amendments is contained in Sections IV, V, and VI above.

formation. We further encouraged commenters to provide empirical data to support their views on any burdens on efficiency, competition or capital formation that might result from adoption of the proposed amendments. We did not receive any empirical data in this regard concerning the proposed amendments. We received some general comments asserting that the proposed amendments to require a surprise examination for advisers with custody of client assets as a result of deducting advisory fees from client accounts would have a significant adverse impact on competition.³²⁶

We believe the amendments we are adopting today to rule 204-2, Part 1A of Form ADV and Form ADV-E in connection with amendments to rule 206(4)-2, which are substantively similar to those we proposed, will promote efficiency and competition, but have little or no effect on capital formation.

The amendments to Part 1A of Form ADV are designed to provide us with additional details concerning the custody practices of advisers registered with the Commission, and to provide additional data to assist in our risk-based examination program. Under the amendments to Form ADV-E, the form and attached accountant's certificate will be filed electronically on the IARD system. In addition, the rule requires the accountant performing an annual surprise examination to, upon the accountant's termination or dismissal, or removal from consideration for reappointment, file Form ADV-E within 4 business days accompanied by a statement explaining any problems relating to examination scope or procedure that contributed to the resignation, dismissal,

³²⁶

See, e.g., ASG Letter; Ameritrade Letter. The amended rule excludes from the surprise examination requirement advisers that have custody of client assets because of deducting advisory fees from client accounts. *See* amended rule 206(4)-2(b)(3).

removal, or other termination. Both Part 1A of Form ADV and Form ADV-E will be available to the public on the Commission's web site.

Public availability of more detailed disclosure of advisers' custodial practices will permit investors to use this information together with other information they obtain from Form ADV in making more informed decisions about whether to hire or retain a particular adviser. A more informed investing public will create a more efficient marketplace and strengthen competition among advisers. Moreover, the electronic filing requirements are expected to expedite and simplify the process of filing Form ADV-E and attached accountant's certificate with the Commission, thus further improving efficiency. We believe, however, that the amendments are unrelated to, and will have little or no effect on, capital formation.

We are amending rule 204-2 to require (i) that, if an independent custodian does not maintain client assets but the adviser or a related person instead serves as a qualified custodian for client funds or securities under the rule in connection with advisory services the adviser provides to clients, the adviser must maintain a copy of any internal control report obtained or received pursuant to amended rule 206(4)-2(a)(6), and (ii) the memorandum describing the basis upon which the adviser determined that the presumption that a related person is not operationally independent was overcome, pursuant to amended rule 206(4)-2(d)(5) for five years from the end of the fiscal year in which, as applicable, the internal control report or memorandum is finalized.³²⁷ The

³²⁷ Rule 206(4)-2 requires that if an independent custodian does not maintain client assets but the adviser or a related person instead serves as a qualified custodian for client funds or securities under the rule in connection with advisory services the adviser provides to clients, the adviser must obtain, or receive from the related person, no less frequently than once each calendar year an internal control report, which includes an opinion from

amendment is designed to provide our examiners important information about the safeguards in place and assess custody-related risks at an adviser or a related person that maintains client assets. We believe that these amendments will not materially increase the compliance burden on advisers under rule 204-2 and thus will not affect competition, efficiency and capital formation.

VIII. STATUTORY AUTHORITY

We are adopting amendments to rule 206(4)-2 (17 CFR 275.206(4)-2) pursuant to our authority set forth in sections 206(4) and 211(a) of the Advisers Act (15 U.S.C. 80b-6(4) and 80b-11(a)). We are adopting amendments to rule 204-2 pursuant to the authority set forth in sections 204 and 211 of the Advisers Act (15 U.S.C. 80b-4 and 80b-11). We are adopting amendments to Part 1 of Form ADV (17 CFR 279.1) pursuant to our authority set forth in sections 203(c)(1), 204, and 211(a) of the Advisers Act (15 U.S.C. 80b-3(c)(1), 80b-4 and 80b-11(a)). We are adopting amendment to Form ADV-E (17 CFR 279.8) pursuant to our authority set forth in sections 204, 206(4), and 211(a) of the Advisers Act (15 U.S.C. 80b-4, 80b-6(4), and 80b-11(a)).

LIST OF SUBJECTS IN 17 CFR PARTS 275 AND 279

Reporting and recordkeeping requirements, Securities.

TEXT OF RULE AND FORM AMENDMENTS

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is amended as follows.

an independent public accountant with respect to the adviser's or related person's controls relating to custody of client assets. *See* amended rule 206(4)-2(a)(6)(ii).

PART 275 – RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for Part 275 continues to read in part as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

* * * * *

2. Section 275.204-2 is amended by:

- a. Removing “in effect, and” at the end of paragraph (a)(17)(i) and adding in its place “in effect;” ;
- b. Removing the period at the end of paragraph (a)(17)(ii) and adding in its place a semicolon;
- c. Adding paragraph (a)(17)(iii); and
- d. Adding paragraph (b)(5).

The addition reads as follows:

§ 275.204-2 Books and records to be maintained by investment advisers.

(a) * * *

(17) * * *

(iii) A copy of any internal control report obtained or received pursuant to § 275.206(4)-2(a)(6)(ii).

(b) * * *

(5) A memorandum describing the basis upon which you have determined that the presumption that any related person is not operationally independent under § 275.206(4)-2(d)(5) has been overcome.

* * * * *

3. Section 275.206(4)-2 is revised to read as follows:

§ 275.206(4)-2 Custody of funds or securities of clients by investment advisers.

(a) Safekeeping required. If you are an investment adviser registered or required to be registered under section 203 of the Act (15 U.S.C. 80b-3), it is a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Act (15 U.S.C. 80b-6(4)) for you to have custody of client funds or securities unless:

(1) Qualified custodian. A qualified custodian maintains those funds and securities:

- (i) In a separate account for each client under that client's name; or
- (ii) In accounts that contain only your clients' funds and securities, under your name as agent or trustee for the clients.

(2) Notice to clients. If you open an account with a qualified custodian on your client's behalf, either under the client's name or under your name as agent, you notify the client in writing of the qualified custodian's name, address, and the manner in which the funds or securities are maintained, promptly when the account is opened and following any changes to this information. If you send account statements to a client to which you are required to provide this notice, include in the notification provided to that client and in any subsequent account statement you send that client a statement urging the client to compare the account statements from the custodian with those from the adviser.

(3) Account statements to clients. You have a reasonable basis, after due inquiry, for believing that the qualified custodian sends an account statement, at least quarterly, to each of your clients for which it maintains funds or securities, identifying the amount of

funds and of each security in the account at the end of the period and setting forth all transactions in the account during that period.

(4) Independent verification. The client funds and securities of which you have custody are verified by actual examination at least once during each calendar year, except as provided below, by an independent public accountant, pursuant to a written agreement between you and the accountant, at a time that is chosen by the accountant without prior notice or announcement to you and that is irregular from year to year. The written agreement must provide for the first examination to occur within six months of becoming subject to this paragraph, except that, if you maintain client funds or securities pursuant to this section as a qualified custodian, the agreement must provide for the first examination to occur no later than six months after obtaining the internal control report. The written agreement must require the accountant to:

(i) File a certificate on Form ADV-E (17 CFR 279.8) with the Commission within 120 days of the time chosen by the accountant in paragraph (a)(4) of this section, stating that it has examined the funds and securities and describing the nature and extent of the examination;

(ii) Upon finding any material discrepancies during the course of the examination, notify the Commission within one business day of the finding, by means of a facsimile transmission or electronic mail, followed by first class mail, directed to the attention of the Director of the Office of Compliance Inspections and Examinations; and

(iii) Upon resignation or dismissal from, or other termination of, the engagement, or upon removing itself or being removed from consideration for being reappointed, file within four business days Form ADV-E accompanied by a statement that includes:

(A) The date of such resignation, dismissal, removal, or other termination, and the name, address, and contact information of the accountant; and

(B) An explanation of any problems relating to examination scope or procedure that contributed to such resignation, dismissal, removal, or other termination.

(5) Special rule for limited partnerships and limited liability companies. If you or a related person is a general partner of a limited partnership (or managing member of a limited liability company, or hold a comparable position for another type of pooled investment vehicle), the account statements required under paragraph (a)(3) of this section must be sent to each limited partner (or member or other beneficial owner).

(6) Investment advisers acting as qualified custodians. If you maintain, or if you have custody because a related person maintains, client funds or securities pursuant to this section as a qualified custodian in connection with advisory services you provide to clients:

(i) The independent public accountant you retain to perform the independent verification required by paragraph (a)(4) of this section must be registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar year-end, by, the Public Company Accounting Oversight Board in accordance with its rules; and

(ii) You must obtain, or receive from your related person, within six months of becoming subject to this paragraph and thereafter no less frequently than once each calendar year a written internal control report prepared by an independent public accountant:

(A) The internal control report must include an opinion of an independent public accountant as to whether controls have been placed in operation as of a specific date, and are suitably designed and are operating effectively to meet control objectives relating to custodial services, including the safeguarding of funds and securities held by either you or a related person on behalf of your advisory clients, during the year;

(B) The independent public accountant must verify that the funds and securities are reconciled to a custodian other than you or your related person; and

(C) The independent public accountant must be registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar year-end, by, the Public Company Accounting Oversight Board in accordance with its rules.

(7) Independent representatives. A client may designate an independent representative to receive, on his behalf, notices and account statements as required under paragraphs (a)(2) and (a)(3) of this section.

(b) Exceptions. (1) Shares of mutual funds. With respect to shares of an open-end company as defined in section 5(a)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a-5(a)(1)) ("mutual fund"), you may use the mutual fund's transfer agent in lieu of a qualified custodian for purposes of complying with paragraph (a) of this section.

(2) Certain privately offered securities. (i) You are not required to comply with paragraph (a)(1) of this section with respect to securities that are:

(A) Acquired from the issuer in a transaction or chain of transactions not involving any public offering;

(B) Uncertificated, and ownership thereof is recorded only on the books of the issuer or its transfer agent in the name of the client; and

(C) Transferable only with prior consent of the issuer or holders of the outstanding securities of the issuer.

(ii) Notwithstanding paragraph (b)(2)(i) of this section, the provisions of this paragraph (b)(2) are available with respect to securities held for the account of a limited partnership (or a limited liability company, or other type of pooled investment vehicle) only if the limited partnership is audited, and the audited financial statements are distributed, as described in paragraph (b)(4) of this section.

(3) Fee deduction. Notwithstanding paragraph (a)(4) of this section, you are not required to obtain an independent verification of client funds and securities maintained by a qualified custodian if:

(i) you have custody of the funds and securities solely as a consequence of your authority to make withdrawals from client accounts to pay your advisory fee; and

(ii) if the qualified custodian is a related person, you can rely on paragraph (b)(6) of this section.

(4) Limited partnerships subject to annual audit. You are not required to comply with paragraphs (a)(2) and (a)(3) of this section and you shall be deemed to have complied with paragraph (a)(4) of this section with respect to the account of a limited partnership (or limited liability company, or another type of pooled investment vehicle) that is subject to audit (as defined in rule 1-02(d) of Regulation S-X (17 CFR 210.1-02(d)):

(i) At least annually and distributes its audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) within 120 days of the end of its fiscal year;

(ii) By an independent public accountant that is registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar year-end, by, the Public Company Accounting Oversight Board in accordance with its rules; and

(iii) Upon liquidation and distributes its audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) promptly after the completion of such audit.

(5) Registered investment companies. You are not required to comply with this section (17 CFR 275.206(4)-2) with respect to the account of an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 to 80a-64).

(6) Certain Related Persons. Notwithstanding paragraph (a)(4) of this section, you are not required to obtain an independent verification of client funds and securities if:

(i) you have custody under this rule solely because a related person holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services you provide to clients; and

(ii) your related person is operationally independent of you.

(c) Delivery to Related Person. Sending an account statement under paragraph (a)(5) of this section or distributing audited financial statements under paragraph (b)(4) of this section shall not satisfy the requirements of this section if such account statements or financial statements are sent solely to limited partners (or members or other beneficial

owners) that themselves are limited partnerships (or limited liability companies, or another type of pooled investment vehicle) and are your related persons.

(d) Definitions. For the purposes of this section:

(1) Control means the power, directly or indirectly, to direct the management or policies of a person, whether through ownership of securities, by contract, or otherwise.

Control includes:

(i) Each of your firm's officers, partners, or directors exercising executive responsibility (or persons having similar status or functions) is presumed to control your firm;

(ii) A person is presumed to control a corporation if the person:

(A) Directly or indirectly has the right to vote 25 percent or more of a class of the corporation's voting securities; or

(B) Has the power to sell or direct the sale of 25 percent or more of a class of the corporation's voting securities;

(iii) A person is presumed to control a partnership if the person has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the partnership;

(iv) A person is presumed to control a limited liability company if the person:

(A) Directly or indirectly has the right to vote 25 percent or more of a class of the interests of the limited liability company;

(B) Has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the limited liability company; or

(C) Is an elected manager of the limited liability company; or

(v) A person is presumed to control a trust if the person is a trustee or managing agent of the trust.

(2) Custody means holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them. You have custody if a related person holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services you provide to clients. Custody includes:

(i) Possession of client funds or securities (but not of checks drawn by clients and made payable to third parties) unless you receive them inadvertently and you return them to the sender promptly but in any case within three business days of receiving them;

(ii) Any arrangement (including a general power of attorney) under which you are authorized or permitted to withdraw client funds or securities maintained with a custodian upon your instruction to the custodian; and

(iii) Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives you or your supervised person legal ownership of or access to client funds or securities.

(3) Independent public accountant means a public accountant that meets the standards of independence described in rule 2-01(b) and (c) of Regulation S-X (17 CFR 210.2-01(b) and (c)).

(4) Independent representative means a person that:

(i) Acts as agent for an advisory client, including in the case of a pooled investment vehicle, for limited partners of a limited partnership (or members of a limited

liability company, or other beneficial owners of another type of pooled investment vehicle) and by law or contract is obliged to act in the best interest of the advisory client or the limited partners (or members, or other beneficial owners);

(ii) Does not control, is not controlled by, and is not under common control with you; and

(iii) Does not have, and has not had within the past two years, a material business relationship with you.

(5) Operationally independent: for purposes of paragraph (b)(6) of this section, a related person is presumed not to be operationally independent unless each of the following conditions is met and no other circumstances can reasonably be expected to compromise the operational independence of the related person: (i) client assets in the custody of the related person are not subject to claims of the adviser's creditors; (ii) advisory personnel do not have custody or possession of, or direct or indirect access to client assets of which the related person has custody, or the power to control the disposition of such client assets to third parties for the benefit of the adviser or its related persons, or otherwise have the opportunity to misappropriate such client assets; (iii) advisory personnel and personnel of the related person who have access to advisory client assets are not under common supervision; and (iv) advisory personnel do not hold any position with the related person or share premises with the related person.

(6) Qualified custodian means:

(i) A bank as defined in section 202(a)(2) of the Advisers Act (15 U.S.C. 80b-2(a)(2)) or a savings association as defined in section 3(b)(1) of the Federal Deposit

Insurance Act (12 U.S.C. 1813(b)(1)) that has deposits insured by the Federal Deposit Insurance Corporation under the Federal Deposit Insurance Act (12 U.S.C. 1811);

(ii) A broker-dealer registered under section 15(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)(1)), holding the client assets in customer accounts;

(iii) A futures commission merchant registered under section 4f(a) of the Commodity Exchange Act (7 U.S.C. 6f(a)), holding the client assets in customer accounts, but only with respect to clients' funds and security futures, or other securities incidental to transactions in contracts for the purchase or sale of a commodity for future delivery and options thereon; and

(iv) A foreign financial institution that customarily holds financial assets for its customers, provided that the foreign financial institution keeps the advisory clients' assets in customer accounts segregated from its proprietary assets.

(7) Related person means any person, directly or indirectly, controlling or controlled by you, and any person that is under common control with you.

PART 279 – FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940

4. The authority citation for Part 279 continues to read as follows:

Authority: The Investment Advisers Act of 1940, 15 U.S.C. 80b-1, et seq.

5. Form ADV (referenced in § 279.1) is amended by:

a. In the General Instructions, revising the first bullet and last paragraph of instruction 4;

b. In Part 1A, revising the last paragraph of Item 7.A. and revising Item 9;

and

c. In Schedule D, revising Section 7.A., and adding Sections 9.C. and 9.D.

The revisions read as follows:

Note: The text of Form ADV does not and this amendment will not appear in the Code of Federal Regulations.

Form ADV

* * * * *

Form ADV: General Instructions

* * * * *

4. * * *

- information you provided in response to Items 1, 3, 9 (except 9.A.(2), 9.B.(2), and 9.(E)), or 11 of Part 1A or Items 1, 2.A. through 2.F., or 2.I. of Part 1B becomes inaccurate in any way;

* * * * *

If you are submitting an other-than-annual amendment, you are not required to update your responses to Items 2, 5, 6, 7, 9.A.(2), 9.B.(2), 9.E., or 12 of Part 1A or Items 2.H. or 2.J. of Part 1B even if your responses to those items have become inaccurate. If you are amending Part II, do not file the amendment with the SEC.

* * * * *

Part 1A

* * * * *

Item 7 Financial Industry Affiliates

* * * * *

A. * * *

If you checked Items 7.A.(1) or (3), you must list on Section 7.A. of Schedule D all your *related persons* that are investment advisers, broker-dealers, municipal securities dealers, or government securities broker or dealers.

* * * * *

Item 9 Custody

In this Item, we ask you whether you or a *related person* has *custody* of *client* assets and about your custodial practices.

A. (1) Do you have *custody* of any advisory *clients* ?

	<u>Yes</u>	<u>No</u>
(a) cash or bank accounts?	<input type="checkbox"/>	<input type="checkbox"/>
(b) securities?	<input type="checkbox"/>	<input type="checkbox"/>

If you are registering or registered with the SEC, answer "No" to Item 9.A.(1)(a) and (b) if you have custody solely because (i) you deduct your advisory fees directly from your clients' accounts, or (ii) a related person maintains client funds or securities as a qualified custodian but you have overcome the presumption that you are not operationally independent (pursuant to Advisers Act rule 206(4)(2)-(d)(5)) from the related person.

(2) If you checked "yes" to Item 9.A.(1)(a) or (b), what is the amount of *client* funds and securities and total number of *clients* for which you have *custody*:

U.S. Dollar Amount	Total Number of <i>Clients</i>
(a) \$ _____	(b) _____

If your related person serves as qualified custodian of client assets, do not include the amount of those assets and the number of those clients in your response to Item 9.A.(2). Instead, include that information in your response to Item 9.B.(2).

B. (1) Do any of your *related persons* have *custody* of any of your advisory *clients* ?

	<u>Yes</u>	<u>No</u>
(a) cash or bank accounts?	<input type="checkbox"/>	<input type="checkbox"/>
(b) securities?	<input type="checkbox"/>	<input type="checkbox"/>

You are required to answer this item regardless of how you answered Item 9.A.(1)(a) or (b).

(2) If you checked "yes" to Item 9.B.(1)(a) or (b), what is the amount of *client* funds and securities and total number of *clients* for which your *related persons* have *custody*:

U.S. Dollar Amount	Total Number of <i>Clients</i>
(a) \$ _____	(b) _____

C. If you or your *related persons* have *custody* of *client* funds or securities, check all the following that apply:

- (1) A qualified custodian(s) sends account statements at least quarterly to the investors in the pooled investment vehicle(s) you manage.
- (2) An independent public accountant audits annually the pooled investment vehicle(s) that you manage and the audited financial statements are distributed to the investors in the pools.
- (3) An independent public accountant conducts an annual surprise examination of *client* funds and securities.
- (4) An independent public accountant prepares an internal control report with respect to custodial services when you or your *related persons* are qualified custodians for *client* funds and securities.

If you checked Item 9.C.(2), C.(3) or C.(4), list in Section 9.C. of Schedule D the accountants that are engaged to perform the audit or examination or prepare an internal control report.

D. Do you or your *related persons* act as qualified custodians for your *clients* in connection with advisory services you provide to *clients*?

	<u>Yes</u>	<u>No</u>
(1) you act as a qualified custodian	<input type="checkbox"/>	<input type="checkbox"/>
(2) your related persons act as qualified custodians	<input type="checkbox"/>	<input type="checkbox"/>

If you checked "yes" to Item 9.D.(2), list in Section 9.D. of Schedule D all your related persons that act as qualified custodians for your clients in connection with advisory services you provide to clients (you do not have to list broker-dealers already identified as qualified custodians in Section 7.A. of Schedule D).

E. If you are filing your annual updating amendment and you were subject to a surprise examination by an independent public accountant during your last fiscal year, provide the date (MM/YYYY) the examination commenced: _____

* * * * *

Schedule D

SECTION 7.A. Affiliated Investment Advisers and Broker-Dealers

You must complete the following information for each *related person* investment adviser and broker-dealer. You must complete a separate Schedule D Page 3 for each listed *related person*.

Check only one box: Add Delete Amend

Legal Name of *Related Person*:

Primary Business Name of *Related Person*:

Related person is (check only one box): Investment Adviser Broker-Dealer Dual (Investment Adviser and Broker-Dealer)

If the *related person* is a broker-dealer, is it a qualified custodian for your *clients* in connection with advisory services you provide to *clients*? Yes No

If you are registering or registered with the SEC and you have answered "yes," have you overcome the presumption that you are not operationally independent (pursuant to Advisers Act rule 206(4)(2)-(d)(5)) from the *related person* broker-dealer, and thus are not required to obtain a surprise examination for your *clients'* funds or securities that are maintained at the *related person*?

Yes No

Related Person Adviser's SEC File Number (if any) 801- _____
Related Person's CRD Number (if any): _____

SECTION 9.C. Independent Public Accountant

You must complete the following information for each independent public accountant engaged to perform a surprise examination, perform an audit of a pooled investment vehicle that you manage, or prepare an internal control report. You must complete a separate Schedule D Page 4 for each independent public accountant.

Check only one box: Add Delete Amend

(1) Name of the independent public accountant:

(2) The location of the independent public accountant's office responsible for the services provided:

 (number and street)

 (city) (state/country) (zip+4/postal code)

(3) Is the independent public accountant registered with the Public Company Accounting Oversight Board? Yes No

(4) If yes to (3) above, is the independent public accountant subject to regular inspection by the Public Company Accounting Oversight Board in accordance with its rules? Yes No

(5) The independent public accountant is engaged to:

- A. audit a pooled investment vehicle
- B. perform a surprise examination of *client* assets
- C. prepare an internal control report

(6) Does the report prepared by the independent public accountant that audited the pooled investment vehicle or that examined internal controls contain an unqualified opinion? Yes No

SECTION 9.D. *Related Person Qualified Custodian*

You must complete the following information for each of your *related persons* that acts as a qualified custodian for your *clients* in connection with advisory services you provide to *clients* (you do not have to list broker-dealers already identified as qualified custodians in Section 7.A. of Schedule D). You must complete a separate Schedule D Page 5 for each listed *related person*.

Check only one box: Add Delete Amend

Legal Name of *Related Person*:

 Primary Business Name of *Related Person*:

The location of the *related person's* office responsible for custody of your *clients'* assets:

 (number and street)

 (city) (state/country) (zip+4/postal code)

Related Person is (check only one box):
 U.S. Bank or Savings Association

Futures Commission Merchant
 Foreign Financial Institution

If you are registering or registered with the SEC, have you overcome the presumption that you are not operationally independent (pursuant to Advisers Act rule 206(4)(2)-(d)(5)) from the *related person* qualified custodian, and thus are not required to obtain a surprise examination for your *clients'* funds or securities that are maintained at the *related person*? Yes No

* * * * *

6. Form ADV-E (referenced in § 279.8) is amended by revising the instructions to the Form.

The revisions read as follows:

Note: The text of Form ADV-E does not and this amendment will not appear in the Code of Federal Regulations.

Form ADV-E

* * * * *

INSTRUCTIONS

This Form must be completed by investment advisers that have custody of client funds or securities and that are subject to an annual surprise examination. This Form may *not* be used to amend any information included in an investment adviser's registration statement (*e.g.*, business address).

Investment Adviser

1. All items must be completed by the investment adviser.
2. Give this Form to the independent public accountant that, in compliance with rule 206(4)-2 under the Investment Advisers Act of 1940 (the "Act") or applicable state law, examines client funds and securities in the custody of the investment adviser within

120 days of the time chosen by the accountant for the surprise examination and upon such accountant's resignation or dismissal from, or other termination of, the engagement, or if the accountant removes itself or is removed from consideration for being reappointed.

Accountant

3. The independent public accountant performing the surprise examination must submit (i) this Form and a certificate of accounting required by rule 206(4)-2 under the Act or applicable state law within 120 days of the time chosen by the accountant for the surprise examination, and (ii) this Form and a statement, within four business days of its resignation or dismissal from, or other termination of, the engagement, or removing itself or being removed from consideration for being reappointed, that includes (A) the date of such resignation, dismissal, removal, or other termination, and the name, address, and contact information of the accountant, and (B) an explanation of any problems relating to examination scope or procedure that contributed to such resignation, dismissal, removal, or other termination:

(a) By mail, until the Investment Adviser Registration Depository ("IARD") accepts electronic filing of the Form, to the Securities and Exchange Commission or appropriate state securities administrators. File the original and one copy with the Securities and Exchange Commission's principal office in Washington, DC at the address on the top of this Form, and one copy with the regional office for the region in which the investment adviser's principal business operations are conducted, or one copy with the appropriate state administrator(s), if applicable; or

(b) By electronic filing of the certificate of accounting and statement regarding resignation, dismissal, other termination, or removal from consideration for reappointment on the IARD, when the IARD accepts electronic filing of the Form.

* * * * *

By the Commission.

Florence E. Harmon
Deputy Secretary

December 30, 2009

From: [Leidinger, Bill](#)
To: [Rebecca Gunnlaugsson](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Tammy Nichols](#); [Faith Wright](#); [Douglas W. Lybrand](#)
Subject: RE: March 20, 21 and 22
Date: Thursday, March 01, 2012 12:13:33 PM

Thank you for reconsidering....you may want to designate an alternative to represent you....Please let me know...Bill

From: Rebecca Gunnlaugsson [mailto:RGunnlaugsson@ic.sc.gov]
Sent: Thursday, March 01, 2012 10:08 AM
To: Leidinger, Bill; Condon, Bill; Tahiliani, Shakun; Tammy Nichols; Faith Wright; Lybrand, Douglas
Subject: RE: March 20, 21 and 22

Bill,

I am so sorry. I thought your original email was asking if these dates would work with us. I did not ascertain from the email that they were set in stone. Did I misunderstand?

I sincerely apologize for the difficulties arising from my schedule conflict. My children are on spring break that week, and we scheduled and paid for a family trip to Puerto Rico almost six months ago. I am available at any other time and will work diligently to do anything I can to accommodate.

Please do not hesitate to let me know if you have additional thoughts on an alternative solution.

Sincerely,
Rebecca

From: Leidinger, Bill [mailto:Bill.Leidinger@sto.sc.gov]
Sent: Thursday, March 01, 2012 9:22 AM
To: Rebecca Gunnlaugsson; Condon, Bill; Tahiliani, Shakun; Tammy Nichols; Faith Wright; Douglas W. Lybrand
Subject: RE: March 20, 21 and 22

Rebecca, I request and urge you to change your schedule if you can to accommodate Bo's very limited availability.....You are an important player in this process and you are the only one who has a conflict (hope that makes you feel sufficiently guilty!) Thanks for reconsidering and I hope you are able to join us.....Thanks again....Bill

From: Rebecca Gunnlaugsson [mailto:RGunnlaugsson@ic.sc.gov]
Sent: Thursday, March 01, 2012 9:13 AM
To: Leidinger, Bill; Condon, Bill; Tahiliani, Shakun; Tammy Nichols; Faith Wright; Lybrand, Douglas
Subject: RE: March 20, 21 and 22

I really apologize, but I will be out of town on all of those dates.

Rebecca

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]

Sent: Wednesday, February 29, 2012 2:34 PM

To: Condon, Bill; Tahiliani, Shakun; Tammy Nichols; Faith Wright; Douglas W. Lybrand; Rebecca Gunnlaugsson

Subject: March 20, 21 and 22

These dates are OK with me.....please advise if OK with you and I will advise Bo....please make every effort to make yourself available since these dates are good with Bo and we want to confirm with him ASAP so he can book the time with us.....also helps us stay on schedule for project.....Great day today! Thanks.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

From: [Leidinger, Bill](#)
To: [Rebecca Gunnlaugsson](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [Tammy Nichols](#); [Faith Wright](#); [Douglas W. Lybrand](#)
Subject: RE: March 20, 21 and 22
Date: Thursday, March 01, 2012 9:22:35 AM

Rebecca, I request and urge you to change your schedule if you can to accommodate Bo's very limited availability.....You are an important player in this process and you are the only one who has a conflict (hope that makes you feel sufficiently guilty!) Thanks for reconsidering and I hope you are able to join us.....Thanks again....Bill

From: Rebecca Gunnlaugsson [<mailto:RGunnlaugsson@ic.sc.gov>]
Sent: Thursday, March 01, 2012 9:13 AM
To: Leidinger, Bill; Condon, Bill; Tahiliani, Shakun; Tammy Nichols; Faith Wright; Lybrand, Douglas
Subject: RE: March 20, 21 and 22

I really apologize, but I will be out of town on all of those dates.

Rebecca

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Wednesday, February 29, 2012 2:34 PM
To: Condon, Bill; Tahiliani, Shakun; Tammy Nichols; Faith Wright; Douglas W. Lybrand; Rebecca Gunnlaugsson
Subject: March 20, 21 and 22

These dates are OK with me.....please advise if OK with you and I will advise Bo....please make every effort to make yourself available since these dates are good with Bo and we want to confirm with him ASAP so he can book the time with us.....also helps us stay on schedule for project.....Great day today! Thanks.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

From: [Leidinger, Bill](#)
To: [Abesamis, Bo](#)
Cc: [Raven, Dinah](#); [Condon, Bill](#); [Tahillani, Shakun](#); [McDermott, Mike](#); [Faith Wright](#); [Tammy Nichols](#); [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#)
Subject: March 20, 21 and 22 in SC
Date: Wednesday, February 29, 2012 3:49:39 PM

Bo, it looks like these dates will work for us here. I have asked everyone here to make sure they make those dates available for you. I will put on our calendars.

As I recall, Mike will send you and all the rest of us a copy of his 'official' scoring sheet and you will provide a memo back to us regarding what and how we decided today.

If you are going to contact the selected candidates for the next step, please retain records of everything you send/say to them and provide the records to Mike/Shakun. If you want us to contact them, let's talk first so we are assured we inform them of /ask them the right things regarding the next step.

Please let me know if there is anything you would like us to do.....Thanks again for a good day! Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

From: [Leidinger, Bill](#)
To: [Faith Wright](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [Tammy Nichols](#); [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#)
Subject: RE: March 20, 21 and 22
Date: Wednesday, February 29, 2012 3:37:41 PM

Thanks.....Bill

From: Faith Wright [mailto:FWright@retirement.sc.gov]
Sent: Wednesday, February 29, 2012 3:36 PM
To: Tahiliani, Shakun; Leidinger, Bill; Condon, Bill; Tammy Nichols; Lybrand, Douglas; Rebecca Gunnlaugsson
Subject: RE: March 20, 21 and 22

These dates are fine with me.

Thanks,
Faith

From: Tahiliani, Shakun [mailto:Shakun.Tahiliani@sto.sc.gov]
Sent: Wednesday, February 29, 2012 2:35 PM
To: Leidinger, Bill; Condon, Bill; Tammy Nichols; Faith Wright; Douglas W. Lybrand; Rebecca Gunnlaugsson
Subject: RE: March 20, 21 and 22

I am good with the dates as well.

Thanks,
Shakun

From: Leidinger, Bill
Sent: Wednesday, February 29, 2012 2:34 PM
To: Condon, Bill; Tahiliani, Shakun; Tammy Nichols; Faith Wright; Lybrand, Douglas; Rebecca Gunnlaugsson
Subject: March 20, 21 and 22

These dates are OK with me.....please advise if OK with you and I will advise Bo....please make every effort to make yourself available since these dates are good with Bo and we want to confirm with him ASAP so he can book the time with us.....also helps us stay on schedule for project.....Great day today! Thanks.....Bill

William Leidinger
Chief of Staff
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(803) 734-5063 Office
(803) 608-2378 Mobile

From: [Leidinger, Bill](#)
To: [Tahiliani, Shakun](#); [Condon, Bill](#); [Tammy Nichols](#); [Faith Wright](#); [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#)
Subject: RE: March 20, 21 and 22
Date: Wednesday, February 29, 2012 2:35:21 PM

Thanks.....Bill

From: Tahiliani, Shakun
Sent: Wednesday, February 29, 2012 2:35 PM
To: Leidinger, Bill; Condon, Bill; Tammy Nichols; Faith Wright; Lybrand, Douglas; Rebecca Gunnlaugsson
Subject: RE: March 20, 21 and 22

I am good with the dates as well.
Thanks,
Shakun

From: Leidinger, Bill
Sent: Wednesday, February 29, 2012 2:34 PM
To: Condon, Bill; Tahiliani, Shakun; Tammy Nichols; Faith Wright; Lybrand, Douglas; Rebecca Gunnlaugsson
Subject: March 20, 21 and 22

These dates are OK with me.....please advise if OK with you and I will advise Bo....please make every effort to make yourself available since these dates are good with Bo and we want to confirm with him ASAP so he can book the time with us.....also helps us stay on schedule for project.....Great day today! Thanks.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

From: [Tahiliani, Shakun](#)
To: [Leidinger, Bill](#); [Condon, Bill](#); [Tammy Nichols](#); [Faith Wright](#); [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#)
Subject: RE: March 20, 21 and 22
Date: Wednesday, February 29, 2012 2:34:49 PM

I am good with the dates as well.

Thanks,
Shakun

From: Leidinger, Bill
Sent: Wednesday, February 29, 2012 2:34 PM
To: Condon, Bill; Tahiliani, Shakun; Tammy Nichols; Faith Wright; Lybrand, Douglas; Rebecca Gunnlaugsson
Subject: March 20, 21 and 22

These dates are OK with me.....please advise if OK with you and I will advise Bo....please make every effort to make yourself available since these dates are good with Bo and we want to confirm with him ASAP so he can book the time with us.....also helps us stay on schedule for project.....Great day today! Thanks.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

From: [Leidinger, Bill](#)
To: [Condon, Bill](#); [Tahiliani, Shakun](#); [Tammy Nichols](#); [Faith Wright](#); [Douglas W. Lybrand](#); [Rebecca Gunnlaugsson](#)
Subject: March 20, 21 and 22
Date: Wednesday, February 29, 2012 2:34:01 PM

These dates are OK with me.....please advise if OK with you and I will advise Bo....please make every effort to make yourself available since these dates are good with Bo and we want to confirm with him ASAP so he can book the time with us.....also helps us stay on schedule for project.....Great day today! Thanks.....Bill

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(803) 734-5063 Office
(803) 608-2378 Mobile

From: [Leidinger, Bill](#)
To: [Hershel Harper](#); [David L. King](#); [Adam Jordan](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Geoffrey Berg](#)
Subject: RE: Custody Propposals Review W/Bo
Date: Monday, February 27, 2012 12:23:00 PM

Rebecca, this is not an open ended invitation to all comers....the Investment Commission has had several staffers attend previous meetings as we worked through the educational and RFP process who are not on the Advisory Section Panel....They are welcome to attend and will have to sign confidentiality agreements just like the panel members....please remember that this is a procurement.....Thanks....Bill

From: Hershel Harper [<mailto:HHarper@ic.sc.gov>]
Sent: Monday, February 27, 2012 12:16 PM
To: Leidinger, Bill; David L. King; Adam Jordan; Rebecca Gunnlaugsson; Lybrand, Douglas; Berg, Geoffrey
Subject: RE: Custody Propposals Review W/Bo

Bill,

Unfortunately, I have a conflict during the first few hours of this meeting and will not be able to attend.

Many thanks!
Hershel

-----Original Appointment-----

From: Rebecca Gunnlaugsson **On Behalf Of** Leidinger, Bill
Sent: Monday, February 27, 2012 11:54 AM
To: David L. King; Adam Jordan; Rebecca Gunnlaugsson; Hershel Harper; Douglas W. Lybrand; Geoffrey Berg
Subject: FW: Custody Propposals Review W/Bo
When: Wednesday, February 29, 2012 9:00 AM-2:00 PM (UTC-05:00) Eastern Time (US & Canada).
Where: STO conference room, 2nd floor, Hampton Bldg.

If any of you are interested in attending, you are welcome. Please let anyone else with a vested interest know as well. Bill indicated it may be standing room only.

-----Original Appointment-----

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Tuesday, February 14, 2012 1:15 PM
To: Leidinger, Bill; Rebecca Gunnlaugsson; Douglas W. Lybrand
Subject: Custody Propposals Review W/Bo
When: Wednesday, February 29, 2012 9:00 AM-2:00 PM (UTC-05:00) Eastern Time (US & Canada).
Where: STO conference room, 2nd floor, Hampton Bldg.

When: Wednesday, February 29, 2012 9:00 AM-2:00 PM (GMT-05:00) Eastern Time (US & Canada).
Where: STO conference room, 2nd floor, Hampton Bldg.

Note: The GMT offset above does not reflect daylight saving time adjustments.

+~+~+~+~+~+~+~+~+~+

From: [Abesamis, Bo](#)
To: [Rebecca Gunnlaugsson](#)
Subject: RE: Revised Draft - SC Custody/Securities Lending Matrix Analysis
Date: Friday, February 24, 2012 9:02:59 AM

Rebecca,

Got your message. I will answer your questions and also discuss with the group. I am aware of the fee contingency that BNY Mellon stipulated and noted that as Footnote 2 on page 13. BNY Mellon did not specify how that would be apportioned given current idle cash balances. I think BNY Mellon made a strategic mistake in putting that contingency. Will explain next week.

BO

From: Rebecca Gunnlaugsson [mailto:RGunnlaugsson@ic.sc.gov]
Sent: Friday, February 24, 2012 3:52 AM
To: Leidinger, Bill
Cc: Abesamis, Bo
Subject: RE: Revised Draft - SC Custody/Securities Lending Matrix Analysis

Bill and Bo,

We are looking forward to seeing you guys next week! Before we get there, I was curious if I could ask a quick question. I noticed in the BNYMellon proposal that all of the flat fees were contingent upon maintaining \$1.5b to \$2b invested in BNYMellon short term investment vehicles at all times. I cannot find that stipulation represented in the cost matrix Bo put together, which is most likely because I am looking in the wrong place:) I couldn't figure out how that \$1.5b to \$2b was to be apportioned across the General Account, LGIP, and Retirement Systems trust funds either. Bo, would you be willing to give some clarification to this point?

Thanks so much!
Rebecca

From: Leidinger, Bill [Bill.Leidinger@sto.sc.gov]
Sent: Thursday, February 23, 2012 10:20 AM
To: Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Douglas W. Lybrand; Tahiliani, Shakun; Condon, Bill; Leidinger, Bill
Cc: Abesamis, Bo; Swilley-Burke, Gwelda; Loftis, Curtis; Hershel Harper; William Blume
Subject: FW: Revised Draft - SC Custody/Securities Lending Matrix Analysis

Folks, the Treasurer has selected, following recommendations from the entities, the following to serve on the Custody Bank Proposal Advisory Review Panel:

1. Retirement Systems – Tammy and Faith
2. Investment Commission – Rebecca and Doug
3. Treasurer's Office – Shakun, Bill and Bill

Attached for your review is Bo's Matrix Analysis which he will lead us through when we meet with him next Wednesday, February 29, from 9AM to

2PM in the STO Conference room, 2nd floor, Hampton Building.

Please remember that the proposals that you have been reviewing as well as this Matrix Analysis are procurement related materials and as such, you have an obligation to safeguard their confidentiality.

See you on Thursday.....Bill

From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Thursday, February 23, 2012 9:54 AM
To: Leidinger, Bill
Cc: Swilley-Burke, Gwelda
Subject: Revised Draft - SC Custody/Securities Lending Matrix Analysis
Importance: High

Bill,

I had last minor edits (cosmetic) to the Draft SC Custody Securities Lending Matrix. Kindly use this version as attached.

Thanks.

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

101 California Street
Suite 3500
San Francisco, CA 94111
P. 415.274.3074
F. 415.291.4016

www.callan.com

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From: [Leidinger, Bill](#)
To: [Rebecca Gunnlaugsson](#)
Cc: [Abesamis, Bo](#)
Subject: RE: Revised Draft - SC Custody/Securities Lending Matrix Analysis
Date: Friday, February 24, 2012 8:30:39 AM

Rebecca, please refrain from contact with Bo....this is a procurement..... He will answer your questions, and everyone else's , on Wednesday.....make a list! Thanks.....Bill

From: Rebecca Gunnlaugsson [mailto:RGunnlaugsson@ic.sc.gov]
Sent: Friday, February 24, 2012 6:52 AM
To: Leidinger, Bill
Cc: Abesamis, Bo
Subject: RE: Revised Draft - SC Custody/Securities Lending Matrix Analysis

Bill and Bo,

We are looking forward to seeing you guys next week! Before we get there, I was curious if I could ask a quick question. I noticed in the BNYMellon proposal that all of the flat fees were contingent upon maintaining \$1.5b to \$2b invested in BNYMellon short term investment vehicles at all times. I cannot find that stipulation represented in the cost matrix Bo put together, which is most likely because I am looking in the wrong place:) I couldn't figure out how that \$1.5b to \$2b was to be apportioned across the General Account, LGIP, and Retirement Systems trust funds either. Bo, would you be willing to give some clarification to this point?

Thanks so much!
Rebecca

From: Leidinger, Bill [Bill.Leidinger@sto.sc.gov]
Sent: Thursday, February 23, 2012 10:20 AM
To: Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Douglas W. Lybrand; Tahiliani, Shakun; Condon, Bill; Leidinger, Bill
Cc: Abesamis, Bo; Swilley-Burke, Gwelda; Loftis, Curtis; Hershel Harper; William Blume
Subject: FW: Revised Draft - SC Custody/Securities Lending Matrix Analysis

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From: Abesamis, Bo [<mailto:abesamis@callan.com>]
Sent: Thursday, February 23, 2012 9:54 AM
To: Leidinger, Bill
Cc: Swilley-Burke, Gwelda
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From: [Leidinger, Bill](#)
To: [Rebecca Gunnlaugsson](#)
Subject: RE: Revised Draft - SC Custody/Securities Lending Matrix Analysis
Date: Friday, February 24, 2012 8:28:54 AM

They are more than welcome so long as seating is available – then they will have to stand.....have a great weekend.....Bill

From: Rebecca Gunnlaugsson [mailto:RGunnlaugsson@ic.sc.gov]
Sent: Friday, February 24, 2012 6:58 AM
To: Leidinger, Bill
Subject: RE: Revised Draft - SC Custody/Securities Lending Matrix Analysis

Hi, Bill! Sorry to bother you again this morning.

I know at the past Commission meeting Treasurer Loftis said the meeting on Wednesday, February 29th was open to everyone and would be video taped. We have a couple of people here at RSIC who would like to attend. Do you mind if I forward your meeting invitation along to them?

Thanks so much!
Rebecca Gunnlaugsson

From: Leidinger, Bill [Bill.Leidinger@sto.sc.gov]
Sent: Thursday, February 23, 2012 10:20 AM
To: Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Douglas W. Lybrand; Tahiliani, Shakun; Condon, Bill; Leidinger, Bill
Cc: Abesamis, Bo; Swilley-Burke, Gwelda; Loftis, Curtis; Hershel Harper; William Blume
Subject: FW: Revised Draft - SC Custody/Securities Lending Matrix Analysis

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Sent: Thursday, February 23, 2012 9:54 AM
To: Leidinger, Bill
Cc: Swilley-Burke, Gwelda
Subject: Revised Draft - SC Custody/Securities Lending Matrix Analysis
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From: [Leidinger, Bill](#)
To: [Tammy Nichols](#); [Faith Wright](#); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#); [Tahiliani, Shakun](#); [Condon, Bill](#); [Leidinger, Bill](#)
Cc: [Abesamis, Bo](#); [Swilley-Burke, Gwelda](#); [Loftis, Curtis](#); [Hershel Harper](#); [William Blume](#)
Subject: FW: Revised Draft - SC Custody/Securities Lending Matrix Analysis
Date: Thursday, February 23, 2012 10:21:15 AM
Attachments: [SouthCarolina-CustodySecendEvaluationMatrix Feb-21-2012 Revised.pdf](#)
Importance: High

Folks, the Treasurer has selected, following recommendations from the entities, the following to serve on the Custody Bank Proposal Advisory Review Panel:

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3. Treasurer’s Office – Shakun, Bill and Bill

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Sent: Thursday, February 23, 2012 9:54 AM
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Cc: Swilley-Burke, Gwelda
Subject: Revised Draft - SC Custody/Securities Lending Matrix Analysis
Importance: High

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February 21, 2012

State of South Carolina

**Trust/Custody and
Securities Lending Evaluation**

DRAFT - CONFIDENTIAL

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February 21, 2012

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STATE OF SOUTH CAROLINA

Trust/Custody and Securities Lending Evaluation

EXECUTIVE SUMMARY

As part of the due diligence evaluation process and best practice initiative by the State Treasurer's Office, Retirement Systems and the Investment Commission ("Stakeholders") and Callan Associates Inc. ("Callan") embarked on a best practice review of bank custody and securities lending services. Core considerations were given to accounting, on-line access reporting, performance measurement and risk analytics, alternative investment support, and other ancillary service requirements. Risk management and collateral management discipline were examined specific to securities lending services.

Due Diligence Process

In order to gauge the level of compliance, availability of leading edge products and services, and measure the core competencies of custody providers, a due diligence evaluation process was established. In preparation for the due diligence process, Callan coordinated with the Stakeholders to discuss current requirements and perform a full inventory of services required.

The next phase of the due diligence process, was the issuance of a Request for Proposal for Trust/Custody and Securities Lending Services. The Stakeholders and Callan collaborated in the development of the RFP. The State Treasurer's Office posted the RFP to invite potential institutional providers who specialized in custody and/or securities lending services. BNY Mellon, JP Morgan Chase, and State Street submitted a response for both custody and securities lending. Wells Fargo Bank decided to provide trust/custody services only. Citibank, Deutsche Bank, and Northern Trust furnished responses for securities lending services only.

The following areas were evaluated specific to Custody Services -

- Safekeeping of U.S. and Non-U.S. Assets
- Plan Accounting
- Settlement and Trade Processing
- Audited Accounting and Reporting
- Book of Record
- Derivatives Processing
- Alternative Investment Support
- Short Term Sweep - Cash Management
- Corporate Actions
- Risk and Internal Controls
- Performance Measurement and Analytics
- Compliance Monitoring
- Accurate and Timely Pricing
- Internet Access
- Investment Compliance Monitoring
- Risk Analytics
- Client Servicing
- Banking Services

In terms of Securities Lending Services, the following factors were examined –

- Organizational Issues
- Program Structure
- Risk Management
- Collateral Management
- Reporting and Systems
- Lending Capabilities
- Revenue Management

Evaluation

This report documents the responses of the custody and securities lending institutions. The candidate firms provided well-articulated discussions about their overall capabilities and service deliverables. Although the candidate firms are able to provide the basic core custody requirements of the State of South Carolina, there are differences that exist specific to the proposals and product/service deliverables. Wells Fargo would not be able to meet the advanced requirements of the Stakeholders, namely: advanced on-line applications, risk analytics, sophisticated performance analytics, and alternative investment support. In the area of securities lending, the candidate firms put forth compelling proposals. The following analysis is divided into four (4) sections as listed below:

- **Custody Evaluation Matrix**
 - Core Custody and Ancillary Services
- **Custody Fee Evaluation Matrix**
 - Annual Explicit and Implicit Costs
- **Securities Lending Evaluation Matrix**
 - Custody- and 3rd Party- Based Securities Lending
- **Investment Manager Feedback Evaluation Matrix**
 - Technical Feedback and Comments

Custody Evaluation Matrix: The custody evaluation was tempered by qualitative and quantitative factors. A scoring system (5 = Best, 1= Poor, or 0= No Product/Service) was devised and the main factors of differentiation were *equally weighted*, accordingly. The matrix tables compare the different institutions specific to their custody and related core capabilities.

Overall, the candidate firms are very dominant in the area of trust and custody. BNY Mellon established themselves as the leader in accounting and performance measurement and analytics, including Internet applications. JP Morgan Chase has built a one-stop shopping concept for institutional investors through product enhancements and strategic acquisitions, and focused on developing robust deliverables. Wells Fargo has focused primarily in their target client asset size range of \$50 million to \$2 billion. They are known for their client service discipline. State Street has fostered a “can do” attitude and a focus on servicing alternative investments, including a retrofit of on-line deliverables, specifically performance measurement and analytics.

Core Factors of Differentiation (200 pts)				
Experience (25 pts)	BNY Mellon	JP Morgan Chase	State Street	Wells Fargo
<input type="checkbox"/> Overall RFP Discussion (5 pts)	4 Discussion was in-depth and well-articulated. Robust detail was noteworthy.	3 Discussion was average and showed vast improvement in product and service initiatives.	4 Discussion was well formulated and products well established. Robust detail was noteworthy.	2 Discussion. Lacks depth of detail and product deliverables, specifically sophisticated investment structure and alternative investments.
<input type="checkbox"/> Revenue Contribution of Trust and Custody (5 pts)	4 Revenue contribution of Trust/Custody is 75% of total bank revenue.	3 Revenue contribution of Trust/Custody is estimated at 4% of total bank revenue.	4 Revenue contribution of Trust/Custody is 87% of total bank revenue.	3 Revenue contribution of Trust/Custody is less than 14% of total bank revenue.
<input type="checkbox"/> Client Turnover [Clients Lost/Clients Gained over the last 5 Yrs] (5 pts)	3 Total Tax-Exempt = 29%	4 Total Tax-Exempt = 18%	3 Total Tax-Exempt = 23%	5 Total Tax-Exempt = 2%
<input type="checkbox"/> Experience and Client Base (5 pts)	4 Tax-Exempt Assets = \$2.9 trillion; Public Fund Assets = \$1.4 trillion	4 Tax-Exempt Assets = \$2.5 trillion; Public Fund Assets = \$1.3 trillion	4 Tax-Exempt Assets = \$3.1 trillion; Public Fund Assets = \$1.3 trillion	2 Tax-Exempt Assets = \$549 billion; Public Fund Assets = \$67 billion
<input type="checkbox"/> Client Distribution based on Number above \$5+ billion across all market segments (5 pts)	4 9% of Total Tax-Exempt Client Base \$5+ bil Public Funds account for 43% of total clients	4 5% of Total Tax-Exempt Client Base \$5+ bil Public Funds account for 41% of total assets	4 7% of Total Tax-Exempt Client Base \$5+ bil Public Funds account for 39% of total assets	0 0% of Total Tax-Exempt Client Base \$5+ bil Public Funds account for 0% of total assets
Experience	19	18	19	12

Client Service (25 pts)	BNY Mellon	JP Morgan Chase	State Street	Wells Fargo
<input type="checkbox"/> Client Servicing and Support Structure (5pts)	<p>4</p> <p>Michelle Cook = 9 yr tenure and 8 clients; Dean Schavolt = 16 yr tenure and 3 clients.</p> <p>Client Relationship Manager and Support Team are Stellar. Deep bench strength.</p>	<p>4</p> <p>Rich Hartzell = 24 yr tenure and 7 clients; Daniel Murphy = 18 yr tenure and 2 clients.</p> <p>Coordination of Support Team can be an issue due to multiple locations.</p>	<p>4</p> <p>Lisa Tyrrell = 13 yr tenure and 5 clients; Sean Quigley = 22 yr tenure and 7 clients.</p> <p>Client Servicing and Relationship, including Support are acceptable. Expansive Public Fund Servicing Group.</p>	<p>3</p> <p>Darcy Kent = 8 yr tenure and 7 clients; Nate Crow = 7 yr tenure and 11 clients.</p> <p>Client Servicing and Relationship may not have the depth of experience and knowledge to handle a multi-billion fund like SC.</p>
<input type="checkbox"/> Service Location (5pts)	<p>3</p> <p>Michelle is located in NYC, while Dean is in Pittsburgh, PA.</p>	<p>2</p> <p>Rich is in Columbus, OH, while Daniel is in NYC</p> <p>Coordination of Support Team can be an issue due to multiple locations – Boston, NYC, and Columbus, OH.</p>	<p>3</p> <p>Lisa and Sean are based in Boston.</p>	<p>3</p> <p>Darcy and Nate are both located in Minneapolis.</p>
<input type="checkbox"/> Staff Turnover (5pts)	<p>4</p> <p>Staff Turnover = at around 8%, but current team is stable last 3 years</p>	<p>4</p> <p>Staff Turnover = 9%</p>	<p>4</p> <p>Staff Turnover = at around 5%</p>	<p>4</p> <p>Staff Turnover = 4%</p>
<input type="checkbox"/> Client Training and Education (5 pts)	<p>4</p> <p>Available</p>	<p>4</p> <p>Available</p>	<p>4</p> <p>Available</p>	<p>3</p> <p>Available (Limited Offerings)</p>
<input type="checkbox"/> Discussion of Working Partnership with Clients and Monitoring Client Satisfaction (5pts)	<p>3</p> <p>Acceptable Examples Provided</p>	<p>3</p> <p>Acceptable Examples Provided</p>	<p>3</p> <p>Acceptable Examples Provided</p>	<p>2</p> <p>Discussion Example – Below Average</p>
Client Service	18	17	18	15

Financials and Risk Issues (25 pts)	BNY Mellon	JP Morgan Chase	State Street	Wells Fargo
<input type="checkbox"/> SSAE 16/SAS 70 Issues (5 pts)	4 SAS 70 – no substantive issues.	3 SAS 70 – no substantive issues, but noted exceptions to control objectives	3 SAS 70 – no substantive issues, but noted exceptions to control objectives	4 SAS 70 – no substantive issues.
<input type="checkbox"/> Financials and Disaster Recovery (5 pts)	4 Publicly held, Bank regulated by the Fed. Discussion provided. Money center bank and must comply with regulatory requirements.	4 Publicly held, Bank regulated by the Fed. Discussion provided. Money center bank and must comply with regulatory requirements.	4 Publicly held, Bank regulated by the Fed. Discussion provided. Money center bank and must comply with regulatory requirements.	4 Publicly held, Bank regulated by the Fed. Discussion provided. Money center bank and must comply with regulatory requirements.
<input type="checkbox"/> Litigation Risk (5 pts)	3 Exposed to Litigation on SecLending and FX Disclosure Issues including class actions. Disclosure is standard corporate communique.	3 Exposed to Litigation on SecLending Issues, including class actions. Disclosure is standard corporate communique.	3 Exposed to Litigation on SecLending and FX Disclosure Issues, including class actions. Disclosure is exceptional and went out of their way to enumerate.	3 Exposed to Litigation on SecLending Issues, including class actions. Disclosure is standard corporate communique.
<input type="checkbox"/> Headline Risk (5 pts)	2 Current Issues are being intensely debated in Trade Press.	3 Big Bank Issues.	3 Steady but not immune.	3 Big Bank Issues.
<input type="checkbox"/> Subcontracted Services (5 pts)	4 Country sub-custodian bank, pricing vendors, and proxy notification.	4 Country sub-custodian bank, pricing vendors, and proxy notification.	4 Country sub-custodian bank, pricing vendors, and proxy notification.	3 Subcontracts global Custody to BNY Mellon; Utilizes Clearwater Analytics, SEI Trust Acctg and SunGard Arena and pricing vendors and proxy notification.
Financials and Risks	17	17	17	17

Custody and Accounting (25 pts)	BNY Mellon	JP Morgan Chase	State Street	Wells Fargo
<input type="checkbox"/> Custody - Asset Servicing (i.e., Income Collection, Corporate Action, etc.) (5 pts)	4 Acceptable Discussion with the requisite custody and asset servicing structure.	4 Acceptable Discussion with the requisite custody and asset servicing structure.	4 Acceptable Discussion with the requisite custody and asset servicing structure.	3 Acceptable Discussion with the requisite custody and asset servicing structure. (Not G/L Driven)
<input type="checkbox"/> Assets Held in Depositories (5 pts)	4 DTC = \$5.2 trillion FBE = \$2.7 trillion	4 DTC = \$9.7 trillion FBE = \$3.1trillion	4 DTC = \$7.5 trillion FBE = \$2.5 trillion	3 DTC = \$445 billion FBE = \$234 billion
<input type="checkbox"/> Accounting, Manager Reconciliation and GASB Reporting Support (5 pts)	4 Substantial Experience and Depth of Capabilities very Apparent in Discussions. Exceptional GASB Reporting Support.	3 Acceptable Experience and Capabilities. Depth of Client Base is Average. GASB Reporting is available.	4 Acceptable Experience and Capabilities. Depth of Client Base is Average. Exceptional GASB Reporting Support.	2 Acceptable Experience and Capabilities. Depth of Client Base is Below Average. GASB Reporting Support can be problematic.
<input type="checkbox"/> Global Custody and Complex Securities Processing (5 pts)	3 Discussion is acceptable and contains requisite information on capabilities. Fail Rate: Equity = Less than 0.2% Int'l Eq = Less than 8%	3 Discussion is acceptable and contains requisite information on capabilities. Fail Rate: Equity = Less than 3% Int'l Eq = Less than 13%	3 Discussion is acceptable and contains requisite information on capabilities. Fail Rate: Equity = Less than 3% Int'l Eq = Less than 6%	2 Discussion is acceptable and contains requisite information on capabilities. Fail Rate: Equity = Less than 1% Int'l Eq = see BNY Mellon
<input type="checkbox"/> Corporate Governance Support Tools – Regulatory Reporting, Class Actions, Proxy Support and Dedicated Resources (5 pts)	4 Corp Governance Tools and Support = Average Area that is going through Major Upgrades and Enhancements.	2 Corp Governance = Below Average – Rethinking the Deliverables – Need to Catch-Up.	4 Corp Governance = Average –Functionality – Better than Most.	1 Corporate Governance is lacking. Area that needs resources and development.
Custody and Accounting	19	16	19	11

Systems and Technology (25 pts)	BNY Mellon	JP Morgan Chase	State Street	Wells Fargo
<input type="checkbox"/> R&D Budget and Tech. Discussion (5 pts)	4 \$600+ million per year the last 3 years Sufficient.	4 \$550+ million per year the last 3 years Sufficient.	4 Around \$600+ million per year the last 3 years Sufficient. (Estimated based on 20 to 25% of Operating Expense.)	3 Estimated at around \$100 million a year
<input type="checkbox"/> Integration of Systems and Applications (5 pts)	4 Integrated – sufficient level of deliverables.	3 Integrated – but not as tight (certain gaps exist) compared to others.	4 Integrated – sufficient level of deliverables.	2 Not totally integrated (certain gaps exist compared to others – Alts, Derivatives and Non-US.
<input type="checkbox"/> Internet Capabilities – Advance Browser Capabilities & Ease of Use (5 pts)	3 Workbench Robust and Intuitive. Going through Enhancements.	3 JP Morgan Access Next Generation is an Improvement but further Integration is coming. Lags the Competition in terms of Depth and Coverage of Took Kit.	4 myStateStreet Next Generation is Exceptional and Very Advanced.	2 CEO Basics are done right; however, advanced functionality needs attention.
<input type="checkbox"/> Data Mining and Wealth of Information – Accounting, Guideline Compliance & Performance (5 pts)	4 Exceptional – Performance Measurement and Analytics.	3 Acceptable – Functionality is Coming Up to Speed.	4 Exceptional – Corporate Governance, Advanced Analytics, Alternative Investments and Risk Mgmt.	2 Below Average – Information is not robust. Utilizes Clearwater Analytics – Good Application but not robust to handle complex mandates.
<input type="checkbox"/> Integrated Access to Risk and Alternative Investments via On-Line (5 pts)	3 Improvements are in Beta.	3 Retrofitting the deliverables to look seamless.	3 Functionality is already available but needs ease of use.	1 None
Systems and Technology	18	16	19	10

Performance Measurement and Analytics (25 pts)	BNY Mellon	JP Morgan Chase	State Street	Wells Fargo
<input type="checkbox"/> Performance Measurement for all asset classes (5pts)	<p>4</p> <p>Acceptable– Stable and Consistent Deliverables. Universe Comparison – Above Average – Access TUCS and Russell; Domestic Equity and International Equity Attribution – Acceptable Domestic Equity and Fixed Income Characteristics – Above Average. Alternative Investment Analytics are available. Lag and Non-Lag Performance is Available.</p>	<p>3</p> <p>Acceptable – Can deploy any Tool preferred by Clients Universe Comparison – Limited but has access to TUCS; Domestic Equity and International Equity Attribution – Acceptable Domestic Equity and Fixed Income Characteristics – Acceptable. Alternative Investment Analytics are available. Lag and Non-Lag Performance is Limited.</p>	<p>4</p> <p>Acceptable – Much improved and enhanced. Universe Comparison – Above Average; Domestic Equity and International Equity Attribution – Acceptable Domestic Equity and Fixed Income Characteristics – Acceptable. Alternative Investment Analytics are available. Lag and Non-Lag Performance is Available.</p>	<p>2</p> <p>Limited – Basic to intermediate level capabilities geared to traditional asset classes. Advanced Analytics are not available compared to competition.</p>
<input type="checkbox"/> Alternative Investment Platform (5 pts)	<p>4</p> <p>Utilize Burgiss Group. Exceptional in processing. Robust Endowment Clients with Alternative Investments.</p>	<p>3</p> <p>Utilize SunGard Investran.</p>	<p>3</p> <p>Utilize in-house Private Edge.</p>	<p>1</p> <p>None Utilizes Clearwater Analytics for aggregation purposes only.</p>
<input type="checkbox"/> Investment Compliance Monitoring (5 pts)	<p>4</p> <p>Above Average – Built as a Service Solution. Acceptable Deliverables.</p>	<p>4</p> <p>Above Average –Built as a Service Solution. Acceptable Deliverables.</p>	<p>4</p> <p>Above Average – Built as a Service Solution. Deliverables well-articulated.</p>	<p>1</p> <p>Lacks clear cut capabilities, employ Clearwater Analytics for limited applications..</p>
<input type="checkbox"/> Risk Analytics (5 pts)	<p>4</p> <p>Average – Area that is going through Major Upgrade and Enhancements. Risk Analytics –through Investor Analytics</p>	<p>3</p> <p>Below Average – Rethinking the Deliverables. Risk analytics being retooled. Available through Algorithmics and other 3rd party platforms.</p>	<p>4</p> <p>Above Average –Functionality - Better than Most. - First in the industry to introduce applications. IFS products well integrated as part of platform – truView.</p>	<p>1</p> <p>Lacks depth of deliverables and capabilities, but engaged Clearwater Analytics to develop capabilities.</p>
<input type="checkbox"/> Look Through Capabilities (5 pts)	<p>3</p> <p>Average – Analytics is Acceptable and Dedicated Group. Beta Testing – “Capstone Project”</p>	<p>3</p> <p>Average – Analytics is Acceptable and Dedicated Group. Going Through Enhancements in Look Through.</p>	<p>4</p> <p>Above Average – Analytics is Acceptable and Dedicated Group. Core deliverables are well established.</p>	<p>0</p> <p>None. Initiatives are being discussed.</p>
Performance Measurement and Analytics	19	16	19	5

Cash and FX (25 pts)	BNY Mellon	JPMorgan Chase	State Street	Wells Fargo
<input type="checkbox"/> Short Term Cash Management (5 pts) Note: Refer to RFP Response and/or Prospectus for Appropriate Vehicles, Risks, Asset Base, and Cash Balance Minimums.	3 EB STIF = \$16 bil EB Govt STIF = \$7 bil No breaks on Sweep Vehicles – due to capital support. Mellon (Dreyfus) and BNY Cash	3 JPM Money Market Funds JP Prime MMF = \$124 bil Govt MMF = \$57 bil No breaks on Sweep Vehicles. JP Morgan Asset Management	3 Collective STIF = \$63 bil Govt STIF = \$11 bi No breaks on Sweep Vehicles. State Street Global Advisors	3 Cash Inv. MMF = \$16.3 bil Govt MMF = \$33.6 bil No breaks on Sweep Vehicles. Wells Capital Management
<input type="checkbox"/> Cash Mgmt Fees (5 pts)	4 EB STIF = 8 bps EB Govt STIF = 8 bps	2 JP MMF Fee Range = 18 bps Govt MMF = 18 bps (Capital Share Class)	4 Collective STIF = 10 bps Govt STIF = 10 bps	2 Money Market Funds = 20 bps
<input type="checkbox"/> Overdraft Charges (5 pts) Note: Refer to RFP Response for Overdraft Details.	3 Fed Funds + 250 to 350 bps	3 Fed Funds + 200 bps	3 Fed Funds + 200 bps	3 Fed Funds + 100 bps
<input type="checkbox"/> FX Disclosure and Discussion ¹ (5 pts)	3 Discussion – Average Program seeks Transparency and Disclosure Going through Enhancements.	4 Discussion – Above Average Program seeks Transparency and Disclosure Reporting Above Average.	4 Discussion – Above Average Program Retooled for Transparency and Disclosure Much Improved.	2 Discussion is Average. (Reporting is Minimal.)
<input type="checkbox"/> 3 rd Party FX Penalty Charge (5 pts)	4 \$35 per trade	5 No Charge (Normal Wire Charge of \$5/trade)	3 \$25 per trade	5 No Charge (Normal Wire Charge)
Cash Mgmt and FX	17	17	17	15

¹ Foreign Exchange execution is a dealer or principal market and there is no distinct exchange for buyers and sellers to post execution; and simultaneously determine spreads. The market is comprised primarily of various FX desks involving commercial banks, investment banks, broker/dealers, investment management houses, and public/corporate treasury desks. Thus, currency execution is very opaque and often misunderstood to what is best execution. Plan sponsors are advised to reach out to their investment managers (who ultimately have investment discretion) and ask if they utilize a competitive bidding on FX for both standing instructions and transactional buys & sells - currency settlements. Investment managers should affirm that foreign currency transactions are subject to review. In addition, plan sponsors should require a report from their custodian banks regarding volume of FX trades executed, time, market value of currency transactions, and spreads above or below the WM fixing rate. Please note that certain intermediate and emerging countries only allow for FX trades executed by custody banks for tracking purposes.

Other Services (25 pts)	BNY Mellon	JP Morgan Chase	State Street	Wells Fargo
<input type="checkbox"/> Maintain \$50 mil of Treasuries in Escrow with Fed Reserve (5 pts)	4 Yes Currently provided by BNY Mellon.	4 Yes Able to meet requirement.	4 Yes Able to meet requirement and offer alternative arrangements.	4 Yes Able to meet requirement.
<input type="checkbox"/> Transfer Agency Services for LGIP and Treasury Portfolios (5 pts)	4 Transfer Agency is available and provided through BNY Mellon	4 Transfer Agency through US Bancorp Fund Services.	4 Transfer Agency through State Street or Affiliate - Boston Financial Services.	3 Transfer Agency through Wells Fargo Shareowner Services
<input type="checkbox"/> QED Experience and Investment Accounting Support Capabilities (5 pts)	4 Eagle STAR which is owned by BNY Mellon (Exceptional Platform)	3 QED will be supported. Alternative is SunGard Arena.	4 Princeton Financial System (PAM) which is owned by State Street. (Above Average)	3 SEI Trust 3000
<input type="checkbox"/> Fund Administration Services – Hedge Funds (5 pts)	4 Yes, Available through Alternative Investment Services, Ltd.	3 Yes, Available through JP Morgan Hedge Fund Services	4 Yes, Available through State Street IFS	0 No discussion or specific description of services.
<input type="checkbox"/> Client Base for Hedge Fund Administration (5 pts)	4 Client = 130 Assets = \$14 billion	3 Client = 50 Assets = \$9 billion	4 Client = 112 Assets = \$23 billion	0 Not Available
Other Services	20	17	20	10
TOTAL SCORE (200 pts)	147	134	148	95

Custody Fee Evaluation Matrix: A common set of assumptions was provided to the custody providers in order for them to calculate a reasonable fee structure. Based on Callan's experience, fees are often negotiable. A few custodian banks will put forth an initial fee that is relatively high and normally would expect the client to negotiate. Other custodian banks believe that by being upfront with a competitive fee in the initial stages of the process is the right thing to do. Regardless of what approach is taken, clients have to be cautious, and weigh capabilities and actual deliverables as the foundation of any negotiation. The table below summarizes the pro-forma fee calculation as proposed by the custodian banks. The worksheet utilizes the same set of assumptions for one-year of actual portfolio holdings and activity. Kindly refer to the Fee Section of the responses to the RFP for complete details.

Estimated Annual Custody Cost

Explicit Cost Estimate	BNY Mellon ²	JP Morgan Chase	State Street	Wells Fargo ³
SC General Acct and LGIP				
Flat Fee with Ability to Lend	\$100,000	\$175,000	\$500,000	Not Applicable
Flat Fee w/o Ability to Lend	\$145,000	\$225,000	\$600,000	\$350,000 Wells Fargo \$496,619 Clearwater
SC Retirement Systems				
Flat Fee with Ability to Lend	\$475,000	\$650,000	\$1,500,000	Not Applicable
Flat Fee w/o Ability to Lend	\$580,000	\$720,000	\$1,800,000	\$1,250,000 Wells Fargo \$1,297,796 Clearwater
What is Included?				
Custody Services	Included	Included	Included	Included
Multi-Currency Accounting	Included	Included	Included	Included
Monthly Valuation	Included	Included	Included	Included
On-Line Internet	Included	Included	Included	Included
Contractual Settlement	Included	Included	Included	Non-US is Actual Settlement
Transition, Conversion, Register	Included	Included	Additional	Included
Penalty Costs- 3 rd Party FX	Additional Charge \$22,890 \$35/trade = 3 rd Party FX	Additional Charge \$3,270 \$5/trade = 3 rd Party FX	Additional Charge \$16,350 \$25/trade = 3 rd Party FX	Included
Penalty Costs – 3 rd Party Seclend	Additional \$50,000 + transaction fees	Additional \$5/ trade Domestic \$20/trade International	Additional – TBD	Included

² BNY Mellon's proposed fee has specific contingencies as specified in RFP Response such as securities lending reinvestment guidelines and minimum cash balance in STIF vehicle.

³ Wells Fargo proposed to subcontract with Clearwater Analytics for Performance Calculations, Independent Derivatives Valuation, Performance Measurement, Advanced Risk Analytics, Investment Compliance Monitoring, and Alternative Investment Support. Clearwater Analytics fee is 0.5 bps on all assets.

Continue...	BNY Mellon	JP Morgan Chase	State Street	Wells Fargo
Out of Pocket Expenses	Additional – Pass Thru Cost	Additional – Pass Thru Cost	Additional – Pass Thru Cost	Included
Proxy Notification	Included	Additional \$11,655 \$15 per notify x 777 proxies	Included	Included
Class Action Claims Filing	Included	Additional \$27,500 \$500 per filing x 55 filings	Included	Included
Training/Education –40 hrs	Included	Included	Included	Included
Investment Compliance	Included	Included	Additional \$36,000 \$2,000/Separate Accts	Included in Clearwater Analytics
Independent Derivatives Valuation	Additional - TBD	Additional - TBD	Additional - TBD	Included in Clearwater Analytics
Perf Measurement Return Calcs (Monthly Frequency)	Included	Included	Included	Included in Clearwater Analytics
Performance Analytics	Included Exec Board Reports - Add'l	Included Drill Down - Additional Exec Board Reports - Add'l	Included	Included in Clearwater Analytics
Advanced Risk Analytics	Included	Additional - TBD	Additional – TBD Estimated at \$302,000	Included in Clearwater Analytics
Interface with 3 rd Party	Basic Included	Additional - TBD	Included	Included
G/L Interface	Included	Included	Included	Included
Corporate Governance Tools	Included	Additional - TBD	Included	Included
Alternative Investment Support	Included	Additional - TBD	Included	Included in Clearwater Analytics
Document Management	Included	Additional - TBD	Included	Included
Others:				
Hedge Fund Administration	Additional - TBD	Additional - TBD	Additional - TBD	Additional - TBD
Investment Acctg (aka QED)	Additional - TBD	Additional - TBD	Additional - TBD	Additional - TBD
Transfer Agency	Additional - TBD	Additional - TBD	Additional - TBD	Additional - TBD
Additional Costs	\$22,890	\$42,425	\$354,350	\$0
ESTIMATED ANNUAL TOTAL EXPLICIT COSTS with Ability to Lend	\$597,890	\$867,425	\$2,354,350	Not Applicable
ESTIMATED ANNUAL TOTAL EXPLICIT COSTS w/o Ability to Lend	\$747,890	\$987,425	\$2,754,350	\$3,394,415

In addition to the above fees, Callan prepared the table below to highlight other costs (implicit fees) that a custodian could potentially earn from other bank provided services. Please note that calculated fees are estimates and based on investment activity over the last year ending June 30, 2011. Fee Components may not be exhaustive of all potential fee revenue of the custodian banks.

Implicit Fees and Other Cost Considerations

Implicit Cost Estimate	BNY Mellon	JP Morgan Chase	State Street	Wells Fargo
Short Term Cash Sweep Mgmt Fees for \$500 mil Average Cash Balance (estimate)	Fee = 8 bps \$400,000	Fee = 18 bps \$900,000	Fee = 10 bps \$500,000	Fee = 20 bps \$1,000,000
Overdraft Charges	Fed Funds + 250 to 350 bps	Fed Funds + 200 bps	Fed Funds + 200 bps	Fed Funds + 100 bps
Earned FX Spread⁴	\$400,000	\$400,000	\$400,000	\$400,000
Securities Lending Split and Cash Management Fees				
▪ Bank Portion of Split (Assume \$1.5 mil in gross revenue for Overnight Reinvest)	\$225,000 (15% Split)	\$225,000 (15% Split)	\$225,000 (15% Split)	Not Applicable
▪ Cash Collateral Mgmt Fee (Assume \$50 mil out-on-loan balance)	\$0 No Cash Collateral Fee	\$0 No Cash Collateral Fee	\$8,750 1.75 Fee	Not Applicable
ESTIMATED ANNUAL TOTAL IMPLICIT COSTS	\$1,025,000	\$1,525,000	\$1,133,750	\$1,400,000

⁴ Assume \$2 billion international securities in separate accounts at 50% turnover = \$1 bil. Then \$1bil x 2 for roundtrip trade = \$2 bil. At 20% of \$2 bil executed by custodian bank = \$400 million. Estimated FX spread at 10 bps x \$400 million = \$400,000 in annual revenue to the custodian bank.

Securities Lending Evaluation Matrix: Specific to securities lending, six (6) institutions responded to the RFP. Three institutions are custody based lending (i.e., BNY Mellon, JP Morgan Chase, and State Street Bank), while the other three firms are 3rd party lending agents (i.e., Citibank, Deutsche Bank, and Northern Trust).

Securities Lending (50pts)			
Securities Lending Custody Based (50pts)	BNY Mellon	JP Morgan Chase	State Street
<input type="checkbox"/> Organizational Issues (5 pts)	3 Program has Litigation Issues; James Slater replaced Kathy Rulong a year ago as Global Head of Custody.	3 Program has Litigation Issues. Minor changes at Management rank.	3 Program has Litigation Issues; Major changes at the Management rank due to departures in 2009.
<input type="checkbox"/> Client Turnover – Last 5 Years Departures/Additions (5 pts)	2 206%.	3 48%.	3 67%
<input type="checkbox"/> SecLending Contribution to Revenue (5 pts)	3 4% of Asset Servicing or \$150 million in 2010.	2 Did not Disclose.	3 4% of total bank revenue or \$318 million in 2010.
<input type="checkbox"/> Total Lendable Base (5 pts)	4 \$2.5 trillion	4 \$1.8 trillion	4 \$2.1 trillion
<input type="checkbox"/> Operational Considerations (5 pts)	4 Mark to Market and Collateralization Levels are Acceptable. Full Transparency is Available Daily.	4 Mark to Market and Collateralization Levels are Acceptable. Full Transparency is Available Daily.	4 Mark to Market and Collateralization Levels are Acceptable. Full Transparency is Available Daily.
<input type="checkbox"/> Securities Lending Program Structure, and Indemnification ⁵ (5 pts)	3 Cash Collateral Reinvestment Losses both Credit (Issuer Default) and Liquidity (Mark to Market) Program has been retooled for the better. <u>Indemnification</u> - Borrower Default (Will provide a limited form of Collateral Reinvestment Risk Indemnification in REPO Program only.)	3 Cash Collateral Reinvestment Losses both Credit (Issuer Default) and Liquidity (Mark to Market) Did not share in Losses due to usage of separate accounts for Cash Collateral Reinvest. <u>Indemnification</u> - Borrower Default (Will provide a limited form of Collateral Reinvestment Risk Indemnification in REPO Program only.)	2 Strains in Liquidity (Mark to Market) Only. Program structure remains intact with clear validation of risk mgmt. process. <u>Indemnification</u> - Borrower Default (Does not wish to provide Collateral Reinvestment Risk Indemnification in REPO Program.)

⁵ Please refer to the Responses to the RFP for specific language regarding limits to indemnification. The candidate firms are able to provide borrower default indemnification and cover operational negligence. However, it would be prudent for South Carolina to verify if the following areas are covered in the Borrower Indemnification clause, namely: (1) Borrowers files for bankruptcy for whatever reason; (2) Failure to recall securities before contractual settlement date for whatever reason; (3) Failure to secure additional collateral and margin requirements; (4) Failure to receive dividends, distributions and all economic benefits of ownership; and, (5) Immediate use of Non-Cash Collateral in lieu of Borrower Bankruptcy. In addition, indemnification specific to operational negligence and trade settlement risk needs verification. (Please note that Callan Associates is not in a position to provide a legal opinion with respect to the coverage, language and limitations of the indemnification clauses provided by the candidate firms.)

Securities Lending Custody Based (50 pts)	BNY Mellon	JP Morgan Chase	State Street
<input type="checkbox"/> Duration Mismatch ⁶ 2011 YTD for Program (A higher number can be risky.) (5 pts)	2 16 to 21 day GAP	3 18 day GAP	2 14 to 43 day GAP
<input type="checkbox"/> Utilization Rate ⁷ 2011 YTD (5 pts) US Equities US Treasuries Intl Equity	3 7% 40% 7%	3 7% 48% 8%	4 10% 49% 13%
<input type="checkbox"/> Cash Collateral Management (5 pts)	4 Centralized Cash Management and Credit Analysis are provided by BNY Mellon CIS -Dreyfus Overnight Options are Available. Can manage both Separate and Commingled Funds.	4 Centralized SecLending Manage Cash using JP Morgan Asset Mgmt. Credit Analysis. Overnight Options are Available. Separate Accounts is the default reinvestment vehicle.	4 Centralized Cash Management and Credit Analysis are provided by SSgA. Overnight Options are Available. Can manage both Separate and Commingled Funds.
<input type="checkbox"/> Securities Lending Revenue Sharing Arrangement (5 pts)	3 85/15 90/10 for 2a-7 Guidelines Applies to both positive & negative revenue except for collateral reinvestment losses Cash Collateral Mgmt Fee = waived	3 85/15 Applies to both positive & negative revenue except for collateral reinvestment losses Cash Collateral Mgmt Fee is currently at zero for separate accounts.	3 85/15 Applies to both positive & negative revenue except for collateral reinvestment losses Cash Collateral Mgmt Fees at 1.75 bps to 5 bps.
<input type="checkbox"/> Will Contract as a Fiduciary?	Limited to Collateral Management.	Limited to Loan and Collateral Management.	Limited to Collateral Management.
Total	31	32	32

⁶ Duration mismatch is said to be controlled when the duration of the loan (liability) and the duration of the collateral reinvestment (asset) are 1 day or what is classified as fully matched. The duration of the liability is by default overnight or 1 day because it can be terminated at will, while the duration of the collateral reinvestment can vary from 1 day to 6 months. The difference between the duration contributes to gap risk. Supposedly, a shorter duration mismatch lessens gap risk. Thus, a higher duration mismatch means a higher level of gap risk. Duration mismatch statistics also provide a glimpse of the usage of term loans, which are customarily greater than seven days and can impact overnight liquidity.

⁷ Utilization Ratio (also called Lending Ratio or Penetration Ratio) is equal to "average out on loan" divided by "average lendable base." This ratio shows the ability to lend securities with the highest utility or penetration in the marketplace. It is common industry knowledge that the higher the ratio the better for plan sponsor clients. Please note that past performance does not guarantee future results. In addition, the statistics provided by the providers are specific to their standard or generic program structure. The statistics (i.e., utilization ratio and spreads) generated by the lenders may not necessarily equate to the same level of results due to client specific restrictions - portfolio structure and investment policy/guideline requirements. General collateral lending (low demand oversupply securities - large cap equities and fixed-income) has been the casualty of the credit crisis. The migration to intrinsic lending (high demand hot securities - small/mid-cap and international equities) could be more of the norm going forward.

Securities Lending Third Party Agent 50 pts)	Citi	Deutsche Bank	Northern Trust
<input type="checkbox"/> Organizational Issues (5 pts)	2 Program had Litigation Issues; Acquired Wells Fargo Securities Lending Program (OpenLend).	3 Program has NO Litigation Issues; No major changes at Management rank, DB Asset Mgmt Group (cash management) is for sale.	3 Program has Litigation Issues; No major changes at Management rank.
<input type="checkbox"/> Client Turnover – Last 5 Years Departures/Additions (5 pts)	4 17%.	3 32%.	1 279%.
<input type="checkbox"/> SecLending Contribution to Revenue (5 pts)	3 Less than 4% of Asset Servicing in 2010.	2 Did not Disclose.	3 5% of total bank revenue for 2010.
<input type="checkbox"/> Total Lendable Base (5 pts)	4 \$611 billion	4 \$346 billion	4 \$670 billion
<input type="checkbox"/> Operational Considerations (5 pts)	4 Mark to Market and Collateralization Levels are Acceptable. Full Transparency is Available Daily.	4 Mark to Market and Collateralization Levels are Acceptable. Full Transparency is Available Daily.	4 Mark to Market and Collateralization Levels are Acceptable. Full Transparency is Available Daily.
<input type="checkbox"/> Securities Lending Program Structure, and Indemnification ⁸ (5 pts)	2 Utilizes NSRO as the main Credit Analysis. Cash Collateral Reinvestment Losses both Credit (Issuer Default) and Liquidity (Mark to Market) for a few clients. <u>Indemnification</u> – Borrower Default (Does not wish to provide Collateral Reinvestment Risk Indemnification in REPO Program.)	3 Cash Collateral Reinvestment Losses both Credit (Issuer Default) and Liquidity (Mark to Market) Program has been retooled for the better. <u>Indemnification</u> – Borrower Default (Will provide a limited form of Collateral Reinvestment Risk Indemnification in REPO Program only.)	3 Cash Collateral Reinvestment Losses both Credit (Issuer Default) and Liquidity (Mark to Market) Program has been retooled for the better. <u>Indemnification</u> - Borrower Default (Will provide a limited form of Collateral Reinvestment Risk Indemnification in REPO Program only.)

⁸ Please refer to the Responses to the RFP for specific language regarding limits to indemnification. The candidate firms are able to provide borrower default indemnification and cover operational negligence. However, it would be prudent for South Carolina to verify if the following areas are covered in the Borrower Indemnification clause, namely: (1) Borrowers files for bankruptcy for whatever reason; (2) Failure to recall securities before contractual settlement date for whatever reason; (3) Failure to secure additional collateral and margin requirements; (4) Failure to receive dividends, distributions and all economic benefits of ownership; and, (5) Immediate use of Non-Cash Collateral in lieu of Borrower Bankruptcy. In addition, indemnification specific to operational negligence and trade settlement risk needs verification. (Please note that Callan Associates is not in a position to provide a legal opinion with respect to the coverage, language and limitations of the indemnification clauses provided by the candidate firms.)

Securities Lending Third Party Agent (50 pts)	Citi	Deutsche Bank	Northern Trust
<input type="checkbox"/> Duration Mismatch ⁹ 2011 YTD for Program (A higher number can be risky.) (5 pts)	3 13 to 17 day GAP	4 5 day GAP	2 21 to 38 day GAP
<input type="checkbox"/> Utilization Rate ¹⁰ for 6 Months Ending 6/30/2011 (5 pts)	2	4	4
US Equities	13%	8%	14%
US Treasuries	20%	39%	54%
Intl Equity	9%	16%	10%
<input type="checkbox"/> Cash Collateral Management (5 pts)	3 Done by Lending Team. Cash Management and Credit Analysis are done by the Lending Team with assistance from CIRA. Overnight Options are Available. Separate Accounts is the default reinvestment vehicle.	3 Centralized Cash Management and Credit Analysis are provided to lending team and DB Asset Mgmt. Overnight Options are Available. Can manage both Separate and Commingled Funds.	4 Centralized Cash Management and Credit Analysis are provided by NTGI. Overnight Options are Available. Can manage both Separate and Commingled Funds.
<input type="checkbox"/> Securities Lending Revenue Sharing Arrangement (5 pts)	4 90/10 Applies positive revenue only and not for negative revenue or collateral reinvestment losses Cash Collateral Mgmt Fee = none	4 90/10 Applies to both positive & negative revenue except for collateral reinvestment losses Cash Collateral Mgmt Fee = none.	2 80/20 Applies to both positive & negative revenue except for collateral reinvestment losses Cash Collateral Admin Fee of 1 to 3 bps.
<input type="checkbox"/> Will Contract as a Fiduciary?	Limited to Collateral Management.	Yes but subject to negotiation.	Yes but subject to negotiation.
Total	31	34	30

⁹ Duration mismatch is said to be controlled when the duration of the loan (liability) and the duration of the collateral reinvestment (asset) are 1 day or what is classified as fully matched. The duration of the liability is by default overnight or 1 day because it can be terminated at will, while the duration of the collateral reinvestment can vary from 1 day to 6 months. The difference between the duration contributes to gap risk. Supposedly, a shorter duration mismatch lessens gap risk. Thus, a higher duration mismatch means a higher level of gap risk. Duration mismatch statistics also provide a glimpse of the usage of term loans, which are customarily greater than seven days and can impact overnight liquidity.

¹⁰ Utilization Ratio (also called Lending Ratio or Penetration Ratio) is equal to "average out on loan" divided by "average lendable base." This ratio shows the ability to lend securities with the highest utility or penetration in the marketplace. It is common industry knowledge that the higher the ratio the better for plan sponsor clients. Please note that past performance does not guarantee future results. In addition, the statistics provided by the providers are specific to their standard or generic program structure. The statistics (i.e., utilization ratio and spreads) generated by the lenders may not necessarily equate to the same level of results due to client specific restrictions - portfolio structure and investment policy/guideline requirements. General collateral lending (low demand oversupply securities - large cap equities and fixed-income) has been the casualty of the credit crisis. The migration to intrinsic lending (high demand hot securities - small/mid-cap and international equities) could be more of the norm going forward.

Revenue Estimate	BNY Mellon	JP Morgan Chase	State Street
<u>Retirement System:</u>			
Overnight Intrinsic 20 bps - REPO	\$1,239,263	\$1,537,809	\$1,969,794
Overnight REPO	\$1,519,903	\$2,000,624	\$2,604,169
SEC 2a-7	\$2,925,595	\$3,737,552	\$3,800,063
<u>General Account/LGIP:</u>			
Overnight Intrinsic 20 bps - REPO	\$27,116	\$24,728	\$85,473
Overnight REPO	\$113,873	\$76,508	\$300,456
SEC 2a-7	\$278,481	\$517,143	\$750,341

Revenue Estimate	Citi	Deutsche Bank	Northern Trust
<u>Retirement System:</u>			
Overnight Intrinsic 20 bps - REPO	\$1,183,408	\$2,283,120	\$908,112
Overnight REPO	\$1,579,538	\$3,403,447	\$1,635,377
SEC 2a-7	\$4,147,568	\$3,694,711	\$3,927,372
<u>General Account/LGIP:</u>			
Overnight Intrinsic 20 bps - REPO	\$60,986	\$54,770	\$20,348
Overnight REPO	\$179,862	\$379,616	\$242,416
SEC 2a-7	\$832,080	\$470,292	\$633,275

Albeit securities lending should be treated as an investment management function and can add value, it takes a backseat from the interest of investment managers and the plan/fund itself. Remember that securities lending is an ancillary process to generate incremental revenue. Revenue estimates are subject to a myriad of variables, such as:

- changes in economic, interest rate, credit, liquidity & market conditions,
- portfolio turnover of the security holdings,
- asset allocation and manager changes,
- portfolio structure,
- statutory changes which includes state, federal, securities law and Federal Reserve guidelines can have an impact,
- policy limits and active proxy voting,
- cross border changes in regulatory environment, market practice, tax and dividend treatments,
- actual cash collateral reinvestment guidelines of the plan sponsor or fund may be inconsistent with a securities lending provider's program structure,
- potential impact of bankruptcies and fraud,
- organizational changes (program and personnel structure) within the securities lending provider can affect both product and performance.

Institutional investors or funds taking a conservative stance cannot be criticized for prioritizing risk management before revenues when it comes to securities lending. Callan believes that securities lending revenue estimates are after all just estimates. In light of the disparity in the securities lending revenue estimates, it would be safe to use the numbers as the probable range of potential outcomes. However, it is dangerous to rely on any specific revenue estimate. Revenue estimates frequently depend on assumptions of interest rate spreads, utilization, and market conditions that may not be true going forward. It has always been Callan's policy to warn clients that complete or heavy reliance on revenue estimates as a major decision variable may not be the most prudent route to take. Securities lending involves risks.

Investment Manager Feedback Evaluation Matrix: The next phase of the process was the development of an investment manager survey to rank the leading large institutional global custodian banks that the Investment Commission’s investment managers are familiar with, namely: BNY Mellon, JP Morgan Chase, Northern Trust, and State Street. Investment manager feedback is an important consideration in the evaluation of any custody provider. Close to 80% of the responsibility of a custodian is to process, settle, value and account for securities and trades of investment managers.

The table below summarizes the investment manager responses in the areas of administrative services, trade processing, reporting, and valuation and pricing. Nineteen (19) investment managers responded to the survey¹¹. Investment managers were requested to score (1 = poor, 5 = excellent) the numerous custody providers. Callan consolidated the responses and ranked the scores from best to worst (1 = Best, 4 = Worst).

Investment Manager Feedback	Overall Admin. Services	Trade Processing	Accounting	Reporting	Valuation & Pricing	Overall Impression	Total Points	Rank Score
BNY Mellon	3.76	3.68	3.92	3.75	3.83	3.86	22.80	1
JP Morgan Chase	3.38	3.60	3.62	3.69	3.82	3.69	21.79	4
Northern Trust	3.50	3.39	3.80	3.73	3.92	3.71	22.04	3
State Street	3.59	3.62	3.78	3.71	3.79	4.00	22.50	2

Based on the survey results provided by the investment managers, BNY Mellon ranked consistently high in the investment manager feedback survey relative to the competition. State Street came in at a close second. Northern Trust faired-well and ranked third at the aggregate. JP Morgan Chase ranked at the lower tier of the Survey.

The accounting and active reconciliation process of BNY Mellon, JP Morgan Chase, Northern Trust, and State Street were considered noteworthy by the investment managers. The web enabled capabilities of the custody banks are valuable to expedite the reconciliation process. Numerous investment managers also shared their deep and intimate knowledge of the custody community. They subcontract their back-office needs to the large institutional custody banks to help them navigate a very complex and fast evolving marketplace.

As mentioned by a number of managers, there is no perfect custodian. However, BNY Mellon and State Street seem to consistently deliver above average services. The large percentage of problem resolution issues with JP Morgan Chase was very apparent in the comments section of the survey. In addition, a number of managers noted the deterioration of quality of services from Northern Trust. Overall, a majority of the managers believe that all four custodian banks have the requisite custody capabilities to meet their core requirements.

¹¹ Please note that four investment managers declined to complete the survey but shared the custodian of their commingled funds, namely: State Street (2), BNY Mellon (1), and JPM Chase (1).

From: [Leidinger, Bill](#)
To: [Hershel Harper](#); [William Blume](#)
Cc: [Loftis, Curtis](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [McDermott, Mike](#); [Robert Feinstein](#); [Adam Jordan](#); [Tammy Nichols](#); [KAREN WICKER karen.wicker@sto.sc.gov](mailto:karen.wicker@sto.sc.gov); [Rebecca Gunnlaugsson](#); [Douglas W. Lybrand](#)
Subject: RE: Documents Re: Custodial Bank Proposals
Date: Thursday, February 02, 2012 10:14:48 AM

Thanks, Hershel. The Treasurer will be there at 8:30 tomorrow morning to begin. Bill Condon and I will accompany him.....I understand you will be forwarding today the proposed staff confidentiality agreements for our review.....see you then.....Thanks again.....Bill

From: [Hershel Harper \[mailto:HHarper@ic.sc.gov\]](mailto:HHarper@ic.sc.gov)
Sent: Wednesday, February 01, 2012 5:25 PM
To: [Leidinger, Bill](#); [William Blume](#)
Cc: [Loftis, Curtis](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [McDermott, Mike](#); [Robert Feinstein](#); [Adam Jordan](#); [Tammy Nichols](#); [Wicker, Karen](#); [Rebecca Gunnlaugsson](#); [Lybrand, Douglas](#)
Subject: RE: Documents Re: Custodial Bank Proposals

Bill,

I have asked Rebecca Gunnlaugsson and Doug Lybrand to participate from the RSIC.

Kind regards,
Hershel

From: [Leidinger, Bill \[mailto:Bill.Leidinger@sto.sc.gov\]](mailto:Bill.Leidinger@sto.sc.gov)
Sent: Monday, January 30, 2012 11:17 AM
To: [William Blume](#); [Hershel Harper](#)
Cc: [Loftis, Curtis](#); [Condon, Bill](#); [Tahiliani, Shakun](#); [McDermott, Mike](#); [Robert Feinstein](#); [Adam Jordan](#); [Tammy Nichols](#); [KAREN WICKER karen.wicker@sto.sc.gov](mailto:karen.wicker@sto.sc.gov)
Subject: Documents Re: Custodial Bank Proposals

Folks, attached are 2 forms regarding confidentiality and conflict of interest that are to be completed by each of the 2 folks from the RS and the IC and the 3 folks from the STO who will be serving on the advisory review panel. Please return the signed copies to Karen Wicker in the STO at your earliest convenience.

Thanks much....Bill

William Leidinger
Chief of Staff

State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

Adam Jordan

From: Adam Jordan
Sent: Tuesday, February 12, 2013 3:14 PM
To: Williams, Reynolds
Subject: FW: Custody Services

FYI

From: Sarah Corbett
Sent: Tuesday, February 12, 2013 1:45 PM
To: Hershel Harper; Adam Jordan
Subject: FW: Custody Services

FYI

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Tuesday, February 12, 2013 12:22 PM
To: Sarah Corbett
Cc: Cook, Michelle D (michelle.cook@bnymellon.com); Dori Ditty; Condon, Bill; Loftis, Curtis
Subject: RE: Custody Services

Sarah, while I understand you have been discussing Private I with Michelle, including pricing, I have had no understanding that you were expecting to enter into a separate contract with BNYM for the services. I believe the BNYM custody contract is with the STO and any services you receive/pay for under that contract will require that the contract be amended by the STO to provide for such.. I do not believe a contract amendment is a unilateral action that can be taken by the BNYM or the Investment Commission.

Bill and I look forward to discussing any contract amendment you may have in mind.....Thanks....Bill

From: Sarah Corbett [<mailto:SCorbett@ic.sc.gov>]
Sent: Tuesday, February 12, 2013 8:30 AM
To: Leidinger, Bill
Cc: Cook, Michelle D (michelle.cook@bnymellon.com); Ditty, Dori
Subject: FW: Custody Services

Hi Bill,

I just wanted to follow up with you on this. Michelle, Dori and I have been working together on Private i. We have worked through the cost and I believe most of the way through the contract. Michelle will be forwarding a draft of the contract back to us soon and will copy you on that communication.

I am hopeful that we can finalize this contract soon and move forward with implementation. I do believe that private i will help us gain greater transparency into the private market investments and I hope that you and the Treasurer will be happy with that outcome.

The next ancillary service I want to discuss with the bank is the compliance module. I anticipate handling that the same way – negotiating prices outside of the RFP.

Just a heads up - this may be mentioned in the coverage of the dashboard at today's audit committee meeting.

Thanks,
Sarah

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Monday, September 24, 2012 3:34 PM
To: Sarah Corbett
Cc: Hershel Harper; Adam Jordan; Tammy Nichols; Faith Wright; William Blume; Douglas W. Lybrand
Subject: RE: Custody Services

Michelle, yes...please forward price to Sarah.....Thanks.....Bill

From: Sarah Corbett [<mailto:SCorbett@ic.sc.gov>]
Sent: Monday, September 24, 2012 3:14 PM
To: Leidinger, Bill
Cc: Harper, Hershel; Adam Jordan; Nichols, Tammy; Faith Wright; Blume, William; Lybrand, Douglas
Subject: FW: Custody Services

Hi Bill,

Will you please notify Michelle that it is ok for her to proceed with providing us a price for Private i as you had indicated earlier? Thanks so much for your assistance in helping us move forward with this important step.

Sarah

From: Cook, Michelle D [<mailto:michelle.cook@bnymellon.com>]
Sent: Monday, September 24, 2012 2:55 PM
To: Sarah Corbett
Subject: RE: Custody Services

Hi Sarah,

Thank you for sending the note from Bill.

I could be reading the email out of context, however I am not able to send any pricing with the forwarded approval.

The information in the email indicates negotiation "outside this procurement and could make no reference to the procurement or procurement prices.....it would all be under current prices".

Please note, the services in question were part of the procurement and price offering. In addition, there is no current servicing for the private investments and therefore no current pricing.

I do realize the IC is requesting pricing for the tracking of the Private Investments, but I am unable to send any new information without an appropriate approval. I hope you understand we are in a black out period and am not able to offer prices different from what was submitted as part of the RFP without explicit and specific approvals for pricing on the named services.

Could you please advise how you would like to move forward?

Thanks

Michelle Cook
Vice President and Relationship Executive
US Corporate, Government and Not for Profit
Tel No.: 212 635-7287
Fax No: 212 635-8780
email: michelle.cook@bnymellon.com

From: Sarah Corbett [<mailto:SCorbett@ic.sc.gov>]
Sent: Monday, September 24, 2012 2:42 PM
To: Cook, Michelle D
Subject: FW: Custody Services

Hi Michelle,

Thanks for getting back to me on Private I. Here is the e-mail I have from Bill Leidinger authorizing us to move forward with you.

Thanks!
Sarah



SARAH N. CORBETT, CPA | DEPUTY CHIEF OF STAFF
P 803.737.7698 | M 803.206.2179 | SCORBETT@IC.SC.GOV
1201 MAIN STREET | SUITE 1510 | COLUMBIA, SC | 29201
SOUTH CAROLINA RETIREMENT SYSTEM
INVESTMENT COMMISSION

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Thursday, August 30, 2012 8:30 AM
To: Adam Jordan; Douglas W. Lybrand; Hershel Harper
Cc: Tammy Nichols; Faith Wright; KAREN WICKER karen.wicker@sto.sc.gov; William Blume
Subject: RE: Custody Services

Fine with me....probably would not be a tri-party BD 100 but rather separate but well coordinated BD 100'syou certainly can go ahead and purchase any thing that you want and need but you would have to negotiate with BNY Mellon outside this procurement and could make no reference to the procurement or procurement prices.....it would all be under current prices....I will be out for a couple of days but will schedule a meeting for next week when I return.....Thanks.....Bill

The information contained in this e-mail, and any attachment, is confidential and is intended solely for the use of the intended recipient. Access, copying or re-use of the e-mail or any attachment, or any information contained therein, by any other person is not authorized. If you are not the intended recipient please return the e-

mail to the sender and delete it from your computer. Although we attempt to sweep e-mail and attachments for viruses, we do not guarantee that either are virus-free and accept no liability for any damage sustained as a result of viruses.

Please refer to <http://disclaimer.bnymellon.com/eu.htm> for certain disclosures relating to European legal entities.

Adam Jordan

From: Cook, Michelle D <michelle.cook@bnymellon.com>
Sent: Monday, January 28, 2013 4:51 PM
To: Leidinger, Bill
Cc: Loftis, Curtis; Raven, Dinah; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Sarah Corbett; Adam Jordan; Geoffrey Berg; David Avant; Tammy Nichols; Faith Wright; Padgett, David; Adams, Clarissa; Schavolt, Dean; Joyce, Douglas E; Weaver, Richard J; Ferris, Karolyn S; Cavallo, Mike; Wargo, Catherine A
Subject: RE: South Carolina STO - BNYM Coordination

Hi Bill,

Thank you for your note.

We at BNY Mellon recognize the State of South Carolina, Office of the Treasurer as the client in its relationship under the custody contract. We also recognize our responsibility to serve the needs of the STO, PEBA and the Investment Commission, as directed by and with the approval of the STO.

As request, I can be the BNY Mellon contact point for the STO with regards to changes in SC enrollment of our products and services, in the support of new initiatives, and with regards to non-operational inquiries. I will communicate with you on the same matters.

Please note, current communication supporting the operational processes under the custodial relationship will continue as it does today. Examples are as listed below, however the list may not be nor is intended to be exhaustive:

- Instruction processing
- Trade Settlement
- Accounting and Valuation
- Performance and Risk Analytics reporting
- Reconciliation
- Alternative Investment processing and support
- Cash Processing
- Securities Lending activities

These aforementioned operational processes are critical for financial viability of the activities executed in the marketplace. We will continue to support these processes under the duly executed and authorized documents provided by and or approved by the State Treasurer.

I will get back to you within the next few days with regards to your request on the issues surrounding the Investment Commission entry into the global markets.

Please feel free to contact me should you have any concerns.

I hope you are well.

Michelle David Cook
Vice President and Relationship Executive
US Corporate, Government and Not for Profit
Tel No.: 212 635-7287
Fax No: 212 635-8780

email: michelle.cook@bnymellon.com

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]

Sent: Monday, January 28, 2013 11:42 AM

To: Cook, Michelle D

Cc: Loftis, Curtis; Raven, Dinah; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Corbett, Sarah; Adam Jordan (AJordan@ic.sc.gov); Berg, Geoffrey; Avant, David; Nichols, Tammy; Faith Wright (FWright@peba.sc.gov); Padgett, David; Adams, Clarissa (FWright@peba.sc.gov);

Subject: South Carolina STO - BNYM Coordination

Michelle, I will follow up with you this week on the BNYM "To Do" list you sent me last week as well as a task list I will develop and send to you which may contain some items not on your "To Do" list. There are, however, 2 things that I would like to put in place right now that will help shape how things progress in the future:

Client Relationship and Communication

- 1) BNYM acknowledges that the STO is the sole client in its relationship under the custody contract and also recognizes that BNYM has the responsibility to serve the needs of the STO, PEBA and the Investment Commission, upon approval by the client, the STO
- 2) In order to avoid confusion and misunderstanding in the future, I will be the point of contact for all questions and all matters coming from the STO, the Investment Commission and the PEBA and directed to BNYM for response. I will forward all questions and matters to you who will have the responsibility to forward to your BNYM team and you will then have the responsibility to respond directly to me. I, in turn, will forward the BNYM response to the SC team if the STO concurs. The same practice principle will apply to you with regard to BNYM questions and matters to the SC team.

I would hope that this does not prove to be burdensome for you. Let me know if you have a better suggestion.

Global Custody

BNYM indicated it would put together and send to the STO a complete and comprehensive document regarding roles and responsibilities, duties, liabilities, risks, costs, role of sub-custodians, reporting on not in bank assets held by global sub-custodians, BNYM's assumption of responsibility and liability of its sub-custodians and all other considerations regarding the Investment Commission becoming more heavily involved in the global markets. Please develop this document to be more like a service contract and not as a marketing piece. There were many questions raised during the discussion of global custody.

Please advise me when this document will be forwarded to the STO.

Please let me know if you are in agreement.

Thanks.....Bill

William J. Leidinger
Chief of Staff
State Treasurer's Office
Wade Hampton Office Building
Columbia, SC 29211
(803) 734-5063

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Adam Jordan

From: Leidinger, Bill <Bill.Leidinger@sto.sc.gov>
Sent: Monday, January 28, 2013 5:19 PM
To: Cook, Michelle D
Cc: Loftis, Curtis; Raven, Dinah; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Sarah Corbett; Adam Jordan; Geoffrey Berg; David Avant; Tammy Nichols; Faith Wright; Padgett, David; Adams, Clarissa; Schavolt, Dean; Joyce, Douglas E; Weaver, Richard J; Ferris, Karolyn S; Cavallo, Mike; Wargo, Catherine A
Subject: RE: South Carolina STO - BNYM Coordination

OK...let's start off as you suggest, with one modification. Please send me a copy of every operational communication referenced in your email as follows: "Please note, current communication supporting the operational processes under the custodial relationship will continue as it does today. Examples are as listed below, however the list may not be nor is intended to be exhaustive:

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- Trade Settlement
- Accounting and Valuation
- Performance and Risk Analytics reporting
- Reconciliation
- Alternative Investment processing and support
- Cash Processing
- Securities Lending activities

These aforementioned operational processes are critical for financial viability of the activities executed in the marketplace. We will continue to support these processes under the duly executed and authorized documents provided by and or approved by the State Treasurer. "

If I decide that it is not necessary to send any of these items to me any longer, I will advise you.

Thanks.....Bill

From: Cook, Michelle D [mailto:michelle.cook@bnymellon.com]
Sent: Monday, January 28, 2013 4:51 PM
To: Leidinger, Bill
Cc: Loftis, Curtis; Raven, Dinah; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Corbett, Sarah; Adam Jordan (AJordan@ic.sc.gov); Berg, Geoffrey; Avant, David; Nichols, Tammy; Faith Wright (FWright@peba.sc.gov) (FWright@peba.sc.gov); Padgett, David; Adams, Clarissa; Schavolt, Dean; Joyce, Douglas E; Weaver, Richard J; Ferris, Karolyn S; Cavallo, Mike; Wargo, Catherine A
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Please feel free to contact me should you have any concerns.

I hope you are well.

Michelle David Cook
Vice President and Relationship Executive
US Corporate, Government and Not for Profit
Tel No.: 212 635-7287
Fax No: 212 635-8780
email: michelle.cook@bnymellon.com

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Monday, January 28, 2013 11:42 AM
To: Cook, Michelle D
Cc: Loftis, Curtis; Raven, Dinah; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Corbett, Sarah; Adam Jordan (AJordan@ic.sc.gov); Berg, Geoffrey; Avant, David; Nichols, Tammy; Faith Wright (FWright@peba.sc.gov); Padgett, David; Adams, Clarissa
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Thanks.....Bill

William J. Leidinger
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Adam Jordan

From: Leidinger, Bill <Bill.Leidinger@sto.sc.gov>
Sent: Monday, January 28, 2013 11:42 AM
To: Cook, Michelle D
Cc: Loftis, Curtis; Raven, Dinah; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Sarah Corbett; Adam Jordan; Geoffrey Berg; David Avant; Tammy Nichols; Faith Wright; Padgett, David; Adams, Clarissa
Subject: South Carolina STO - BNYM Coordination

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I would hope that this does not prove to be burdensome for you. Let me know if you have a better suggestion.

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Thanks.....Bill

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Chief of Staff
State Treasurer's Office
Wade Hampton Office Building
Columbia, SC 29211
(803) 734-5063

Adam Jordan

From: Leidinger, Bill <Bill.Leidinger@sto.sc.gov>
Sent: Monday, December 31, 2012 2:18 PM
To: David Avant; Tammy Nichols; Faith Wright; Hershel Harper; Adam Jordan; Brenda Gadson; Nicole Waites; Tahiliani, Shakun; McDermott, Mike; Prioleau, Mable
Cc: Loftis, Curtis; Condon, Bill; Padgett, David; AMY WRIGHT Amy.Wright@sto.sc.gov; Cook, Michelle D (michelle.cook@bnymellon.com)
Subject: Custody Workshop

Folks, you and your staff are invited to attend a 2 day Custody Workshop being planned by the STO and the BNY Mellon. The Custody Workshop will be held here in Columbia for 2 consecutive days on January 15th and 16th **or** 16th and 17th. Please let me know ASAP which set of 2 consecutive days are best for your group. The Custody Workshop will be held in the Governor's Conference Room on the 1st floor of the Wade Hampton Building.

The Custody Workshop will cover a variety of discussion topics useful and helpful to all of us. I ask you to suggest and forward to me discussion topics you believe will be most helpful and informative for your group. I will take all our suggestions and work with BNY Mellon to develop a final Custody Workshop program which will be sent to you in advance of the Custody Workshop. We will also have plenty of time for questions and answers.

Each group should plan on having no more than 8 staff attend from their group. We can adjust final attendance prior to the event.

Please plan on attending, advise me of the number and names of folks from your group that you believe will be attending, advise me of your preferred dates and send me your suggested Custody Workshop discussion topics.....by Friday of this week.

Thanks much.....Bill

William J. Leidinger
Chief of Staff
State Treasurer's Office
Wade Hampton Office Building
Columbia, SC 29211
(803) 734-5063

Adam Jordan

From: Rebecca Gunnlaugsson
Sent: Wednesday, May 30, 2012 11:38 AM
To: Leidinger, Bill (Bill.Leidinger@sto.sc.gov)
Subject: RE: What's this I hear?

Hi Bill,

Yes, I am leaving to help my husband in his medical practice and have more flexible hours to spend time with my children. It has been a real pleasure working with you in the custody selection process, and I truly look forward to all the positive outcomes from implementation of the new functionality.

With regards to the memo regarding securities lending, I ran into the problem that none of the internal RSIC experts on securities lending were privy to the details of the proposals reviewed by the evaluation panel. And, since it is a confidential RFP, I was unable to share it with them. That is why we asked Bo to write a memo to address all the issues. I think he did an excellent job of describing all the pros and cons of a securities lending program. The Commissioners may still require additional information to reach a decision (like a specific recommendation). If this is the case, I think it would be beneficial for the panel to have internal RSIC securities lending experts examine the proposals and analyze the risk-reward tradeoffs.

Due to the Commissioners' decision at Wampee (that securities lending revenue must flow directly to the trust fund and not offset custody costs), the securities lending decision no longer impacts the decisions on custody and ancillary services. So, at least those portions can proceed until it is determined how to have RSIC experts in securities lending obtain information about the securities lending proposals to evaluate them.

Again, it has been a privilege working with people so dedicated to making South Carolina a better place. Thank you for all your work toward this goal!

Rebecca

From: Leidinger, Bill [mailto:Bill.Leidinger@sto.sc.gov]
Sent: Wednesday, May 30, 2012 10:40 AM
To: Rebecca Gunnlaugsson
Subject: What's this I hear?

Rebecca, Adam just called and left message that you were going to be spending this summer at home with your boys and he would be replacing you on the Advisory Selection Panel. What does this mean with respect to the decision piece you were working on for the Commission re: securities lending?

I tried to call but could not find your number in the State directory. Please give me a call at 734-5063.

Thanks much.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

Adam Jordan

From: Leidinger, Bill <Bill.Leidinger@sto.sc.gov>
Sent: Tuesday, May 08, 2012 11:49 AM
To: Hershel Harper; Adam Jordan; Rebecca Gunnlaugsson; Douglas W. Lybrand
Cc: Loftis, Curtis; Condon, Bill
Subject: Custody RFP

Folks, good to meet this AM and discuss informing the Commissioners at Wampee re: the status of the custody RFP.

For the record, I have no problem with us advising the Commission in general, non-specific terms of the process we have employed in this procurement , the current status of the procurement, what we believe the timeline ahead will be and issues that may be explored/questions that may asked by the Advisory Selection Panel as it goes forward to finish its work and be in a position to make a specific recommendation(s) to the Treasurer. I will be pleased to help develop the presentation as well as participate in the presentation.

I will remind you again that we can not reveal at Wampee who the selected finalist banks are, content of and contrasts between finalist proposals or any other information of a specific nature sufficient to identify the banks or the contents of their proposals.

When I returned to the office I reviewed our conversation with Bill Condon and I became aware that I may have misspoken during our meeting. Since this is the Treasurer's procurement and ultimately the Treasurer's contract to sign, there may not be an opportunity for the Commission to "approve" or "disapprove" the contract. Rather, the IC staff members who are on the Selection Advisory Panel are expected to advise the full Selection Advisory Panel of the wants and needs of the Investment Commission. Once the contract is finalized and signed by the Treasurer, the Investment Commission will be able to select the ancillary services it wants that are provided by the selected custodian following whatever process it chooses.

If Rebecca and Doug feel that a certain vendor or certain vendor's ancillary services or tools are critical or most important to the Investment Commission, they should make that very clear to the Selection Advisory Panel as we go forward. They may even want to ask the Commissioners what they think is most important to the Commission, but they would have to do so without disclosing confidential procurement information.

I apologize for my error.

Thanks.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

Adam Jordan

From: Douglas W. Lybrand
Sent: Monday, February 13, 2012 1:32 PM
To: Adam Jordan
Subject: RE: Meeting re: Review of Custody Proposals

Adam, can you help me get up to speed on the Custody Proposal? Based on what Hershel told me, Rebecca and I have been selected to help evaluate the Custody proposal. Shortly thereafter I received an email asking me to sign two forms regarding confidentiality and conflict of interest. Upon reading each I learned that I was being asked to certify that I had received the Advisory Review Panel Briefing, which I had not. So I advised Bill Leidinger and Karen Wicker that I had not received any briefing instructions. Bill responded that he would bring them to me but he never did. I mentioned that to him and he said we would take care of things at the appropriate time.

Now I am receiving an email (second hand) stating we will meeting to review the custody proposals with Bo Abesamis on February 29th. Who is Bo Abesamis? I am also being asked to read my copies of the proposals and come prepared for a full discussion. I have never received any proposals nor any responses and have no idea what I am being asked to discuss. As the sheriff in Cool Hand Luke would say, "What we have here is a failure to communicate." Any help would be appreciated.

Doug

From: Adam Jordan
Sent: Monday, February 13, 2012 11:15 AM
To: Rebecca Gunnlaugsson; Douglas W. Lybrand
Subject: FW: Meeting re: Review of Custody Proposals

fyi

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Monday, February 13, 2012 11:10 AM
To: Loftis, Curtis; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Robert Feinstein; Adam Jordan; Tammy Nichols; William Blume; Hershel Harper; Tammy Nichols
Cc: Abesamis, Bo
Subject: Meeting re: Review of Custody Proposals

Folks, we will met with to review the custody proposals with Bo Abesamis on February 29th from 9AM till 2PM. Bo will present the results of his decision matrix review of the proposals. We will discuss his findings and schedule next steps.

We will meet in State Treasurer's Office conference room on the 2nd floor of the Hampton building. This is the same conference room we previously met in. Please read your copies of the proposals and come prepared for a full discussion.

Please share this with those who will be attending but who may not be included among the above addressees.....Thanks much and happy reading.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

Adam Jordan

From: Leidinger, Bill <Bill.Leidinger@sto.sc.gov>
Sent: Thursday, January 12, 2012 9:35 AM
To: Adam Jordan
Subject: RE: Jan. 19 RSIC Meeting - Custody RFP

Adam, It's a good idea but a bit premature. Proposals (I expect to receive 6 or 7) are due at 5PM on January 17. We then have to forward them to Bo so he can begin his review and analysis. We (meaning me), also have to assemble a review panel and have the panel work with Bo to nail down the priority evaluation criteria. Then the evaluation process has to be conducted and that may include some travel to offerer's sites to learn more about and view how they work and then we will have interviews. This process is all laid out in the contract with Callan.

It will take a while to get to contract discussion stage but I agree with you that the Commission should have in mind what it needs and be ready when the to be evaluation team starts its work.

Suffices to say that it would not be productive to have an agenda item for the Commission on the 19th.

Thanks.....Bill

From: Adam Jordan [mailto:AJordan@ic.sc.gov]
Sent: Wednesday, January 11, 2012 5:24 PM
To: Leidinger, Bill
Subject: Jan. 19 RSIC Meeting - Custody RFP

Bill,

Following up on our phone discussion from two weeks ago, Chairman Gillespie would like to include an agenda topic for the Jan. 19 RSIC meeting to address the Custody RFP and associated issues, such as Securities Lending. As we discussed, it would be helpful if someone from the Treasurer's Office would brief the Commission on the plans for the Custody RFP. In particular, the decision-making process and the contemplated contractual structure would be important topics.

You mentioned during our call that it might be helpful if the Treasurer, Allen, and/or staff could meet ahead of time to review the issues. Allen said he would be available next Wednesday for a meeting, and our staff is also available between now and Wednesday for a staff-level discussion. Please let me know how you would like to proceed.

Thanks,



ADAM JORDAN | CHIEF OF STAFF
P 803.737.6814 | M 803.553.2433 | AJORDAN@IC.SC.GOV
1201 MAIN STREET | SUITE 1510 | COLUMBIA, SC | 29201
SOUTH CAROLINA RETIREMENT SYSTEM

INVESTMENT COMMISSION

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Wednesday, October 24, 2012 11:09 AM
To: Sarah Corbett; Dori Ditty
Subject: BNYM Amended Agreements
Attachments: Mellon Analytical Solutions Services Addendum.pdf; Exhibit A BNYM Services Agreement prelim.pdf

Attached are addendums to our BNYM agreements related to Performance & Risk Analytics. These are the most recent documents of which I am aware. Schedule A contains the most detailed list of services we contracted to receive from BNYM. Although we tried to be more specific, the final language is as specific to which BNYM would agree.

Be aware that the costs of these services could change dramatically under BNYM's latest response to our custodial RFP. I have records of the old and proposed costs but am bound to keep the new costs confidential at this time. Please let me know if I can be of further assistance.

Doug



DOUGLAS W. LYBRAND, CFA, CTP, FRM
SENIOR RISK MANAGEMENT OFFICER
P 803.737.7582 | M 803.201.4542 | DLYBRAND@IC.SC.GOV
1201 MAIN STREET | SUITE 1510 | COLUMBIA, SC | 29201
SOUTH CAROLINA RETIREMENT SYSTEM

INVESTMENT COMMISSION

MELLON ANALYTICAL SOLUTIONS SERVICES ADDENDUM

The terms of this Addendum to the Workbench Services Agreement dated March 20, 2008 (the "Agreement") shall apply only to the MELLON ANALYTICAL SOLUTIONS, LLC ("MAS"), services provided by MAS to South Carolina Retirement System Investment Commission, having its place of business at 200 Arbor Lake Drive, Suite 120, Columbia, South Carolina 29223 (hereinafter "Customer").

Intending to be legally bound, the parties hereby agree as follows:

1. Agency: Mellon is acting solely in the capacity as an agent of MAS, and on its behalf with respect to the execution and implementation of this Addendum. Customer agrees this Addendum constitutes a direct agreement between MAS and Customer, and the Services are being provided directly to Customer by MAS.

2. Incorporation by Reference: Portions of the Agreement are incorporated herein by reference with the following modifications except where otherwise specified:

(a) all references to "Mellon" in the incorporated paragraphs are deleted and replaced with "MAS," as defined herein, all references to "Mellon" in this Addendum shall continue to mean Mellon as defined in the Agreement;

(b) all references to "Information Delivery Services" in the incorporated paragraphs are deleted and replaced with "Services," as defined herein,

(c) all references to "Exhibit A" shall be deemed to mean Exhibit A to this Addendum.

(d) all references to "Agreement" in the incorporated paragraphs are deleted and replaced with "Addendum."

3. Definitions

The following definitions are incorporated from the Agreement by reference: "Authorized User," "Information Provider," and "Information Transmitter."

"Commands" shall mean directions given by Customer via computer, including but not limited to keystrokes and mouse clicks.

"Customer Data" shall mean data and information related to Customer and Customer's accounts or securities portfolios provided to MAS by Mellon or Customer, provided however that Customer Data shall not be construed to include non-unique or non-identifying data or information, such as, without limitation, securities pricing, CUSIP numbers and securities descriptions.

"Non-Customer Information" shall mean the information, reports and data provided as a part of the Services other than Customer Data.

"Proprietary Software" shall mean those Services containing computer code such as Mellon Performance Attribution or Mellon Performance Universes.

"Services" shall mean the MAS services described in Exhibit A.

"Workbench Web Site" shall mean the Internet web site hosted by Mellon on the World Wide Web through which Authorized Users may access the Services.

4. Services: MAS shall provide Services to Customer via the Workbench Web Site or another agreed upon delivery method on a daily, monthly or quarterly schedule as identified in Exhibit A. Customer agrees that it will only provide access to the Services to Customer and Customer's affiliates on whose behalf the Customer can legally contract and bind, unless otherwise authorized directly by MAS in writing.

5. Fees: The fees reflected in Exhibit A of the Global Custody Agreement dated April 27, 2007 between Treasurer, State of South Carolina and The Bank of New York shall be in effect for all services identified within the contract and specified in Exhibit A. Any additional services or product expansions may incur additional fees as negotiated between the relevant parties.

6. Term and Termination

(a) The term of this Addendum shall commence on the date execution was completed by all parties and shall continue until terminated as provided herein.

(b) Section 4(b) of the Agreement is incorporated by reference with the following additional modifications:

(i) After the third sentence insert "If an agreement between MAS and a provider of data distributed through the Services is terminated, Customer may terminate any individual Service(s) or this entire Addendum. Termination of a Service(s) will not affect the terms and conditions of this Addendum as they apply to any remaining Service(s) provided under this Addendum."

(ii) The last reference to "Mellon" shall remain "Mellon" rather than be replaced with "MAS."

MELLON ANALYTICAL SOLUTIONS SERVICES ADDENDUM

(c) Section 4(c) of the Agreement is incorporated by reference.

(d) Section 4(d) of the Agreement is incorporated by reference with the following added to the end of the paragraph: "Upon termination of this Addendum, Customer shall not use any Services or proprietary third-party data contained therein for any purpose but may retain a copy for historical corporate record keeping. Proprietary third party data is designated with the third party's name (e.g. "Russell" 2000 Index, "S&P" 500)."

7. License/Proprietary Rights

(a) Section 5(a)(1) of the Agreement is incorporated by reference.

(b) Section 5(b) is incorporated with the following changes:

- (i) At the end of the first sentence, delete "internal computer system only. To the extent such internal computer system" and replace with "internal, single user computer. Unless otherwise specified in Exhibit A, this license is for an internal, single user computer and it is not a multiple seat, multiple user or server license. To the extent such internal computer."
- (ii) Delete the sentence: "If the Proprietary Software is to be installed on a computer system not under the control of Customer, Customer shall so advise Mellon and Mellon may require the individual or entity that controls such computer system to sign a separate agreement with Mellon."
- (iii) Insert the following at the end of the paragraph "All rights not expressly granted, including without limitation translation rights, are exclusively reserved by MAS or its Information Providers."

(c) Customer is granted a non-exclusive, non-transferable license for the term of this Addendum to access and use Non-Customer Information for Customer's internal use. Customer shall not re-market or re-distribute any output from the Service(s) - including but not limited to raw data (such as entire index databases of historical returns or security level data), all or substantially all of the reports output by the Service(s) - without MAS' prior written permission. Customer may use the output from the Service(s) to produce internal and external performance comparisons and/or analyses, including marketing and Customer service materials for use with their prospects and Customers, but not for viewing by the general public (for example Customer cannot put a Mellon Performance Universe graph on Customer's public website). Customer may incorporate inconsequential portions of the Service deliverable into Customer produced comparison or analytical reports (for example, Customer may include Mellon Performance Universe graphs within a report it sends

to clients). Permitted redistribution by Customer must comply with the Notice Provisions described below.

(d) The Services may contain data licensed from third-party suppliers which is identified by the third-party supplier's name (for example Russell 2000®). This licensed data is the intellectual property of those vendors and is subject to restrictions contained in the licenses, which MAS cannot unilaterally change. If the third-party supplier adds additional restrictions to the data's use, MAS shall notify Customer of the change either in writing or via a posting on the web where the vendor's other copyright and trademark information is posted. Customer's continued use of the data after receipt of notice shall constitute Customer's acceptance of the revised usage provisions. Customer may not use the Service as a substitute for obtaining a license from the third-party licensor.

(e) The Services, and all data not identified to a specific third-party are the intellectual property of MAS or its licensors but for purposes hereof shall be deemed MAS' Intellectual Property. MAS reserves all right, title and interest in and to the Intellectual Property. Customer may use the Intellectual Property for Customer's internal use only.

Customer shall not (i) transfer, loan, sell, lease, rent, assign, disclose, publish or copy any of the Intellectual Property; (ii) alter, modify, adapt, translate or create derivative works from any of the Intellectual Property; or (iii) use the Intellectual Property in any manner that may infringe, violate or misappropriate any applicable law or any intellectual property right that MAS may have therein. Customer shall not edit, revise, manipulate or present the Intellectual Property in a way that could be misleading or have an impact on its accuracy or completeness. Any of Customer's employees, officers, agents, investment managers, consultants, subcontractors or others having access to the Intellectual Property or any portion thereof from Customer ("Other Recipients") must be subject to an agreement that restricts and obligates such Other Recipient's access to and use of the Intellectual Property to the same extent Customer is obligated and restricted in its access to and use of the Intellectual Property by this Section 7. Requests for exceptions to any requirements in Section 7 must be reviewed for conformity with contractual obligations and licensing rights and restrictions before being considered and may only be granted in writing. Permitted redistribution by Customer as identified in Section (c) must comply with the Notice Provisions described below.

(f) Notice Provisions: Notwithstanding the provisions of Section 5(a)(1) of the Agreement prohibiting the use of trademarks, logos and/or service marks, if Customer incorporates data from or portions of the output from the Service(s) into any comparison or analytical report or other document produced by Customer, Customer shall note MAS, or the designated data source as the source of data, including

MELLON ANALYTICAL SOLUTIONS SERVICES ADDENDUM

suitable notice of copyright which shall be in accordance with the standards of the 1976 U.S. Copyright Law as amended. When including universe (peer group) data or data without benchmarks insert the following notice for the current calendar year: Data source: © 200# Mellon Analytical Solutions, LLC. All Rights Reserved.

(g) For all other purposes, Customer may refer to MAS' Services in writing by the associated MAS trademarks provided (i) Customer has obtained MAS' prior written consent to such use, which consent may be withheld at MAS' sole discretion; (ii) such reference to MAS and MAS trademarks is truthful and not derogatory or misleading; and (iii) such reference complies with the then-current MAS Trademark and Logo Policies. Customer is hereby put on notice that MAS may have to get approval from third party licensors before consenting to such use.

(h) Customer shall immediately notify MAS of any breach by a Customer of the obligations or restrictions placed on such client as a condition to such client receiving the Services or Intellectual Property, so that the Parties may work together to bring Customer's use into compliance with the applicable licenses.

8. Sections 7(a), 8(b) through (e), 9(b), 10, 11 and 12 of the Agreement are incorporated by reference

9. Section 13 of the Agreement is incorporated by reference with the following modifications: delete from Section 13(d) "of this Agreement: 4, 5, 8, 9, 10, 11, 12 and 13" and replace with "of this Addendum: 5, 6, 7, 8 and 9."

Version Date:

Exhibit A

Deliverable:

Invoice Customer Code # –

Service
Start Date

The fees reflected in Exhibit A of the Global Custody Agreement dated April 27, 2007 between Treasurer, State of South Carolina and The Bank of New York shall be in effect for all services identified within the contract and specified in Exhibit A. Any additional services or product expansions may incur additional fees as negotiated between the relevant parties.

MAS agrees to provide the following services to Customer:

- | | |
|---|--------|
| • Monthly Total and Asset Class Performance Returns – Portfolios and Consolidations | 5/1/08 |
| • Monthly Security Level Returns – From Conversion Date | 5/1/08 |
| • Monthly Flash Performance | 5/1/08 |
| • TUCS – Trust Universe Comparison Service | 5/1/08 |
| • Wilshire Axiom Fixed Income Attribution | 5/1/08 |
| • Workbench Report Writers | 5/1/08 |
| • Monthly Analytics – Equity and Fixed Income Characteristics | 5/1/08 |
| • Custom Benchmarks – Fund Level | 5/1/08 |
| • General Market Indices – Total Level Performance | 5/1/08 |

*The Service Start Date for the Annual Service will be the date used to calculate service renewal periods.

MAS acknowledges and agrees that Customer will have (5-7) users accessing the Services.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date(s) set forth below. All signed copies of this Agreement shall be deemed to be originals.

MELLON ANALYTICAL SOLUTIONS, LLC

Signature Redacted

BY Guy M. Holappa
NAME (PRINT) First Vice President
TITLE 5/16/08
DATE

Address for Notices:

1313 Broadway Plaza
Tacoma, Washington 98402

TREASURER, STATE OF SOUTH CAROLINA

Signature Redacted

BY Robert L. Borden
NAME (PRINT) Chief Investment Officer
TITLE May 1, 2008
DATE

Customer's Address for Legal Notices:

200 Arbor Lake Drive, Suite 120
Columbia, South Carolina 29223



BNY MELLON
ASSET SERVICING

May 18, 2009

1313 BROADWAY PLAZA
TACOMA, WA 98402-3416
TEL: 253.396.6000
FAX: 253.396.6492

Mr. Douglas W. Lybrand
Compliance and Risk Management Officer
South Carolina Retirement System Investment Commission
200 Arbor Lake Drive
Suite 120
Columbia, SC 29223

Dear Doug,

This letter represents confirmation of a change in the services to which your firm currently subscribes. This change in your subscription requires a revised agreement between our organizations. As a result, we are enclosing a revised Exhibit A to the Mellon Analytical Solutions Services Addendum (Services Agreement) executed with BNY Mellon Performance & Risk Analytics, LLC ("BNY Mellon") (formerly Mellon Analytical Solutions), dated May 16, 2008. All other terms and conditions of the Services Agreement shall remain unchanged, and your acceptance of this revised Exhibit A represents your continued agreement and compliance therewith.

You have decided to add Workbench U.S. Equity Attribution, Security-Level Contribution to Return, and U.S. Equity Profiles reports, as well as Charts and Universe services, effective June 1, 2009. The terms and conditions for this new Service shall run for one (1) year from the Annual Service Start Date listed on the attached Exhibit A.

Please print two originals of this letter, sign both, and return them to BNY Mellon. Once received, we will provide a fully-executed original for your files. **This letter, the attached revised Exhibit A, and the Services Agreement will represent an up-to-date Agreement between your organization and BNY Mellon.**

We would appreciate your signing and returning this letter within 15 days of receipt. Thank you for your prompt attention to this matter.

Regards,

David Fisher

I certify that I am duly authorized to sign this Letter Agreement. I further certify that the company on whose behalf my signature appears agrees to be bound by the terms and conditions as set forth herein.

BNY MELLON PERFORMANCE & RISK ANALYTICS, LLC

South Carolina Retirement System Investment Commission

Signature Redacted

BY

NAME (PRINT)

TITLE

DATE

BY
ROBERT L. BORDEN, CFA
NAME (PRINT)
CHIEF EXECUTIVE OFFICER and CIO
TITLE
7-6-09
DATE



Exhibit A

Deliverable:

ONGOING SERVICES			
Invoice Customer Code #C	Service Start Date	Invoice Start Date	Fee (\$US)
Monthly Total and Asset Class Performance Returns – Portfolios and Consolidations	5/1/08		
Monthly Security Level Returns – From Conversion Date	5/1/08		
Monthly Flash Performance	5/1/08		
TUCS – Trust Universe Comparison Service	5/1/08		
Wilshire Axiom Fixed Income Attribution	5/1/08		
Workbench Report Writers	5/1/08		
Monthly Analytics – Equity and Fixed Income Characteristics	5/1/08		
Custom Benchmarks – Fund Level	5/1/08		
General Market Indices – Total Level Performance	5/1/08		
Workbench U.S. Equity Attribution (Dynamic) – long-only managers	6/1/09		
Workbench Security-Level Contribution to Return – long-only managers	6/1/09		
Workbench U.S. Equity Profiles reports – long-only managers	6/1/09		
Workbench Charts and Monthly Mellon Universe reports	6/1/09		

*The Service Start Date for the Annual Service will be the date used to calculate service renewal periods.

Invoice Customer Code #C –	Service Start and End Date

Customer Affiliates, as set forth in Section 10.7 include the following:



BNY MELLON
ASSET SERVICING

May 18, 2009

1313 BROADWAY PLAZA
TACOMA, WA 98402-3416
TEL: 253.396.6000
FAX: 253.396.6492

Mr. Douglas W. Lybrand
Compliance and Risk Management Officer
South Carolina Retirement System Investment Commission
200 Arbor Lake Drive
Suite 120
Columbia, SC 29223

Dear Doug,

This letter represents confirmation of a change in the services to which your firm currently subscribes. This change in your subscription requires a revised agreement between our organizations. As a result, we are enclosing a revised Exhibit A to the Mellon Analytical Solutions Services Addendum (Services Agreement) executed with BNY Mellon Performance & Risk Analytics, LLC ("BNY Mellon") (formerly Mellon Analytical Solutions), dated May 16, 2008. All other terms and conditions of the Services Agreement shall remain unchanged, and your acceptance of this revised Exhibit A represents your continued agreement and compliance therewith.

You have decided to add Workbench U.S. Equity Attribution, Security-Level Contribution to Return, and U.S. Equity Profiles reports, as well as Charts and Universe services, effective June 1, 2009. The terms and conditions for this new Service shall run for one (1) year from the Annual Service Start Date listed on the attached Exhibit A.

Please print two originals of this letter, sign both, and return them to BNY Mellon. Once received, we will provide a fully-executed original for your files. **This letter, the attached revised Exhibit A, and the Services Agreement will represent an up-to-date Agreement between your organization and BNY Mellon.**

We would appreciate your signing and returning this letter within 15 days of receipt. Thank you for your prompt attention to this matter.

Regards,

David Fisher

I certify that I am duly authorized to sign this Letter Agreement. I further certify that the company on whose behalf my signature appears agrees to be bound by the terms and conditions as set forth herein.

BNY MELLON PERFORMANCE & RISK ANALYTICS, LLC

South Carolina Retirement System Investment Commission

Signature Redacted

BY

BY

NAME (PRINT)

ROBERT L. BORDEN, CFA

NAME (PRINT)

TITLE

CHIEF EXECUTIVE OFFICER and CIO

TITLE

DATE

7-6-09

DATE



Exhibit A

Deliverable:

ONGOING SERVICES			
Invoice Customer Code #C	Service Start Date	Invoice Start Date	Fee (SUS)
Monthly Total and Asset Class Performance Returns – Portfolios and Consolidations	5/1/08		
Monthly Security Level Returns – From Conversion Date	5/1/08		
Monthly Flash Performance	5/1/08		
TUCS – Trust Universe Comparison Service	5/1/08		
Wilshire Axiom Fixed Income Attribution	5/1/08		
Workbench Report Writers	5/1/08		
Monthly Analytics – Equity and Fixed Income Characteristics	5/1/08		
Custom Benchmarks – Fund Level	5/1/08		
General Market Indices – Total Level Performance	5/1/08		
Workbench U.S. Equity Attribution (Dynamic) – long-only managers	6/1/09		
Workbench Security-Level Contribution to Return – long-only managers	6/1/09		
Workbench U.S. Equity Profiles reports – long-only managers	6/1/09		
Workbench Charts and Monthly Mellon Universe reports	6/1/09		

*The Service Start Date for the Annual Service will be the date used to calculate service renewal periods.

Invoice Customer Code #C –	Service Start and End Date

Customer Affiliates, as set forth in Section 10.7 include the following:

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Thursday, May 30, 2013 9:30 AM
To: Sarah Corbett
Subject: BNYM Settlement/RFP

Will you please share a copy of the documents that select staff has received concerning the pending/final BNYM Settlement/Custodian RFP? As a member of the evaluation committee, I feel sufficiently involved to justify inclusion. It would help me to better understand how the Treasurer's actions have or will impacted the project. I hope you feel the same way.

Thanks for your help Sarah.

Doug



DOUGLAS W. LYBRAND, CFA, CTP, FRM
SENIOR RISK MANAGEMENT OFFICER
P 803.737.7582 | M 803.201.4542 | DLYBRAND@IC.SC.GOV
1201 MAIN STREET | SUITE 1510 | COLUMBIA, SC | 29201
SOUTH CAROLINA RETIREMENT SYSTEM

INVESTMENT COMMISSION

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Tuesday, May 08, 2012 3:09 PM
To: Hershel Harper; Rebecca Gunnlaugsson
Subject: Custodial RFP

Hello,

As you know, the Advisory Selection Panel for Custodial Services and Securities Lending plans to meet Tuesday, May 22nd from 9:00 am - 2:00 pm. Unfortunately, I will not be able to participate personally on that day. I am scheduled to be on annual leave for the entire week. I may call in but there is no guarantee my mobile phone will work from my location. Naturally, I want to do whatever I can to offer my input into the selection process. I will complete Bo's evaluation worksheet when it becomes available but I wondered if you wanted to talk before the meeting. I will be traveling on business the rest of this week and Wampee is scheduled for Thursday and Friday next week, leaving only Monday through Wednesday to get together.

I would be glad to set up a meeting between us assuming you want to talk and have time. Please let me know what you want to do. I trust you want my honest opinion about our choices. I just want to find the right opportunity to share them before the meeting. Thanks.

Doug

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Tuesday, May 15, 2012 4:09 PM
To: Abesamis, Bo (abesamis@callan.com)
Subject: Custodial Services/Securities Lending Recommendation

As I will not be available Tuesday, May 22nd for the day-long evaluation of the Custodial Services and Securities Lending proposals, please see my thoughts below.

In short, I would vote to retain Bank of New York Mellon (BNYM) for Custodial Services and move the Securities Lending operations to Deutsche Bank as soon as possible.

Custodial Services

After reviewing the voluminous responses from each of the proposers, the local and on-site presentations, as well as our consultant's independent assessment, the collective scorecard of the evaluation panel, reference checks and the collective opinion of the investment manager community, I believe that BNYM and State Street can be considered equally qualified to provide Custodial Services.

Although State Street is perceived to currently possess a minor technological/reporting advantage, our consultant on this project, Callan Associates, has advised that BNYM is expected to leap-frog State Street in the next several months/quarters as improved system and process capabilities are moved into production.

Although State Street delivered an impressive on-site demonstration, I do not believe their "performance" dramatically changes the underlying, fundamental capabilities of the proposers. And so from a capabilities perspective, I was not swayed to recommend changing custodians, especially given the time and effort involved in such an undertaking. I do not believe the juice is worth the squeeze.

From a cost perspective, I believe that BNYM offers the Retirement System and Investment Commission a far more competitively priced package than State Street. Based upon the revised proposals, which priced each service independently (see table below), BNYM offers a comparable package of services costing only 1/3rd as much, or over \$2.1 million less than State Street. Based upon my experiences, BNYM has dramatically cut or now offers many services for free. They have taken a very aggressive stance to retain our business and I believe they should.

Cost Comparisons

	<u>BNYM</u>	<u>State Street</u>
Account Fees	0	141,000
Custody Fees	115,527	808,298
Transactions	132,498	288,345
Other Services		
Performance Measurement		
Monthly Return Calculations	200,000	201,125

Daily Return Calculations	75,000	465,750
Independent Derivatives Processing and Evaluation	54,000	0
Portfolio Characteristics & Risk Adjusted Returns	0	0
Peer Universe Comparison	0	50,000
TUCS Universe	0	74,000
Attribution	0	63,250
Basic Compliance	0	323,000
Intermediate Compliance	0	392,600
Advanced Risk Analytics	140,000	302,000
Alternative Investment Support		150,000
Private I, Private Informant, Cap Call Mgt., etc.	125,000	
Hedge Fund Transparency	150,000	
HF Administrative Services	TBD	
Daily Valuation	125,000	
Total	1,117,025	3,259,368

BNYM estimated the cost of a hosted Data Warehousing and Investment Portfolio Accounting solution of \$630,000. State Street requested more information before proposing a cost for those services.

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Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Tuesday, May 15, 2012 4:04 PM
To: Hershel Harper; Rebecca Gunnlaugsson
Subject: Custodial Services/Securities Lending Recommendation

As I will not be available Tuesday, May 22nd for the day-long evaluation of the Custodial Services and Securities Lending proposals, please see my thoughts below.

In short, I would vote to retain Bank of New York Mellon (BNYM) for Custodial Services and move the Securities Lending operations to Deutsche Bank as soon as possible.

Custodial Services

After reviewing the voluminous responses from each of the proposers, the local and on-site presentations, as well as our consultant's independent assessment, the collective scorecard of the evaluation panel, reference checks and the collective opinion of the investment manager community, I believe that BNYM and State Street can be considered equally qualified to provide Custodial Services.

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Although State Street delivered an impressive on-site demonstration, I do not believe their "performance" dramatically changes the underlying, fundamental capabilities of the proposers. And so from a capabilities perspective, I was not swayed to recommend changing custodians, especially given the time and effort involved in such an undertaking. I do not believe the juice is worth the squeeze.

From a cost perspective, I believe that BNYM offers the Retirement System and Investment Commission a far more competitively priced package than State Street. Based upon the revised proposals, which priced each service independently (see table below), BNYM offers a comparable package of services costing only 1/3rd as much, or over \$2.1 million less than State Street. Based upon my experiences, BNYM has dramatically cut or now offers many services for free. They have taken a very aggressive stance to retain our business and I believe they should.

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Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Tuesday, May 15, 2012 3:23 PM
To: Abesamis, Bo (abesamis@callan.com)
Subject: Custodian cost comparison
Attachments: Custodian cost comparisons.xlsx

Bo,

Here is my summary sheet.

Neither proposal includes data warehousing estimates in the totals.

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Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Friday, April 06, 2012 2:53 PM
To: 'Wright, Amy'
Cc: Rebecca Gunnlaugsson
Subject: Custodian On-site visits

Hi Amy, Doug Lybrand here. Bill told me you were coordinating the travel and lodging arrangements for the folks from the STO for the on-site visits to NYC and Boston. I was wondering if you would mind sharing some of your efforts to help me (and Rebecca) make similar arrangements? Do you have the addresses of the offices we plan to visit. Have you selected a hotel near the Boston offices that meet the cost limitations? Have you identified convenient flights to fit within our proposed schedule. Are you/we planning on taking a train or a plane from NYC to Boston? If by train is that Amtrak? I would appreciate any input you could share with me as I need to get started ASAP. Thanks.

Douglas Lybrand
Sr. Risk Management Officer
SCRS Investment Commission
803-737-7582 Work
803-201-4542 Mobile
DLybrand@ic.sc.gov

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Monday, December 09, 2013 4:18 PM
To: Geoffrey Berg
Subject: Custodian RFP Recommendation
Attachments: Custodian RFP Recommendation.docx

I hope this helps.

Douglas Lybrand

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In short, I would vote to retain Bank of New York Mellon (BNYM) for Custodial Services and move the Securities Lending operations to Deutsche Bank as soon as possible.

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Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Friday, March 16, 2012 3:18 PM
To: Gary Li
Subject: Custodian RFP

Gary,

Just a reminder that I will be attending presentations from the finalists on the Custodian RFP all day Tuesday and Wednesday.

Doug

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Monday, February 13, 2012 3:19 PM
To: 'Bill.Leidinger@sto.sc.gov'
Cc: karen.wicker@sto.sc.gov
Subject: Custody Proposal

Hi Bill,

I just today received two large and heavy boxes containing the responses to the custody RFP. And, according to the email forwarded to me by Adam Jordan, I am being asked to come prepared for a full discussion by February 29th. Today I also requested and just received a copy of the RFP. But I still have not received the Advisory Review Panel Briefing. As I am being asked to certify that I have received this briefing, it must surely have some bearing on the RFP and the responses I am being asked to evaluate. Will you please provide this document at your earliest convenience. I would hate to read so much material without the proper perspective on this proposal. I appreciate your help.

Respectfully yours,

Douglas W. Lybrand
803-737-7582

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Friday, May 31, 2013 5:02 PM
To: Danny Varat; Hershel Harper; Reynolds Williams
Cc: Robert Feinstein; Darry Oliver
Subject: FW: Advisory Selection Panel Conference Call

Please note in the email below that I expressed my preferences to Bill Leiding prior to the meeting. I was expecting Hershel and Adam to provide further input. DWL

From: Leiding, Bill [mailto:Bill.Leiding@sto.sc.gov]
Sent: Wednesday, June 13, 2012 9:44 AM
To: Douglas W. Lybrand
Cc: Adam Jordan; Abesamis, Bo; Swilley-Burke, Gwelda
Subject: RE: Advisory Selection Panel Conference Call

Doug, I am sorry to hear of your loss. Of course I understand that you may not be on the call. Talk to you soon.....Bill

-----Original Appointment-----

From: Douglas W. Lybrand [mailto:DLybrand@ic.sc.gov]
Sent: Wednesday, June 13, 2012 9:39 AM
To: Leiding, Bill
Cc: Harper, Hershel; Adam Jordan; Abesamis, Bo (abesamis@callan.com)
Subject: Tentative: Advisory Selection Panel Conference Call
When: Thursday, June 14, 2012 12:00 PM-1:00 PM (GMT-05:00) Eastern Time (US & Canada).
Where:

Bill (et al), I may not be able to attend all or any part of the conference call. I had a beloved aunt die and the funeral is scheduled for 2:00 pm.

As we have discussed, I support retention of the Bank of New York Mellon as our custodian. I would also support moving our Securities Lending program to Deutsche Bank. I believe Hershel and Adam are able to best express the Commission's preferences with any overriding legal or budgetary considerations. If I can provide any additional input, please let me know. I will do my best to participate.

Douglas Lybrand, CFA, CTP, FRM
803-737-7582

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Tuesday, May 15, 2012 4:36 PM
To: Adam Jordan
Subject: FW: Custodial Services/Securities Lending Recommendation

FYI

From: Douglas W. Lybrand
Sent: Tuesday, May 15, 2012 4:04 PM
To: Hershel Harper; Rebecca Gunnlaugsson
Subject: Custodial Services/Securities Lending Recommendation

As I will not be available Tuesday, May 22nd for the day-long evaluation of the Custodial Services and Securities Lending proposals, please see my thoughts below.

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Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Friday, May 31, 2013 5:09 PM
To: Danny Varat; Reynolds Williams
Cc: Hershel Harper; Robert Feinstein; Darry Oliver
Subject: Memo recommending custodian/sec lending agent

She originally suggested she could find something, but we will have to ask someone else. DWL

From: Tammy Nichols
Sent: Friday, May 31, 2013 5:02 PM
To: Douglas W. Lybrand
Cc: Faith Wright
Subject:

As we discussed over the phone, I do not have any memo but the committee did unanimously agree and a recommendation was made through Leidinger to the Treasurer. Bo from Callan may be able to provide more details. I'm pretty sure Rebekah was still a part of the team representing the RSIC but I think she left shortly after the recommendation was made.

Tammy

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Thursday, August 30, 2012 10:00 AM
To: Sarah Corbett
Subject: Questions to clarify ancillary serices
Attachments: Custodian Questions to clarify.docx

I hope the following dialogue is what you're looking for. I found this format better for bringing in those who have not been involved from the beginning. I thought the leading questions were more effective than pages of questions in bullet format.

Also, I did not find the responses to the RFP very useful in addressing our questions. I haven't seen where the RFP asked the questions we're currently addressing. I will look closer but please let me know if I'm missing something.

Can I share this document with others involved with reporting?

Thanks.

Doug



DOUGLAS W. LYBRAND, CFA, CTP, FRM
SENIOR RISK MANAGEMENT OFFICER
P 803.737.7582 | M 803.201.4542 | DLYBRAND@IC.SC.GOV
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SOUTH CAROLINA RETIREMENT SYSTEM

INVESTMENT COMMISSION

Questions to help clarify ancillary services

Within "Performance and Risk Analytics," for which services are we currently being charged and which have been added and are now included within the \$200,000 charge? Describe the look-thru analytics and if it extends to comingled funds. Describe the Mellon Universe and its timeliness for peer comparisons. Describe the available power and the limitations of portfolio- and fund-level attribution. How much data is necessary for a thorough attribution analysis? Are any of the Performance and Risk Analytics components significantly enhanced thru the Investment Data Hub and/or related Accounting component?

Please compare and contrast in sufficient detail the enhanced (or redundant) functionality that becomes available with the Investment Data Hub (IDH) versus RSIC's current capabilities using Workbench alone. For example, how does it help us better disaggregate our Portfolio into more granular sectors? Can it provide and enhance daily security-level transparency of long-only "not-in-bank" assets and comingled funds? Are comingled holdings updated daily or just monthly? Can it provide daily valuation of individual holdings and group those securities by industry-standard and user-defined asset class, subclass, category, sub-category and manager? How about various sector, sub-sector, industry classification of S&P, Russell, or any other classification schemes? Does it facilitate Portfolio-level reporting of contributions and distributions, daily realized and unrealized gains and losses and/or returns, (and end-of-day holdings) by security, by asset class, by manager, etc.? Does it allow RSIC to create user-defined fields and lookup tables to better define and slice and dice our data? How much data can be saved?

How could the IDH facilitate better reporting of our Strategic Partnerships? Could it account for daily flows and returns between asset classes and or underlying managers? Could it provide security-level transparency to long-only mandates? How about long/short strategies? Can the IDH actually link to Strategic Partners' systems if permitted?

If daily transparency was available on hedge funds on the Lighthouse platform, could the underlying securities be accurately reported like long-only managers. What is required to achieve comparable reporting capabilities between long-only and long-short or short investment strategies? Please compare and contrast the power and flexibility to analyze and report hedged or short securities between Workbench and the IDH (with and/or without the Accounting component).

What are the important functional and cost similarities and differences between an Administrator and an IDH with accounting capabilities? Given the type of securities currently held by RSIC and the desired level of reporting sophistication, under what circumstances – for what type of investing - does it become essential to employ an administrator and / or an IDH with accounting capabilities? Are these two services interchangeable?

What additional functionality and reporting capabilities are achieved by adding BNYM Hedge Fund Transparency and Hedge Fund Administrative Services, given the existing capabilities of the Lighthouse Hedge Fund platform? Does the Lighthouse platform together with the IDH and / or accounting component potentially eliminate the need to subscribe to BNYM HF Transparency and HF Administrative Services?

Would the IDH facilitate detailed financial and investment analysis versus our benchmarks? Can our target asset allocation be saved and used for reporting purposes? Can it use our benchmarks to

calculate Policy and Strategy Benchmark returns? Can it create security-level blended benchmarks? Can these blended security-level holdings be compared with our daily holdings by manager, by asset class or sub-class, by sector, sub-sector, industry, etc.? How else does it enhance our reporting capabilities?

Is it necessary and or recommended to acquire the Accounting component to report ANY of the above, like gains and losses? Can one accurately track transactions and “flows” between managers (Portfolio-level) and within manager accounts without the Accounting component? Can one decompose daily changes in values (flows) into contributions, distributions, realized and unrealized gains and losses, dividends and coupon income (accrued versus cash), maturities, etc.? Is accounting essential given our reporting wish list? Could it handle all types of securities? What can it not handle?

Describe the benefits of the IDH if one doesn’t acquire and implement the accounting component(s)? Describe the additional functionality and any redundancy with existing capabilities if the accounting component is acquired.

Which functional components discussed above (for both the IDH and Accounting) are severely limited for asset classes with lagged (45 days) or no transparency, like hedge funds? How is an application like Private i, which handles private equity and other limited partnerships normally interfaced with the IDH?

Please describe the overall process associated with employing/using the IDH. Would RSIC interact with a single liaison or with more technical people as well? Are canned reports available? Are developers included to help us create simple applications, automated processes or perhaps a data dashboard? Are report writing services included? If not, describe the normal billing process for each. Does the IDH include a report writer application? Is it proprietary, more technically oriented or common off-the-shelf software? Is the purchase of Crystal or other report writers recommended? Does the IDH explain the schema and or record layouts to facilitate report writing?

What would be RSIC’s responsibility in terms of IT, accounting, etc., regarding the Investment Data Hub? How many people, with what skill sets, would SC need to hire during implementation or longer-term? Is it normal and / or desirable for existing staff to perform multiple roles associated with implementation, data management, investment analysis and portfolio and or risk management? Please describe the normal support staff required by \$25 billion pension plans with comparable investments, strategic partnerships (including a separate hedge fund platform like Lighthouse), Beta Overlay Manager, comingled and separately managed accounts with assets that are not-in-bank. Does the IDH provide a project plan and / or project manager to describe and lead the project, its timelines and milestones of implementation?

Please describe the existing data interfaces between the BNYM and the IDH? Are additional interfaces normally necessary / recommended? Please comment on the following specific interfaces: Managers whose assets are not-in-bank, comingled funds, managers on the Lighthouse platform (Hedge Funds and other), manager administrators and/or prime brokers and strategic partnerships. Which interfaces have already been created to managers or other software applications (i.e. Portfolio Management, Risk Systems, and Bloomberg) and are available without charge? Who would bear the costs of creating interfaces? Please estimate the implementation costs for the IDH, the Accounting component and interfaces in general.

Please describe the input and output options available with an IDH. What is the underlying database platform: SQL (Microsoft), Sybase (SAP), Oracle? Which database platforms and or programming

languages should RSIC employees be familiar with? Is output available in pivot tables, OLAP cubes, multiple dimensions (by legal entity, by manager, by asset class, etc.)? Are hard-copy or on-line manuals or help files available? Is technical support available 24/7?

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Wednesday, October 24, 2012 2:14 PM
To: Dori Ditty
Cc: Sarah Corbett
Subject: RE: BNYM Amended Agreements

I am aware BNY should have countersigned. I seem to recall requesting the copy be sent to Nancy. And Nancy may have reminded me, at some point, to remind them. Check with her. If it were sent to me, I would have given it to Nancy. I would think we could get a copy from BNYM. DWL

From: Dori Ditty
Sent: Wednesday, October 24, 2012 2:07 PM
To: Douglas W. Lybrand
Cc: Sarah Corbett
Subject: RE: BNYM Amended Agreements

Thanks for checking. If you happen to discover anything else, please send it on.

Also, on the letter dated May 18, 2009, to you, are you aware of a countersignature by BNY? Or do you know if Bob was the only party signing?

From: Douglas W. Lybrand
Sent: Wednesday, October 24, 2012 1:59 PM
To: Dori Ditty
Cc: Sarah Corbett
Subject: RE: BNYM Amended Agreements

I don't recall ever seeing that and I don't know where it is located, sorry.

DWL

From: Dori Ditty
Sent: Wednesday, October 24, 2012 11:46 AM
To: Douglas W. Lybrand
Cc: Sarah Corbett
Subject: RE: BNYM Amended Agreements

Thanks, Doug!

What about the Workbench Services Agreement dated March 20, 2008? Do you have that? It is referred to in the Mellon Analytical Solutions Services Addendum.

From: Douglas W. Lybrand
Sent: Wednesday, October 24, 2012 11:09 AM
To: Sarah Corbett; Dori Ditty
Subject: BNYM Amended Agreements

Attached are addendums to our BNYM agreements related to Performance & Risk Analytics. These are the most recent documents of which I am aware. Schedule A contains the most detailed list of services we contracted to receive from BNYM. Although we tried to be more specific, the final language is as specific to which BNYM would agree.

Be aware that the costs of these services could change dramatically under BNYM's latest response to our custodial RFP. I have records of the old and proposed costs but am bound to keep the new costs confidential at this time. Please let me know if I can be of further assistance.

Doug



DOUGLAS W. LYBRAND, CFA, CTP, FRM
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Ashleigh Hollins

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Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Thursday, May 30, 2013 11:44 AM
To: Sarah Corbett
Subject: RE: BNYM Settlement/RFP

Understand. I'll ask David and/or Legal. Thanks a lot. Doug

From: Sarah Corbett
Sent: Thursday, May 30, 2013 10:51 AM
To: Douglas W. Lybrand
Subject: RE: BNYM Settlement/RFP

Doug,

I cannot provide the document – it is not within my purview to do so. I have been instructed not to share it. You will have to ask Legal and/or David Phillips to provide you a copy.

Sarah

From: Douglas W. Lybrand
Sent: Thursday, May 30, 2013 9:30 AM
To: Sarah Corbett
Subject: BNYM Settlement/RFP

Will you please share a copy of the documents that select staff has received concerning the pending/final BNYM Settlement/Custodian RFP? As a member of the evaluation committee, I feel sufficiently involved to justify inclusion. It would help me to better understand how the Treasurer's actions have or will impacted the project. I hope you feel the same way.

Thanks for your help Sarah.

Doug



DOUGLAS W. LYBRAND, CFA, CTP, FRM
SENIOR RISK MANAGEMENT OFFICER
P 803.737.7582 | M 803.201.4542 | DLYBRAND@IC.SC.GOV
1201 MAIN STREET | SUITE 1510 | COLUMBIA, SC | 29201
SOUTH CAROLINA RETIREMENT SYSTEM

INVESTMENT COMMISSION

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Friday, April 06, 2012 3:16 PM
To: 'Wright, Amy'
Subject: RE: Custodian On-site visits

Thanks Amy. You're very helpful! Have a great Easter. Doug

From: Wright, Amy [mailto:amy.wright@sto.sc.gov]
Sent: Friday, April 06, 2012 3:15 PM
To: Douglas W. Lybrand
Subject: RE: Custodian On-site visits

Hey Doug – I was only asked to help today with trying to find some available and cost effective flights. I've given my list to Bill and Shakun to review and then we will book those. While it is cheaper to fly out of Charlotte, not so sure everyone would want to be at CLT for a 6:15am flight. As soon as I get the information back I will let you know what they decided.

I haven't been asked to provide any other assistance at this moment but if so I will be glad to share that as well with you as soon as I get it.

Thanks,
Amy

From: Douglas W. Lybrand [mailto:DLybrand@ic.sc.gov]
Sent: Friday, April 06, 2012 2:53 PM
To: Wright, Amy
Cc: Rebecca Gunnlaugsson
Subject: Custodian On-site visits

Hi Amy, Doug Lybrand here. Bill told me you were coordinating the travel and lodging arrangements for the folks from the STO for the on-site visits to NYC and Boston. I was wondering if you would mind sharing some of your efforts to help me (and Rebecca) make similar arrangements? Do you have the addresses of the offices we plan to visit. Have you selected a hotel near the Boston offices that meet the cost limitations? Have you identified convenient flights to fit within our proposed schedule. Are you/we planning on taking a train or a plane from NYC to Boston? If by train is that Amtrak? I would appreciate any input you could share with me as I need to get started ASAP. Thanks.

Douglas Lybrand
Sr. Risk Management Officer
SCRS Investment Commission
803-737-7582 Work
803-201-4542 Mobile
DLybrand@ic.sc.gov

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Monday, March 05, 2012 1:34 PM
To: 'Leidinger, Bill'
Subject: RE: Custody and Securities Lending Presentations (March 20 and 21)

Looks good to me.

Doug Lybrand

From: Leidinger, Bill [mailto:Bill.Leidinger@sto.sc.gov]
Sent: Monday, March 05, 2012 12:00 PM
To: Tammy Nichols; Faith Wright; Rebecca Gunnlaugsson; Douglas W. Lybrand; Tahiliani, Shakun; Condon, Bill; Leidinger, Bill; McDermott, Mike
Cc: Adams, Clarissa; Swilley-Burke, Gwelda
Subject: FW: Custody and Securities Lending Presentations (March 20 and 21)

Folks, please look over Bo's suggested agenda for the bank presentations and let me know **ASAP** if you have questions, suggestions, additions, deletions, etc.....Thanks Much.....Bill

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Monday, March 05, 2012 11:51 AM
To: Leidinger, Bill
Cc: Tahiliani, Shakun
Subject: Custody and Securities Lending Presentations (March 20 and 21)
Importance: High

Bill,

Just wanted to relay that BNY Mellon, State Street and Deutsche Bank (SecLending only) are participating in the presentations on March 20 and 21. Here is what I am thinking.

CUSTODY PRESENTATIONS **March 20, 2012 (Tuesday)**

State Street (8:30 am to 11:30 am)
BNY Mellon (1:00 pm to 4:00 pm)

Custody Topic for Discussion

Organization
Client Service Team
Custody and Accounting + Reporting
Performance Measurement and Risk Analytics
Alternative Investment Support (P/E, Real Estate, and Absolute Strategies)

SECURITIES LENDING PRESENTATIONS **March 21, 2012 (Wednesday)**

BNY Mellon (8:30 am to 9:30 am)
State Street (10:00 am to 11:00 am)
Deutsche Bank (11:30 am to 12:30 pm)

Securities Lending Topic for Discussion

Organization and Experience
Program Structure (Distinct Capabilities)

Kindly check with everybody if this is acceptable, so that I can relay to BNY Mellon, State Street and Deutsche the agenda and topics to cover, and at least give them time to arrange travel to Columbia.

Thanks.

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

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Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Wednesday, April 04, 2012 10:20 AM
To: Robert Feinstein
Subject: RE: Custody timeline update - CONFIDENTIAL; A/C PRIVILEGED COMMUNICATION

I read this after speaking w you. You should have told me Rebecca brought this up. Oh well.

From: Robert Feinstein
Sent: Tuesday, April 03, 2012 5:17 PM
To: Rebecca Gunnlaugsson; Adam Jordan; Hershel Harper
Cc: Douglas W. Lybrand
Subject: RE: Custody timeline update - CONFIDENTIAL; A/C PRIVILEGED COMMUNICATION

Rebecca:

Thanks very much for the update. The timelines strike me as sensible, prudent and realistic.

As to your questions:

1. *What are the financial implications of moving sec lending out of BNYMellon to another party (either DB or SS)?*

I need to review this with Adam, Hershel and others, as this:

- a. Will likely entail a fundamental change in the way in which the trust funds pay for custody; and
- b. Will also represent a new arrangement for compensating sec lending agent.

2. *What type of timeline is required for notification and completion of the termination?*

Under the terms of (what I believe is still) the existing sec lending agreement, either party may terminate the agreement at any time, but the date of termination may not be less than 30 days after date of receipt of notice of termination. Translated: it shouldn't take too long to recall the existing loans relating to the trust funds' component of the sec lending program. I suspect, however, that termination of the "state funds" component of the sec lending program could get a bit dicier, given the different (less resolved?) nature of the state funds' troubled legacy holdings. What, you expected a simple answer?

R.

From: Rebecca Gunnlaugsson
Sent: Tuesday, April 03, 2012 4:38 PM
To: Adam Jordan; Hershel Harper; Robert Feinstein
Cc: Douglas W. Lybrand
Subject: Custody timeline update

Recap of next steps in custody RFP from today's meeting:

April 17th – Clarification of pricing details, questions and issues due back from 3 finalists (BNYMellon, SS, Deutsche Bank)
April 30th – May 2nd – Onsite visits

Conversion possibilities:

1. If we select **BNYMellon** for both:
 - a. July 1 – switch to Boston BNYMellon group
 - b. Implement ancillary services over next year or two
2. If we select **SS** for both:
 - a. Custody and sec lending conversion would realistically be Nov/Dec timeframe
 - b. Ancillary services would continue to be built out over subsequent year or two
3. If we select **BNYMellon** for custody and **DB** for sec lending:

- a. July 1 – switch to Boston BNYMellon group
- b. Implement ancillary services over next year or two
- c. Complete sec lending conversion in Nov/Dec

Questions (Probably for Robert): *What are the financial implications of moving sec lending out of BNYMellon to another party (either DB or SS)? What type of timeline is required for notification and completion of the termination?*

Doug, Did I miss anything?

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Wednesday, April 04, 2012 10:14 AM
To: 'Rebecca Gunnlaugsson'
Subject: RE: Custody timeline update

You're good.

From: Rebecca Gunnlaugsson
Sent: Tuesday, April 03, 2012 4:38 PM
To: Adam Jordan; Hershel Harper; Robert Feinstein
Cc: Douglas W. Lybrand
Subject: Custody timeline update

Recap of next steps in custody RFP from today's meeting:

April 17th – Clarification of pricing details, questions and issues due back from 3 finalists (BNYMellon, SS, Deutsche Bank)
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3. If we select **BNYMellon** for custody and **DB** for sec lending:
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 - b. Implement ancillary services over next year or two
 - c. Complete sec lending conversion in Nov/Dec

Questions (Probably for Robert): What are the financial implications of moving sec lending out of BNYMellon to another party (either DB or SS)? What type of timeline is required for notification and completion of the termination?

Doug, Did I miss anything?

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Tuesday, July 03, 2012 11:55 AM
To: 'Leidinger, Bill'; Adam Jordan; Hershel Harper
Subject: RE: Custody

2:00 is better for me. Doug

From: Leidinger, Bill [mailto:Bill.Leidinger@sto.sc.gov]
Sent: Tuesday, July 03, 2012 11:54 AM
To: Adam Jordan; Hershel Harper; Douglas W. Lybrand
Subject: RE: Custody

Let's meet Monday at either 10:30 or 2. I don't think we need more than 1 hour. Let me know which works best for you.....Bill

From: Adam Jordan [mailto:AJordan@ic.sc.gov]
Sent: Tuesday, July 03, 2012 11:25 AM
To: Leidinger, Bill; Harper, Hershel; Lybrand, Douglas
Subject: RE: Custody

Bill,

Welcome back and thank you for your email. We look forward to a discussion on the issues outlined below. Hershel will be traveling as part of the investment consultant RFP process on Thursday and Friday. Would Monday (7/9) from 9:30 - 12:00 or after 2:00 work for you? If not, then Doug and I can meet with you on Friday, but I would prefer to have Hershel attend.

Thanks,

Adam

From: Leidinger, Bill [mailto:Bill.Leidinger@sto.sc.gov]
Sent: Tuesday, July 03, 2012 11:02 AM
To: Hershel Harper; Douglas W. Lybrand; Adam Jordan
Subject: Custody

Folks, if your schedules permit, I would like to come over on Thursday or Friday and have a general discussion about going forward on the custody RFP.

Now that it looks like the IC most probably will not receive the additional funding it had sought, I would like to discuss the specific services the IC would like to receive from a custodian bank to strengthen your back office and investment management practices and the associated costs of each. I also would like to discuss working together to frame up a BD 100 to secure the needed additional funding that the Treasurer and the IC can together support.

I would also like to discuss the process to be used in securing the IC's approval.

Please let me know what days and times are good for you.....Thanks.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
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Columbia, SC 29201

(803) 734-5063 Office
(803) 608-2378 Mobile

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Tuesday, July 03, 2012 11:28 AM
To: 'Adam Jordan'; Leidinger, Bill; Hershel Harper
Subject: RE: Custody

I'm scheduled to be off this Friday, sorry.

From: Adam Jordan
Sent: Tuesday, July 03, 2012 11:25 AM
To: Leidinger, Bill; Hershel Harper; Douglas W. Lybrand
Subject: RE: Custody

Bill,

Welcome back and thank you for your email. We look forward to a discussion on the issues outlined below. Hershel will be traveling as part of the investment consultant RFP process on Thursday and Friday. Would Monday (7/9) from 9:30 - 12:00 or after 2:00 work for you? If not, then Doug and I can meet with you on Friday, but I would prefer to have Hershel attend.

Thanks,

Adam

From: Leidinger, Bill [mailto:Bill.Leidinger@sto.sc.gov]
Sent: Tuesday, July 03, 2012 11:02 AM
To: Hershel Harper; Douglas W. Lybrand; Adam Jordan
Subject: Custody

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I would also like to discuss the process to be used in securing the IC's approval.

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Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Tuesday, February 07, 2012 10:18 AM
To: Leidinger, Bill
Subject: RE: Documents Re: Custodial Bank Proposals

Hi Bill,

I never saw you Friday. I assume you will provide at the appropriate time. Thanks. Doug

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Thursday, February 02, 2012 10:50 AM
To: Douglas W. Lybrand
Subject: RE: Documents Re: Custodial Bank Proposals

Doug, I will bring a copy for you tomorrow AM when I am over there....I didn't originally send it since there may be a change or two after we meet with Bo from Callan here shortly.....Thanks.....bill

From: Douglas W. Lybrand [<mailto:DLybrand@ic.sc.gov>]
Sent: Thursday, February 02, 2012 10:34 AM
To: Leidinger, Bill
Subject: RE: Documents Re: Custodial Bank Proposals

Hi Bill,

Upon review of the confidentiality agreements I noticed I am being asked to certify that I have received the Advisory Review Panel Briefing Instructions, I have not. I advised Karen Wicker and now you of that fact. Please advise. Thanks.

Douglas Lybrand
803-737-7582

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Thursday, February 02, 2012 9:32 AM
To: Hershel Harper; William Blume
Cc: Loftis, Curtis; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Robert Feinstein; Adam Jordan; Tammy Nichols; KAREN WICKER karen.wicker@sto.sc.gov; Rebecca Gunnlaugsson; Douglas W. Lybrand
Subject: RE: Documents Re: Custodial Bank Proposals

Thanks, Hershel. The Treasurer will be there at 8:30 tomorrow morning to begin. Bill Condon and I will accompany him.....I understand you will be forwarding today the proposed staff confidentiality agreements for our review.....see you then.....Thanks again.....Bill

From: Hershel Harper [<mailto:HHarper@ic.sc.gov>]
Sent: Wednesday, February 01, 2012 5:25 PM
To: Leidinger, Bill; William Blume
Cc: Loftis, Curtis; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Robert Feinstein; Adam Jordan; Tammy Nichols;

Wicker, Karen; Rebecca Gunnlaugsson; Lybrand, Douglas
Subject: RE: Documents Re: Custodial Bank Proposals

Bill,

I have asked Rebecca Gunnlaugsson and Doug Lybrand to participate from the RSIC.

Kind regards,
Hershel

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Monday, January 30, 2012 11:17 AM
To: William Blume; Hershel Harper
Cc: Loftis, Curtis; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Robert Feinstein; Adam Jordan; Tammy Nichols; KAREN WICKER karen.wicker@sto.sc.gov
Subject: Documents Re: Custodial Bank Proposals

Folks, attached are 2 forms regarding confidentiality and conflict of interest that are to be completed by each of the 2 folks from the RS and the IC and the 3 folks from the STO who will be serving on the advisory review panel. Please return the signed copies to Karen Wicker in the STO at your earliest convenience.

Thanks much....Bill

William Leidinger
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State Treasurer's Office
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(803) 734-5063 Office
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Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Thursday, February 02, 2012 10:34 AM
To: Leidinger, Bill
Subject: RE: Documents Re: Custodial Bank Proposals

Hi Bill,

Upon review of the confidentiality agreements I noticed I am being asked to certify that I have received the Advisory Review Panel Briefing Instructions, I have not. I advised Karen Wicker and now you of that fact. Please advise. Thanks.

Douglas Lybrand
803-737-7582

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Thursday, February 02, 2012 9:32 AM
To: Hershel Harper; William Blume
Cc: Loftis, Curtis; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Robert Feinstein; Adam Jordan; Tammy Nichols; KAREN WICKER karen.wicker@sto.sc.gov; Rebecca Gunnlaugsson; Douglas W. Lybrand
Subject: RE: Documents Re: Custodial Bank Proposals

Thanks, Hershel. The Treasurer will be there at 8:30 tomorrow morning to begin. Bill Condon and I will accompany him.....I understand you will be forwarding today the proposed staff confidentiality agreements for our review.....see you then.....Thanks again.....Bill

From: Hershel Harper [<mailto:HHarper@ic.sc.gov>]
Sent: Wednesday, February 01, 2012 5:25 PM
To: Leidinger, Bill; William Blume
Cc: Loftis, Curtis; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Robert Feinstein; Adam Jordan; Tammy Nichols; Wicker, Karen; Rebecca Gunnlaugsson; Lybrand, Douglas
Subject: RE: Documents Re: Custodial Bank Proposals

Bill,

I have asked Rebecca Gunnlaugsson and Doug Lybrand to participate from the RSIC.

Kind regards,
Hershel

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Monday, January 30, 2012 11:17 AM
To: William Blume; Hershel Harper
Cc: Loftis, Curtis; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Robert Feinstein; Adam Jordan; Tammy Nichols; KAREN WICKER karen.wicker@sto.sc.gov
Subject: Documents Re: Custodial Bank Proposals

Folks, attached are 2 forms regarding confidentiality and conflict of interest that are to be completed by each of the 2 folks from the RS and the IC and the 3 folks from the STO who will be serving on the advisory review panel. Please return the signed copies to Karen Wicker in the STO at your earliest convenience.

Thanks much....Bill

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Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Friday, April 06, 2012 2:28 PM
To: 'Leidinger, Bill'
Subject: RE: Draft Agenda for On-Sites

Hi Bill,

I would be interested to learn to what extent the custodians can keep us informed on proxy voting.

I would also be interest in the reporting capabilities surrounding Class Action suits. When are suits filed? What is the extent of our participation? Did we file in time? Did we get paid? When, how much?

It seems to me that Bo has duplicated many issues supposedly covered in the written responses and in-house presentations. I hope we can avoid going over the same thing multiple times and focus on those issues best discerned in their offices.

Given the shortage of time overall, some demos would seem to be a waste of time, like those we have already seen. Some demos I've seen have lasted hours. There are some who may want to see Burgiss more, however (me too). I am also interested in hedge fund transparency and administrative services. Gary Li and I will see another demo on Investor Analytics (BNYM's risk application) in-house next week. Perhaps we could arrange something similar with State Street.

I would also be interested in a better understanding of how Eagle data services (BNYM) could play a role in our operations. Perhaps Eagle could briefly demonstrate/illustrate how other clients use/could use their services. Especially in conjunction with other proposed services.

Also some custody services are so... fundamental. Is it really necessary to demonstrate how the two best in the country perform these duties. A "life of the trade" is admittedly a useful framework, but can we keep it at a high level?

Also let us try and focus on the differences in the (BNYM) offices (Boston or Pittsburg) that could service our private equity, hedge fund and other alternative investments.

These are my thoughts. I hope this is what you are looking for.

Hey Bill, should we start making transportation and lodging arrangements or is someone going to coordinate major parts of that for us? Please advise as we have to jump through hoops on our side. Thanks.

Doug

From: Leidinger, Bill [mailto:Bill.Leidinger@sto.sc.gov]
Sent: Tuesday, April 03, 2012 5:12 PM
To: Abesamis, Bo
Cc: Tammy Nichols; Hershel Harper; Tahiliani, Shakun; Douglas W. Lybrand; Raven, Dinah; McDermott, Mike; Rebecca Gunnlaugsson; Faith Wright; Swilley-Burke, Gwelda; William Blume
Subject: RE: Draft Agenda for On-Sites

Folks, as we discussed with Bo today, please review and add anything you believe should be added from the perspective of your entity and return to me. I will compile in a master edited document which contains all of edits and send to you and Bo.....Please try to have your edits to me by close of business next Tuesday.....Thanks.....Bill

From: Abesamis, Bo [<mailto:abesamis@callan.com>]

Sent: Tuesday, April 03, 2012 4:48 PM

To: Leidinger, Bill

Cc: Tammy Nichols; Harper, Hershel; Tahiliani, Shakun; Lybrand, Douglas; Raven, Dinah; McDermott, Mike; Rebecca Gunnlaugsson; fwright@retirement.sc.gov; Swilley-Burke, Gwelda; wblume@retirement.sc.gov

Subject: Draft Agenda for On-Sites

Bill,

As requested, please see attached draft of the Agenda for the On-sites. Kindly review.

Callan

Bo Abesamis | Executive Vice President
Trust, Custody and Securities Lending Group

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Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Monday, February 13, 2012 2:56 PM
To: Hershel Harper
Subject: RE: Final RFP for custody search

Thanks.

From: Hershel Harper
Sent: Monday, February 13, 2012 2:55 PM
To: Douglas W. Lybrand; Rebecca Gunnlaugsson
Subject: Final RFP for custody search

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Monday, February 13, 2012 3:24 PM
To: 'Leidinger, Bill'
Subject: RE: Meeting re: Review of Custody Proposals

Hi Bill,

I just today received two large and heavy boxes containing the responses to the custody RFP. And, according to the email forwarded to me by Adam Jordan, I am being asked to come prepared for a full discussion by February 29th. Today I also requested and just received a copy of the RFP. But I still have not received the Advisory Review Panel Briefing. As I am being asked to certify that I have received this briefing, it must surely have some bearing on the RFP and the responses I am being asked to evaluate. Will you please provide this document at your earliest convenience. I would hate to read so much material without the proper perspective on this proposal. I appreciate your help.

Respectfully yours,

Douglas W. Lybrand
803-737-7582

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Monday, February 13, 2012 12:57 PM
To: Adam Jordan
Cc: Rebecca Gunnlaugsson; Douglas W. Lybrand
Subject: RE: Meeting re: Review of Custody Proposals

Thanks much.....Bill

From: Adam Jordan [<mailto:AJordan@ic.sc.gov>]
Sent: Monday, February 13, 2012 12:37 PM
To: Leidinger, Bill
Cc: Rebecca Gunnlaugsson; Lybrand, Douglas
Subject: RE: Meeting re: Review of Custody Proposals

Bill,

For ease of communication purposes, can you also copy our advisory panel participants (Rebecca and Doug) on related emails? I've copied them so you would have their addresses.

Thanks,

Adam

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Monday, February 13, 2012 11:10 AM
To: Loftis, Curtis; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Robert Feinstein; Adam Jordan; Tammy Nichols; William Blume; Hershel Harper; Tammy Nichols
Cc: Abesamis, Bo
Subject: Meeting re: Review of Custody Proposals

Folks, we will meet with to review the custody proposals with Bo Abesamis on February 29th from 9AM till 2PM. Bo will present the results of his decision matrix review of the proposals. We will discuss his findings and schedule next steps.

We will meet in State Treasurer's Office conference room on the 2nd floor of the Hampton building. This is the same conference room we previously met in. Please read your copies of the proposals and come prepared for a full discussion.

Please share this with those who will be attending but who may not be included among the above addressees.....Thanks much and happy reading.....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
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Columbia, SC 29201

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(803) 608-2378 Mobile

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Monday, February 13, 2012 1:32 PM
To: Adam Jordan
Subject: RE: Meeting re: Review of Custody Proposals

Adam, can you help me get up to speed on the Custody Proposal? Based on what Hershel told me, Rebecca and I have been selected to help evaluate the Custody proposal. Shortly thereafter I received an email asking me to sign two forms regarding confidentiality and conflict of interest. Upon reading each I learned that I was being asked to certify that I had received the Advisory Review Panel Briefing, which I had not. So I advised Bill Leidinger and Karen Wicker that I had not received any briefing instructions. Bill responded that he would bring them to me but he never did. I mentioned that to him and he said we would take care of things at the appropriate time.

Now I am receiving an email (second hand) stating we will meeting to review the custody proposals with Bo Abesamis on February 29th. Who is Bo Abesamis? I am also being asked to read my copies of the proposals and come prepared for a full discussion. I have never received any proposals nor any responses and have no idea what I am being asked to discuss. As the sheriff in Cool Hand Luke would say, "What we have here is a failure to communicate." Any help would be appreciated.

Doug

From: Adam Jordan
Sent: Monday, February 13, 2012 11:15 AM
To: Rebecca Gunnlaugsson; Douglas W. Lybrand
Subject: FW: Meeting re: Review of Custody Proposals

fyi

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]
Sent: Monday, February 13, 2012 11:10 AM
To: Loftis, Curtis; Condon, Bill; Tahiliani, Shakun; McDermott, Mike; Robert Feinstein; Adam Jordan; Tammy Nichols; William Blume; Hershel Harper; Tammy Nichols
Cc: Abesamis, Bo
Subject: Meeting re: Review of Custody Proposals

Folks, we will met with to review the custody proposals with Bo Abesamis on February 29th from 9AM till 2PM. Bo will present the results of his decision matrix review of the proposals. We will discuss his findings and schedule next steps.

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Please share this with those who will be attending but who may not be included among the above addressees.....Thanks much and happy reading.....Bill

William Leidinger
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State Treasurer's Office
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Columbia, SC 29201

(803) 734-5063 Office
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Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Thursday, July 26, 2012 8:27 AM
To: Sarah Corbett
Subject: RE: Message from KMBT_C452
Attachments: FW: South Carolina

Please advise if you are interested in preliminary drafts which may provide more detail but not final estimated prices.

From: Sarah Corbett
Sent: Thursday, July 26, 2012 8:11 AM
To: Douglas W. Lybrand
Subject: RE: Message from KMBT_C452

For now I would like to see costs from BNY please

From: Douglas W. Lybrand
Sent: Wednesday, July 25, 2012 5:20 PM
To: Sarah Corbett
Subject: RE: Message from KMBT_C452

Do you want costs from everyone? Do you want anything else, like a recommendation? DWL

From: Sarah Corbett
Sent: Wednesday, July 25, 2012 4:43 PM
To: Douglas W. Lybrand
Subject: FW: Message from KMBT_C452

Hi Doug,

Can you please share the cost of the custody services and ancillary services with me?
Thanks!

From: Condon, Bill [mailto:Bill.Condon@sto.sc.gov]
Sent: Wednesday, July 25, 2012 4:26 PM
To: Sarah Corbett
Cc: Dori Ditty; Leidinger, Bill
Subject: FW: Message from KMBT_C452

Here is the accepted agreement. Sarah, I am hoping that Doug, Adam, Hershel, or Rebecca has the info you need. I think every advisory panel member has been given the same info. Let me or Bill L know if you need something that they don't have.

From: copier@sto.sc.gov [mailto:copier@sto.sc.gov]
Sent: Wednesday, July 25, 2012 4:16 PM
To: Condon, Bill
Subject: Message from KMBT_C452

Ashleigh Hollins

From: Leidinger, Bill <Bill.Leidinger@sto.sc.gov>
Sent: Thursday, June 07, 2012 8:21 AM
To: Abesamis, Bo; Swilley-Burke, Gwelda
Cc: Douglas W. Lybrand; Adam Jordan; Tammy Nichols; Faith Wright; Condon, Bill; Tahiliani, Shakun
Subject: FW: South Carolina
Attachments: South Carolina Fee Follow-up June 2012 Final.doc; 060612 Letter Final.pdf

Importance: High

Categories: Custodian

Thanks much, Bo.....we sincerely appreciate your efforts on our behalf....have a great weekend....bill

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Wednesday, June 06, 2012 6:10 PM
To: Leidinger, Bill
Cc: Swilley-Burke, Gwelda
Subject: FW: South Carolina
Importance: High

Bill,

Here is the email on the Fee Clarification Proposal from BNY Mellon.

BO

From: susan.swigor@bnymellon.com [mailto:susan.swigor@bnymellon.com]
Sent: Wednesday, June 06, 2012 8:22 AM
To: Abesamis, Bo
Cc: claire.sonnenberg@bnymellon.com; robert.carroll@bnymellon.com; catherine.wargo@bnymellon.com
Subject: South Carolina

Bo,

As promised, attached please find proposed fees for South Carolina based upon our most recent discussion. Thank you for your time, insight and guidance. We look forward to the next steps.

Kindly,

Susan

Susan D. Swigor, Managing Director • The Bank of New York Mellon
US Asset Servicing • Tel 617.382.2399 • Mobile 617.306.4654 • susan.swigor@bnymellon.com

The information contained in this e-mail, and any attachment, is confidential and is intended solely for the use of the intended recipient. Access, copying or re-use of the e-mail or any attachment, or any information

contained therein, by any other person is not authorized. If you are not the intended recipient please return the e-mail to the sender and delete it from your computer. Although we attempt to sweep e-mail and attachments for viruses, we do not guarantee that either are virus-free and accept no liability for any damage sustained as a result of viruses.

Please refer to <http://disclaimer.bnymellon.com/eu.htm> for certain disclosures relating to European legal entities.

State of South Carolina Retirement Systems

	<u>April Proposal</u>	<u>June Proposal</u>
Domestic Custody & Accounting	\$260,000	\$260,000
<ul style="list-style-type: none"> • Core Services including, but not limited to: safekeeping of assets, trade settlement, income collection, cash processing, accounting, monthly reporting, manager reconciliations, corporate actions, proxy notification, class action processing, regulatory reporting • On-line Reporting (Workbench) • Data Interface with 3rd Party Providers (already established feeds) 		
Global Custody & Accounting		
<ul style="list-style-type: none"> • Above fee for Domestic Custody & Accounting includes: up to \$200 million in active developed global markets & the first 1,000 developed global markets transactions • See attached tiers for any global assets & transactions over the above parameters 		
3 rd Party FX Transactions	\$35 per transaction	\$10 per transaction
Daily Valuation	\$125,000	\$125,000
<ul style="list-style-type: none"> • Provides an audited NAV calculation on a daily basis 		
Private Investment Support	\$125,000	\$125,000
<ul style="list-style-type: none"> • Private i base product • Private i Advanced Analytics • Private informant • Private IQ • Data Management • Capital Call Management • Document Management • Reconciliation Support 		
Performance & Risk Analytics	\$200,000	\$200,000
<ul style="list-style-type: none"> • Monthly Returns to Sector Level • Non-Lagged Performance • Monthly Analytics • Monthly Look-thru Analytics • Daily Analytics • Manager Return Reconciliations • BNYM Universe & Charts • Portfolio Level Attribution • Total Fund Attribution • Daily Compliance 		
TUCS	not quoted	\$15,000
<ul style="list-style-type: none"> • TUCS can also be substituted for BNY Mellon Universe & Charts within the flat P&RA fee 		
Daily Performance	\$75,000	\$75,000

Monthly Investor Analytics	\$140,000	\$140,000
<ul style="list-style-type: none"> • One plan – each additional plan = \$10,000 • Access to Investor Analytics’ fully interactive website • Integration with BNY Mellon in order to aggregate positions into the IA Risk Service • Calculation of VaR and other risk statistical analysis on a single plan, its portfolios and two different reporting hierarchies • Portfolio level correlations • Liability modeling feature • Custom market model creation tool • Market stress and portfolio stress tools • Historical reports 		
Daily Investor Analytics	\$260,000	\$230,000
<ul style="list-style-type: none"> • One plan – each additional plan = \$15,000 • Same access (except on a daily basis) as stated in the Monthly Investor Analytics Service 		
3 rd Party Lending	\$75,000 per lender	\$75,000 per lender
Out of Pocket Fees (stamp duty & re-registration)	pass-through	pass-through
Data Interface with 3 rd Party Providers (new feeds)	not quoted	pass-through
Independent Derivatives Valuation	\$54,000 (unbundled)	\$50,000 (flat)
<ul style="list-style-type: none"> • Monthly independent valuation for OTC derivatives utilizing third party vendors 		
ProxyEdge	not quoted	\$2,500
<ul style="list-style-type: none"> • ProxyEdge Standard – ability to suppress all paper ballots, vote across an entire security as opposed to account by account, maintain SEC compliance 		
Extended Investment Transparency	\$150,000	\$50,000
<ul style="list-style-type: none"> • Normalize & store data • Reporting capabilities • Once the product is out of beta testing mode and in production, the fee will increase to \$150,000 		
Eagle (Assets Under Management not in excess of \$35 billion)		
<ul style="list-style-type: none"> • Investment Data Hub* 	\$418,000	\$380,000
<ul style="list-style-type: none"> • Accounting* 	\$506,000	\$250,000

* Fees do not include implementation costs

State of South Carolina Treasurer’s Office General Account and LGIP

	<u>April Proposal</u>	<u>June Proposal</u>
Domestic Custody & Accounting	\$165,000	\$125,000
<ul style="list-style-type: none"> • Core Services including, but not limited to: safekeeping of assets, trade settlement, income collection, cash processing, accounting, monthly reporting, manager reconciliations, corporate actions, proxy notification, class action processing, regulatory reporting • On-line Reporting (Workbench) • Data Interface with 3rd Party Providers (already established feeds) 		
Performance & Risk Analytics	\$25,000	\$25,000
<ul style="list-style-type: none"> • Monthly Returns to Sector Level • Monthly Analytics • Monthly Look-thru Analytics • Daily Analytics • Manager Return Reconciliations • BNYM Universe & Charts • Portfolio Level Attribution • Total Fund Attribution • Daily Compliance 		
Monthly Investor Analytics	\$20,000	\$20,000
<ul style="list-style-type: none"> • One plan – each additional plan = \$10,000 • Access to Investor Analytics’ fully interactive website • Integration with BNY Mellon in order to aggregate positions into the IA Risk Service • Calculation of VaR and other risk statistical analysis on a single plan, its portfolios and two different reporting hierarchies • Portfolio level correlations • Liability modeling feature • Custom market model creation tool • Market stress and portfolio stress tools • Historical reports 		
Transfer Agency Services*	\$75,000	\$75,000

* Fees do not include implementation costs

Active Global Market Fees

Developed

Tier 1 - 1 bp, \$10 per trade – Australia, Canada, Cedel, Euroclear, France, Germany, Italy, Japan, Netherlands, Sweden, UK

Tier 2 - 3 bps, \$15 per trade – Belgium, Denmark, Finland, Ireland, Mexico, New Zealand, Norway, South Africa, Spain, Switzerland

Tier 3 - 5 bps, \$20 per trade – Austria, Brazil, Greece, Hong Kong, Luxembourg, Malaysia, Portugal, Singapore, South Korea, Thailand, Turkey

Intermediate

Tier 4 - 20 bps, \$50 per trade – Argentina, Bangladesh, Chile, China, Croatia, Czech Rep, Egypt, Estonia, Hungary, India, Indonesia, Israel, Latvia, Lithuania, Philippines, Poland, Russia, Sri Lanka, Taiwan

Tier 5 - 40 bps, \$70 per trade – Bermuda, Cayman Islands, Channel Islands, Colombia, Cyprus, Ecuador, Iceland, Malta, Mauritius, Morocco, Pakistan, Peru, Slovak Republic, Vietnam

Emerging

Tier 6 - 60 bps, \$85 per trade – Botswana, Ghana, Jordan, Kenya, Namibia, Nigeria, Romania, Swaziland, Venezuela, Zambia, Zimbabwe

Tier 7 - 90 bps, \$150 per trade – Bahrain, Benin, Bolivia, Bulgaria, Burkina Faso, Costa Rica, Guinea Bissau, Ivory Coast, Jamaica, Kazakhstan, Kuwait, Lebanon, Mali, Niger, Oman, PAA, Panama, Qatar, Saudi Arabia, Senegal, Serbia, Slovenia, Togo, Trinidad, Tobago, Tunisia, Uganda, Ukraine, UAE, Uruguay



BNY MELLON
ASSET SERVICING

Susan Swigor
Managing Director
BNY Mellon Asset Servicing

(617) 382-2399 Office
(617) 382-2004 Fax

June 6, 2012

Mr. Virgilio Abesamis
Executive Vice President
Callan
101 California Street
San Francisco, CA 94111

Dear Bo,

Thank you for taking time to walk through the South Carolina Fee Schedule with us. We appreciate your feedback and have revised the fee proposal based upon our discussion. Attached please find a document, detailing both individual fees and information regarding specific products and services associated with each fee. Please note the following as you review the information:

- An overall fee reduction of \$174,000 was incorporated.
- A fee of \$380,000 is proposed for the Eagle PACE Data Hub.
- There are two services which also have associated implementation fees, Eagle and Transfer Agency. If South Carolina is interested in these two services, we would suggest further discussion and perhaps an on-site visit to better estimate these costs.

On behalf of the BNY Mellon team, thank you. Subsequent to your review of this information, we would be pleased to discuss further.

Best regards,

Signature Redacted

Attachment

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Wednesday, July 25, 2012 5:20 PM
To: 'Sarah Corbett'
Subject: RE: Message from KMBT_C452

Do you want costs from everyone? Do you want anything else, like a recommendation? DWL

From: Sarah Corbett
Sent: Wednesday, July 25, 2012 4:43 PM
To: Douglas W. Lybrand
Subject: FW: Message from KMBT_C452

Hi Doug,

Can you please share the cost of the custody services and ancillary services with me?
Thanks!

From: Condon, Bill [mailto:Bill.Condon@sto.sc.gov]
Sent: Wednesday, July 25, 2012 4:26 PM
To: Sarah Corbett
Cc: Dori Ditty; Leidinger, Bill
Subject: FW: Message from KMBT_C452

Here is the accepted agreement. Sarah, I am hoping that Doug, Adam, Hershel, or Rebecca has the info you need. I think every advisory panel member has been given the same info. Let me or Bill L know if you need something that they don't have.

From: copier@sto.sc.gov [mailto:copier@sto.sc.gov]
Sent: Wednesday, July 25, 2012 4:16 PM
To: Condon, Bill
Subject: Message from KMBT_C452

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Wednesday, September 05, 2012 11:55 AM
To: Sarah Corbett
Subject: RE: Questions to clarify ancillary serices
Attachments: Custody Ancillary Services.docx

See attached file for more focused version. Let me know if you want me to make any changes. Thanks. Doug

From: Sarah Corbett
Sent: Tuesday, September 04, 2012 9:41 PM
To: Douglas W. Lybrand
Subject: RE: Questions to clarify ancillary serices

Hi Doug,

Thanks for putting this together. Can you try to condense this and come up with key questions that we need to ask? I know this is all important but if we get to have a conversation with Bo, I would like for it to be really focused. Will you please try to narrow it?

Thanks,
Sarah

From: Douglas W. Lybrand
Sent: Thursday, August 30, 2012 10:00 AM
To: Sarah Corbett
Subject: Questions to clarify ancillary serices

I hope the following dialogue is what you're looking for. I found this format better for bringing in those who have not been involved from the beginning. I thought the leading questions were more effective than pages of questions in bullet format.

Also, I did not find the responses to the RFP very useful in addressing our questions. I haven't seen where the RFP asked the questions we're currently addressing. I will look closer but please let me know if I'm missing something.

Can I share this document with others involved with reporting?

Thanks.

Doug



DOUGLAS W. LYBRAND, CFA, CTP, FRM
SENIOR RISK MANAGEMENT OFFICER
P 803.737.7582 | M 803.201.4542 | DLYBRAND@IC.SC.GOV
1201 MAIN STREET | SUITE 1510 | COLUMBIA, SC | 29201
SOUTH CAROLINA RETIREMENT SYSTEM

INVESTMENT COMMISSION

What are the estimated costs of services we currently receive?

Wouldn't it include the following?

Custody Fees	115,527
Transactions	132,498
Monthly return calculations (specify included services)	<u>200,000</u>
	448,025

Please describe each of Burgiss Software's products and services and their associated costs.

Private i	
Private Informant	
Document Management	
Capital Call Management and Reconciliation Support	
Total cost	125,000

How many RSIC employees (FTEs) are essential/recommended to implement/maintain each of the above products/services? What are their recommended skill sets?

Does Burgiss or BNYM provide a project plan and/or project manager to describe and lead the project, its timelines and milestones of implementation?

Please describe the essential stand-alone and bundled capabilities of the Data Warehousing and Investment Portfolio Accounting products/services. How effective is one without the other?

Investment Data Hub	320,000
Investment Accounting	386,000
Bundled Data Hub w Investment Accounting	630,000

How many RSIC employees (FTEs) are essential/recommended to implement/maintain each of the above services? What are their recommended skill sets?

Does Eagle or BNYM provide a project plan and/or project manager to describe and lead the project, its timelines and milestones of implementation?

Please describe any essential and or recommended data interfaces among the custodian - BNYM, Burgiss Software products/services, the Eagle Data Hub, in-bank or not-in-bank investment managers, Strategic Partnerships, overlay managers, administrators, prime brokers, or other parties (like SCRS) or applications (like Bloomberg or Investor Analytics).

Which interfaces have already been created and are available without charge?

Who would bear the costs of creating additional interfaces? What are those estimated costs?

How many RSIC employees (FTEs) are essential/recommended to implement/maintain each of the essential/recommended data interfaces? What are their recommended skill sets?

How many RSIC employees (FTEs) are essential/recommended to implement/maintain an advanced risk system?

Advanced Risk Analytics	140,000
-------------------------	---------

How many data interfaces are essential/recommended to drive this type of application/service (with and without an Investment Data Hub)?

How many RSIC employees (FTEs) are essential/recommended to implement/maintain Hedge Fund transparency and or HF Administrative Services?

Hedge Fund Transparency	150,000
HF Administrative Services	TBD

How many RSIC employees (FTEs) are essential/recommended to implement/maintain other services offered by BNYM without charge, like Compliance?

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Thursday, January 24, 2013 1:50 PM
To: Danny Varat
Subject: RE: RFP
Attachments: FINAL BankSecuritiesRFP.pdf

Normally, I would charge \$6.59, but because you work here... no charge.

From: Danny Varat
Sent: Thursday, January 24, 2013 10:03 AM
To: Douglas W. Lybrand
Subject: RFP

Doug, may I please have a PDF copy of the Custodial Bank RFP? Thanks,

Danny



DANNY VARAT
PUBLIC INFORMATION DIRECTOR
P 803.737.7556 | M 803.528.5554 | DVARAT@IC.SC.GOV
1201 MAIN STREET | SUITE 1510 | COLUMBIA, SC | 29201
SOUTH CAROLINA RETIREMENT SYSTEM

INVESTMENT COMMISSION



State of South Carolina
Request for Proposal

Solicitation Number: [INSERT # IF APPLICABLE]
 Date Issued: December 15, 2011
 Procurement Officer: William J. Leidinger
 Phone: 803 734-5063
 E-Mail Address: bill.leidinger@sto.sc.gov

DESCRIPTION: MASTER CUSTODY BANK AND SECURITIES LENDING SERVICES
 USING GOVERNMENTAL UNIT: STATE TREASURER'S OFFICE

The Term "Offer" Means Your "Bid" or "Proposal". Unless submitted on-line, your offer must be submitted in a sealed package. Solicitation Number & Opening Date must appear on package exterior. See "Submitting Your Offer" provision.

SUBMIT YOUR SEALED OFFER TO EITHER OF THE FOLLOWING ADDRESSES:

MAILING ADDRESS:
 State Treasurer's Office
 Wade Hampton Building
 P.O. Box 11778
 Columbia, SC 29211

PHYSICAL ADDRESS:
 State Treasurer's Office
 1200 Senate Street
 Wade Hampton Building
 Columbia, SC 29202

SUBMIT OFFER BY (Opening Date/Time): **January 15, 2012** (See "Deadline For Submission Of Offer" provision)

QUESTIONS MUST BE RECEIVED BY: **December 15, 2011** (See "Questions From Offerors" provision)

NUMBER OF COPIES TO BE SUBMITTED: **One (1) original in hardcopy and eight (8) copies (marked 'copy')**
Two (2) electronic copies, one(1) as specified Magnetic Media, and one(1) as specified Submitting Redacted Offers.

CONFERENCE TYPE: **Not Applicable**
 DATE & TIME:

LOCATION: **Not Applicable**

(As appropriate, see "Conferences - Pre-Bid/Proposal" & "Site Visit" provisions)

AWARD & AMENDMENTS

Award will be posted on November 23, 2011. The award, this solicitation, any amendments, and any related notices will be posted at the following web address:

<http://www.treasurer.sc.gov/divisions/Pages/Investments.aspx>

Unless submitted on-line, you must submit a signed copy of this form with Your Offer. By submitting a bid or proposal, You agree to be bound by the terms of the Solicitation. You agree to hold Your Offer open for a minimum of sixty (60) calendar days after the Opening Date. (See "Signing Your Offer" and "Electronic Signature" provisions.)

NAME OF OFFEROR
 (full legal name of business submitting the offer)

Any award issued will be issued to, and the contract will be formed with, the entity identified as the Offeror. The entity named as the offeror must be a single and distinct legal entity. Do not use the name of a branch office or a division of a larger entity if the branch or division is not a separate legal entity, i.e., a separate corporation, partnership, sole proprietorship, etc.

AUTHORIZED SIGNATURE
 (Person must be authorized to submit binding offer to contract on behalf of Offeror.)

TAXPAYER IDENTIFICATION NO.
 (See "Taxpayer Identification Number" provision)

TITLE
 (business title of person signing above)

STATE VENDOR NO.
 Required of successful vendor
 (Register to Obtain S.C. Vendor No. at www.procurement.sc.gov)

PRINTED NAME

DATE SIGNED

STATE OF INCORPORATION

(printed name of person signing above)

(If you are a corporation, identify the state of incorporation.)

OFFEROR'S TYPE OF ENTITY: (Check one)

(See "Signing Your Offer" provision.)

Sole Proprietorship

Partnership

Other _____

Corporate entity (not tax-exempt)

Corporation (tax-exempt)

Government entity (federal, state, or local)

COVER PAGE

PAGE TWO

(Return Page Two with Your Offer)

HOME OFFICE ADDRESS (Address for offeror's home office / principal place of business)	NOTICE ADDRESS (Address to which all procurement and contract related notices should be sent.) (See "Notice" clause)
	Area Code - Number - Extension Facsimile
	E-mail Address

PAYMENT ADDRESS (Address to which payments will be sent.) (See "Payment" clause)	ORDER ADDRESS (Address to which purchase orders will be sent) (See "Purchase Orders and "Contract Documents" clauses)
_____ Payment Address same as Home Office Address _____ Payment Address same as Notice Address (check only one)	_____ Order Address same as Home Office Address _____ Order Address same as Notice Address (check only one)

ACKNOWLEDGMENT OF AMENDMENTS
 Offerors acknowledges receipt of amendments by indicating amendment number and its date of issue. (See "Amendments to Solicitation" Provision)

Amendment No.	Amendment Issue Date	Amendment No.	Amendment Issue Date	Amendment No.	Amendment Issue Date	Amendment No.	Amendment Issue Date

DISCOUNT FOR PROMPT PAYMENT (See "Discount for Prompt Payment" clause)	10 Calendar Days (%)	20 Calendar Days (%)	30 Calendar Days (%)	_____ Calendar Days (%)
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PREFERENCES - A NOTICE TO VENDORS: PREFERNCES DO NOT APPLY TO THIS SOLICITATION

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I. SCOPE OF SOLICITATION

The Office of the State Treasurer requires master custody services such as: plan/fund accounting, safekeeping, trade processing, asset servicing, on-line internet access, monthly accounting reports, support of annual GASB reports, corporate actions and proxy processing, and monthly accounting reconciliation with investment managers. All stakeholders are also interested to learn more about your firm's capabilities in the areas of performance measurement and analytics, drill down or fund look through, investment guideline compliance monitoring, risk analytics, alternative investment support, securities lending, and end of day short term cash sweeps and any other middle and back office support services. The resulting master custody services contract will also be utilized by the Retirement Systems and the Investment Commission.

ACQUIRE SERVICES

The purpose of this solicitation is to acquire services complying with the enclosed description and/or specifications and conditions.

MAXIMUM CONTRACT PERIOD - ESTIMATED

Start date: July 1, 2012. End date: June 30, 2017 with an option to renew annually for additional 2 years. Dates provided are estimates only. Any resulting contract will begin on the date specified in the notice of award. See clause entitled "Term of Contract - Effective Date/Initial Contract Period".

II. INSTRUCTIONS TO OFFERORS - A. GENERAL INSTRUCTIONS

DEFINITIONS

EXCEPT AS OTHERWISE PROVIDED HEREIN, THE FOLLOWING DEFINITIONS ARE APPLICABLE TO ALL PARTS OF THE SOLICITATION.

AMENDMENT means a document issued to supplement the original solicitation document.

BUYER means the Procurement Officer.

CHANGE ORDER means any written alteration in specifications, delivery point, rate of delivery, period of performance, price, quantity, or other provisions of any contract accomplished by mutual agreement of the parties to the contract.

CONTRACT See clause entitled Contract Documents & Order of Precedence.

CONTRACT MODIFICATION means a written order signed by the Procurement Officer, directing the contractor to make changes which the changes clause of the contract authorizes the Procurement Officer to order without the consent of the contractor.

CONTRACTOR means the Offeror receiving an award as a result of this solicitation.

COVER PAGE means the top page of the original solicitation on which the solicitation is identified by number. Offerors are cautioned that Amendments may modify information provided on the Cover Page.

OFFER means the bid or proposal submitted in response this solicitation. The terms Bid and Proposal are used interchangeably with the term Offer.

OFFEROR means the single legal entity submitting the offer. The term Bidder is used interchangeably with the term Offeror. See bidding provisions entitled Signing Your Offer and Bid/Proposal as Offer to Contract.

ORDERING ENTITY Using Governmental Unit that has submitted a Purchase Order.

PAGE TWO means the second page of the original solicitation, which is labeled Page Two.

PROCUREMENT OFFICER means the person, or his successor, identified as such on the Cover Page.

PLAN or PLANS or FUNDS mean the Retirement Systems, General Deposit Accounts and Local Government Investment Pool.

YOU and YOUR means Offeror.

SOLICITATION means this document, including all its parts, attachments, and any Amendments.

STAKEHOLDERS means the Office of the State Treasurer, Retirement Systems, and the Investment Commission.

STATE means the Using Governmental Unit(s) identified on the Cover Page.

SUBCONTRACTOR means any person having a contract to perform work or render service to Contractor as a part of the Contractor's agreement arising from this solicitation.

USING GOVERNMENTAL UNIT means the unit(s) of government identified as such on the Cover Page.

WORK means all labor, materials, equipment and services provided or to be provided by the Contractor to fulfill the Contractor's obligations under the Contract.

AMENDMENTS TO SOLICITATION

(a) The Solicitation may be amended at any time prior to opening. All actual and prospective Offerors should monitor the following web site for the issuance of Amendments: <http://www.treasurer.sc.gov> (b) Offerors shall acknowledge receipt of any amendment to this solicitation (1) by signing and returning the amendment, (2) by identifying the amendment number and date in the space provided for this purpose on Page Two, (3) by letter, or (4) by submitting a bid that indicates in some way that the bidder received the amendment. (c) If this solicitation is amended, then all terms and conditions which are not modified remain unchanged.

AWARD NOTIFICATION

Notice regarding any award or cancellation of award will be posted at the location specified on the Cover Page.

BID/PROPOSAL AS OFFER TO CONTRACT

By submitting Your Bid or Proposal, You are offering to enter into a contract with the Using Governmental Unit(s). Without further action by either party, a binding contract shall result upon final award. Any award issued will be issued to, and the contract will be formed with, the entity identified as the Offeror on the Cover Page. An Offer may be submitted by only one legal entity; "joint bids" are not allowed.

BID ACCEPTANCE PERIOD

In order to withdraw Your Offer after the minimum period specified on the Cover Page, You must notify the Procurement Officer in writing.

BID IN ENGLISH and DOLLARS

Offers submitted in response to this solicitation shall be in the English language and in US dollars, unless otherwise permitted by the Solicitation.

STATE TREASURER AS PROCUREMENT AGENT

(a) Authorized Agent. All authority regarding the conduct of this procurement is vested solely with the responsible Procurement Officer AS DESIGNATED BY THE STATE TREASURER. Unless specifically delegated in writing, the Procurement Officer is the only government official authorized to bind the government with regard to this procurement.

(b) Purchasing Liability. The Procurement Officer is an employee of the STATE TREASURER'S OFFICE acting on behalf of the STATE TREASURER. Any contracts awarded as a result of this procurement are between the Contractor and the STATE TREASURER'S OFFICE.

CERTIFICATE OF INDEPENDENT PRICE DETERMINATION

GIVING FALSE, MISLEADING, OR INCOMPLETE INFORMATION ON THIS CERTIFICATION MAY RENDER YOU SUBJECT TO PROSECUTION UNDER SECTION 16-9-10 OF THE SOUTH CAROLINA CODE OF LAWS AND OTHER APPLICABLE LAWS.

(a) By submitting an offer, the offeror certifies that-

(1) The prices in this offer have been arrived at independently, without, for the purpose of restricting competition, any consultation, communication, or agreement with any other offeror or competitor relating to-

- (i) Those prices;
- (ii) The intention to submit an offer; or
- (iii) The methods or factors used to calculate the prices offered.

(2) The prices in this offer have not been and will not be knowingly disclosed by the offeror, directly or indirectly, to any other offeror or competitor before bid opening (in the case of a sealed bid solicitation) or contract award (in the case of a negotiated solicitation) unless otherwise required by law; and

(3) No attempt has been made or will be made by the offeror to induce any other concern to submit or not to submit an offer for the purpose of restricting competition.

(b) Each signature on the offer is considered to be a certification by the signatory that the signatory-

(1) Is the person in the offeror's organization responsible for determining the prices being offered in this bid or proposal, and that the signatory has not participated and will not participate in any action contrary to paragraphs (a)(1) through (a)(3) of this certification; or

(2)(i) Has been authorized, in writing, to act as agent for the offeror's principals in certifying that those principals have not participated, and will not participate in any action contrary to paragraphs (a)(1) through (a)(3) of this certification [As used in this subdivision (b)(2)(i), the term "principals" means the person(s) in the offeror's organization responsible for determining the prices offered in this bid or proposal];

(ii) As an authorized agent, does certify that the principals referenced in subdivision (b)(2)(i) of this certification have not participated, and will not participate, in any action contrary to paragraphs (a)(1) through (a)(3) of this certification; and

(iii) As an agent, has not personally participated, and will not participate, in any action contrary to paragraphs (a)(1) through (a)(3) of this certification.

(c) If the offeror deletes or modifies paragraph (a) (2) of this certification, the offeror must furnish with its offer a signed statement setting forth in detail the circumstances of the disclosure.

CERTIFICATION REGARDING DEBARMENT AND OTHER RESPONSIBILITY MATTERS

(a) (1) by submitting an Offer, Offeror certifies, to the best of its knowledge and belief, that-

(i) Offeror and/or any of its Principals-

(A) Are not presently debarred, suspended, proposed for debarment, or declared ineligible for the award of contracts by any state or federal agency;

(B) Have not, within a three-year period preceding this offer, been convicted of or had a civil judgment rendered against them for: commission of fraud or a criminal offense in connection with obtaining, attempting to obtain, or performing a public (Federal, state, or local) contract or subcontract; violation of Federal or state antitrust statutes relating to the submission of offers; or commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, tax evasion, or receiving stolen property; and

(C) Are not presently indicted for, or otherwise criminally or civilly charged by a governmental entity with, commission of any of the offenses enumerated in paragraph (a)(1)(i)(B) of this provision.

(ii) Offeror has not, within a three-year period preceding this offer, had one or more contracts terminated for default by any public (Federal, state, or local) entity.

(2) "Principals," for the purposes of this certification, means officers; directors; owners; partners; and, persons having primary management or supervisory responsibilities within a business entity (e.g., general manager; plant manager; head of a subsidiary, division, or business segment, and similar positions).

(b) Offeror shall provide immediate written notice to the Procurement Officer if, at any time prior to contract award, Offeror learns that its certification was erroneous when submitted or has become erroneous by reason of changed circumstances.

(c) If Offeror is unable to certify the representations stated in paragraphs (a) (1), Offer must submit a written explanation regarding its inability to make the certification. The certification will be considered in connection with a review of the Offeror's responsibility. Failure of the Offeror to furnish additional information as requested by the Procurement Officer may render the Offeror nonresponsible.

(d) Nothing contained in the foregoing shall be construed to require establishment of a system of records in order to render, in good faith, the certification required by paragraph (a) of this provision. The knowledge and information of an Offeror is not required to exceed that which is normally possessed by a prudent person in the ordinary course of business dealings.

(e) The certification in paragraph (a) of this provision is a material representation of fact upon which reliance was placed when making award. If it is later determined that the Offeror knowingly or in bad faith rendered an erroneous certification, in addition to other remedies available to the State, the Procurement Officer may terminate the contract resulting from this solicitation for default.

EXEMPT PROCUREMENT

On July 13, 1982, The Budget and Control Board exempted the purchase of the following services by governmental bodies from the purchasing procedures and the reporting requirements of the Consolidated Procurement Code: (j) investment services.

On February 14, 2002, the Board also exempted both brokerage services and investment management and advisory services.

COMPLETION OF FORMS/CORRECTION OF ERRORS

All prices and notations should be printed in ink or typewritten. Errors should be crossed out, corrections entered and initialed by the person signing the bid. Do not modify the solicitation document itself (including bid schedule). (Applicable only to offers submitted on paper.)

DEADLINE FOR SUBMISSION OF OFFER

Any offer received after the Procurement Officer of the governmental body or his designee has declared that the time set for opening has arrived, shall be rejected unless the offer has been delivered to the designated purchasing office or the governmental bodies mail room which services that purchasing office prior to the bid opening.

DRUG FREE WORK PLACE CERTIFICATION

By submitting an Offer, Contractor certifies that, if awarded a contract, Contractor will comply with all applicable provisions of The Drug-free Workplace Act, Title 44, Chapter 107 of the South Carolina Code of Laws, as amended.

DUTY TO INQUIRE

Offeror, by submitting an Offer, represents that it has read and understands the Solicitation and that its Offer is made in compliance with the Solicitation. Offerors are expected to examine the Solicitation thoroughly and should request an explanation of any ambiguities, discrepancies, errors, omissions, or conflicting statements in the Solicitation. Failure to do so will be at the Offeror's risk. Offeror assumes responsibility for any patent ambiguity in the Solicitation that Offeror does not bring to the State's attention.

ETHICS CERTIFICATE

By submitting an offer, the offeror certifies that the offeror has and will comply with, and has not, and will not, induce a person to violate Title 8, Chapter 13 of the South Carolina Code of Laws, as amended (ethics act). The following statutes require special attention: Section 8-13-700, regarding use of official position for financial gain; Section 8-13-705, regarding gifts to influence action of public official; Section 8-13-720, regarding offering money for advice or assistance of public official; Sections 8-13-755 and 8-13-760, regarding restrictions on employment by former public official; Section 8-13-775, prohibiting public official with economic interests from acting on contracts; Section 8-13-790, regarding recovery of kickbacks; Section 8-13-1150, regarding statements to be filed by consultants; and Section 8-13-1342, regarding restrictions on contributions by contractor to candidate who participated in awarding of contract. The state may rescind any contract and recover all amounts expended as a result of any action taken in violation of this provision. If contractor participates, directly or indirectly, in the evaluation or award of public contracts, including without limitation, change orders or task orders regarding a public contract, contractor shall, if required by law to file such a statement, provide the statement required by Section 8-13-1150 to the procurement officer at the same time the law requires the statement to be filed.

OMIT TAXES FROM PRICE

Do not include any sales or use taxes in your price that the State may be required to pay.

PUBLIC OPENING

Offers will be publicly opened at the date/time and at the location identified on the Cover Page, or last Amendment, whichever is applicable.

QUESTIONS FROM OFFERORS

(a) Any prospective offeror desiring an explanation or interpretation of the solicitation, drawings, specifications, etc., must request it in writing. Questions must be received by the Procurement Officer no later than five (5) days prior to opening unless otherwise stated on the Cover Page. Label any communication regarding your questions with the name of the procurement officer, and the solicitation's title and number. Oral explanations or instructions will not be binding. Any information given a prospective offeror concerning a solicitation will be furnished promptly to all other prospective offerors as an Amendment to the solicitation, if that information is necessary for submitting offers or if the lack of it would be prejudicial to other prospective offerors. (b) The State seeks to permit maximum practicable competition. Offerors are urged to advise the Procurement Officer -- as soon as possible -- regarding any aspect of this procurement, including any aspect of the Solicitation, that unnecessarily or inappropriately limits full and open competition.

REJECTION/CANCELLATION

The State may cancel this solicitation in whole or in part. The State may reject any or all proposals in whole or in part.

RESPONSIVENESS/IMPROPER OFFERS

(a) Bid as Specified. Offers for supplies or services other than those specified will not be considered unless authorized by the Solicitation.

(b) Multiple Offers. Offerors may submit more than one Offer, provided that each Offer has significant differences other than price. Each separate Offer must satisfy all Solicitation requirements. If this solicitation is an Invitation for Bids, each separate offer must be submitted as a separate document. If this solicitation is a Request for Proposals, multiple offers may be submitted as one document, provided that you clearly differentiate between each offer and you submit a separate cost proposal for each offer, if applicable.

(c) Responsiveness. Any Offer which fails to conform to the material requirements of the Solicitation may be rejected as nonresponsive. Offers which impose conditions that modify material requirements of the Solicitation may be rejected. If a fixed price is required, an Offer will be rejected if the total possible cost to the State cannot be determined. Offerors will not be given an opportunity to correct any material nonconformity. Any deficiency resulting from a minor informality may be cured or waived at the sole discretion of the Procurement Officer.

(d) Price Reasonableness: Any offer may be rejected if the Procurement Officer determines in writing that it is unreasonable as to price.

(e) Unbalanced Bidding. The State may reject an Offer as nonresponsive if the prices bid are materially unbalanced between line items or subline items. A bid is materially unbalanced when it is based on prices significantly less than cost for some work and prices which are significantly overstated in relation to cost for other work, and if there is a reasonable doubt that the bid will result in the lowest overall cost to the State even though it may be the low evaluated bid, or if it is so unbalanced as to be tantamount to allowing an advance payment.

RESTRICTIONS APPLICABLE TO OFFERORS

Violation of these restrictions may result in disqualification of your offer, suspension or debarment, and may constitute a violation of the state Ethics Act. (a) After issuance of the solicitation, all communications must be solely with the Procurement Officer. This restriction may be lifted by express written permission from the Procurement Officer. This restriction expires once a contract has been formed. (b) Unless otherwise approved in writing by the Procurement Officer, *you agree not to give anything to any Using Governmental Unit or its employees, agents or officials prior to award.*

SIGNING YOUR OFFER

Every Offer must be signed by an individual with actual authority to bind the Offeror. (a) If the Offeror is an individual, the Offer must be signed by that individual. If the Offeror is an individual doing business as a firm, the Offer must be submitted in the firm name, signed by the individual, and state that the individual is doing business as a firm. (b) If the Offeror is a partnership, the Offer must be submitted in the partnership name, followed by the words by its Partner, and signed by a general partner. (c) If the Offeror is a corporation, the Offer must be submitted in the corporate name, followed

by the signature and title of the person authorized to sign. (d) An Offer may be submitted by a joint venture involving any combination of individuals, partnerships, or corporations. If the Offeror is a joint venture, the Offer must be submitted in the name of the Joint Venture and signed by every participant in the joint venture in the manner prescribed in paragraphs (a) through (c) above for each type of participant. (e) If an Offer is signed by an agent, other than as stated in subparagraphs (a) through (d) above, the Offer must state that it has been signed by an Agent. Upon request, Offeror must provide proof of the agent's authorization to bind the principal.

STATE OFFICE CLOSINGS

If an emergency or unanticipated event interrupts normal government processes so that offers cannot be received at the government office designated for receipt of bids by the exact time specified in the solicitation, the time specified for receipt of offers will be deemed to be extended to the same time of day specified in the solicitation on the first work day on which normal government processes resume. In lieu of an automatic extension, an Amendment may be issued to reschedule bid opening. If state offices are closed at the time a pre-bid or pre-proposal conference is scheduled, an Amendment will be issued to reschedule the conference. Useful information may be available at:

http://www.scemd.org/scgovweb/weather_alert.html

SUBMITTING CONFIDENTIAL INFORMATION

(An overview is available at www.procurement.sc.gov) For every document Offeror submits in response to or with regard to this solicitation or request, Offeror must separately mark with the word "CONFIDENTIAL" every page, or portion thereof, that Offeror contends contains information that is exempt from public disclosure because it is either (a) a trade secret as defined in Section 30-4-40(a)(1), or (b) privileged and confidential. For every document Offeror submits in response to or with regard to this solicitation or request, Offeror must separately mark with the words "TRADE SECRET" every page, or portion thereof, that Offeror contends contains a trade secret as that term is defined by Section 39-8-20 of the Trade Secrets Act. For every document Offeror submits in response to or with regard to this solicitation or request, Offeror must separately mark with the word "PROTECTED" every page, or portion thereof, that Offeror contends is protected. All markings must be conspicuous; use color, bold, underlining, or some other method in order to conspicuously distinguish the mark from the other text. Do not mark your entire response (bid, proposal, quote, etc.) as confidential, trade secret, or protected. If your response or any part thereof, is improperly marked as confidential or trade secret or protected, the State may, in its sole discretion, determine it nonresponsive. If only portions of a page are subject to some protection, do not mark the entire page. By submitting a response to this solicitation or request, Offeror (1) agrees to the public disclosure of every page of every document regarding this solicitation or request that was submitted at any time prior to entering into a contract (including, but not limited to, documents contained in a response, documents submitted to clarify a response, and documents submitted during negotiations), unless the page is conspicuously marked "TRADE SECRET" or "CONFIDENTIAL" or "PROTECTED", (2) agrees that any information not marked, as required by these bidding instructions, as a "Trade Secret" is not a trade secret as defined by the Trade Secrets Act, and (3) agrees that, notwithstanding any claims or markings otherwise, any prices, commissions, discounts, or other financial figures used to determine the award, as well as the final contract amount, are subject to public disclosure. In determining whether to release documents, the State will detrimentally rely on Offeror's marking of documents, as required by these bidding instructions, as being either "Confidential" or "Trade Secret" or "PROTECTED". By submitting a response, Offeror agrees to defend, indemnify and hold harmless the State of South Carolina, its officers and employees, from every claim, demand, loss, expense, cost, damage or injury, including attorney's fees, arising out of or resulting from the State withholding information that Offeror marked as "confidential" or "trade secret" or "PROTECTED". (All references to S.C. Code of Laws.)

SUBMITTING YOUR OFFER OR MODIFICATION

(a) Offers and offer modifications shall be submitted in sealed envelopes or packages (unless submitted by electronic means) - (1) Addressed to the office specified in the Solicitation; and (2) Showing the time and date specified for opening, the solicitation number, and the name and address of the bidder. (b) If you are responding to more than one solicitation, each offer must be submitted in a different envelope or package. (c) Each Offeror must submit the number of copies indicated on the Cover Page. (d) Offerors using commercial carrier services shall ensure that the Offer is addressed and marked on the outermost envelope or wrapper as prescribed in paragraphs (a)(1) and (2) of this provision when delivered to the office specified in the Solicitation. (e) Facsimile or e-mail offers, modifications, or withdrawals, will not be considered unless authorized by the Solicitation. (f) Offers submitted by electronic commerce shall be considered only if the electronic commerce method was specifically stipulated or permitted by the solicitation.

TAX CREDIT FOR SUBCONTRACTING WITH DISADVANTAGED SMALL BUSINESSES

Pursuant to Section 12-6-3350, a taxpayer having a contract with this State who subcontracts with a socially and economically disadvantaged small business is eligible for an income tax credit equal to four percent of the payments to that subcontractor for work pursuant to the contract. The subcontractor must be certified as a socially and economically disadvantaged small business as defined in Section 11-35-5010 and regulations pursuant to it. The credit is limited to a maximum of fifty thousand dollars annually. A taxpayer is eligible to claim the credit for ten consecutive taxable years beginning with the taxable year in which the first payment is made to the subcontractor that qualifies for the credit. After the above ten consecutive taxable years, the taxpayer is no longer eligible for the credit. A taxpayer claiming the credit shall maintain evidence of work performed for the contract by the subcontractor. The credit may be claimed on Form TC-2, "Minority Business Credit." A copy of the subcontractor's certificate from the Governor's Office of Small and Minority Business (OSMBA) is to be attached to the contractor's income tax return. Questions regarding the tax credit and how to file are to be referred to: SC Department of Revenue, Research and Review, Phone: (803) 898-5786, Fax: (803) 898-5888. Questions regarding subcontractor certification are to be referred to: Governor's Office of Small and Minority Business Assistance, Phone: (803) 734-0657, Fax: (803) 734-2498.

TAXPAYER IDENTIFICATION NUMBER

- (a) If Offeror is owned or controlled by a common parent as defined in paragraph (b) of this provision, Offeror shall submit with its Offer the name and TIN of common parent.
- (b) Definitions: "Common parent," as used in this provision, means that corporate entity that owns or controls an affiliated group of corporations that files its Federal income tax returns on a consolidated basis, and of which the offeror is a member. "Taxpayer Identification Number (TIN)," as used in this provision, means the number required by the Internal Revenue Service (IRS) to be used by the offeror in reporting income tax and other returns. The TIN may be either a Social Security Number or an Employer Identification Number.
- (c) If Offeror does not have a TIN, Offeror shall indicate if either a TIN has been applied for or a TIN is not required. If a TIN is not required, indicate whether (i) Offeror is a nonresident alien, foreign corporation, or foreign partnership that does not have income effectively connected with the conduct of a trade or business in the United States and does not have an office or place of business or a fiscal paying agent in the United States; (ii) Offeror is an agency or instrumentality of a state or local government; (iii) Offeror is an agency or instrumentality of a foreign government; or (iv) Offeror is an agency or instrumentality of the Federal Government.

WITHDRAWAL OR CORRECTION OF OFFER

Offers may be withdrawn by written notice received at any time before the exact time set for opening. If the Solicitation authorizes facsimile offers, offers may be withdrawn via facsimile received at any time before the exact time set for opening. A bid may be withdrawn in person by a bidder or its authorized representative if, before the exact time set for opening, the identity of the person requesting withdrawal is established and the person signs a receipt for the bid.

VENDOR REGISTRATION MANDATORY

After award, Contractor must obtain a state vendor number before payment can be processed by the State of South Carolina. To obtain a state vendor number, visit www.procurement.sc.gov and select New Vendor Registration. (To determine if your business is already registered, go to "Vendor Search"). Upon registration, you will be assigned a state vendor number. Vendors must keep their vendor information current. If you are already registered, you can update your

information by selecting Change Vendor Registration. (Please note that vendor registration does not substitute for any obligation to register with the S.C. Secretary of State or S.C. Department of Revenue. You can register with the agencies at <http://www.scbos.com/default.htm>)

II. INSTRUCTIONS TO OFFERORS -- B. SPECIAL INSTRUCTIONS

BIDDERS

Bidders may not be State employees or State Officials.

CONTENTS OF OFFER (RFP)

- (a) Offers should be complete and carefully worded and should convey all of the information requested.
- (b) Offers should be prepared simply and economically, providing a straightforward, concise description of offeror's capabilities to satisfy the requirements of the RFP. Emphasis should be on completeness and clarity of content.
- (c) Each copy of your offer should be bound in a single volume where practical. All documentation submitted with your offer should be bound in that single volume.
- (d) If your offer includes any comment over and above the specific information requested in the solicitation, you are to include this information as a separate appendix to your offer. Offers which include either modifications to any of the solicitation's contractual requirements or an offeror's standard terms and conditions may be deemed non-responsive and not considered for award.

CLARIFICATION

The Procurement Officer may elect to communicate with you after opening for the purpose of clarifying either your offer or the requirements of the solicitation. Such communications may be conducted only with offerors who have submitted an offer which obviously conforms in all material aspects to the solicitation. Clarification of an offer must be documented in writing and included with the offer. Clarifications may not be used to revise an offer or the solicitation.

DISCUSSIONS and NEGOTIATIONS

Submit your best terms from a cost or price and from a technical standpoint. Your proposal may be evaluated and your offer accepted without any discussions, negotiations, or prior notice. Ordinarily, nonresponsive proposals will be rejected outright. Nevertheless, the State may elect to conduct discussions, including the possibility of limited proposal revisions, but only for those proposals reasonably susceptible of being selected for award. If improper revisions are submitted, the State may elect to consider only your unrevised initial proposal. The State may also elect to conduct negotiations, beginning with the highest ranked offeror, or seek best and final offers. If negotiations are conducted, the State may elect to disregard the negotiations and accept your original proposal.

MAGNETIC MEDIA – REQUIRED FORMAT (Modified)

As noted on the cover page, an original hard copy of your offer must be accompanied by the specified number of copies in the following electronic format: compact disk (CD) in one of the following formats: **CD-R; DVD ROM; DVD-R; or DVD+R**. Formats such as CD-RW, DVD-RAM, DVD-RW, DVD-+RW, or DVIX **are not acceptable** and will result in the Offeror's proposal being rejected. Every CD must be labeled with offeror's name, solicitation number, and specify whether contents address technical proposal or business proposal. If multiple CD sets are provided, each CD in the set must be appropriately identified as to its relationship to the set, e.g., 1 of 2. Each CD must be identical to the original hard copy. File format shall be MS Word 97 or later, or Portable Document Format (.pdf) as one document.

SUBMITTING REDACTED OFFERS

You are required to mark the original copy of your offer to identify any information that is exempt from public disclosure. You must do so in accordance with the clause entitled "Submitting Confidential Information." In addition, you must also submit one complete copy of your offer from which you have removed any information that you marked as exempt, i.e., a redacted copy. The information redacted should mirror in every detail the information marked as exempt from public disclosure. The redacted copy should (i) reflect the same pagination as the original, (ii) show the empty space from which information was redacted, and (iii) be submitted on magnetic media. (See clause entitled "Magnetic Media Required Format.") Except for the redacted information, the CD must be identical to the original hard copy and accessible for reproduction by MMO. Portable Document Format (.pdf) as one document is preferred.

DELIVERY OF PROPOSAL

The State prefers Offerors to use carriers such as FEDEX, UPS or other professional carriers to deliver proposals. Offers delivered by the United States Postal Service or hand delivered to the address on the Cover Page will be accepted if requirements of submission are met.

OPENING PROPOSALS - PRICES NOT DIVULGED

In competitive sealed proposals, prices will not be divulged at opening.

DELIVER PROPOSALS TO:

SC State Treasurer's Office
1200 Senate Street
Wade Hampton State Office Building
Room 205

Attn: Shakun Tahiliani

III. SCOPE OF WORK AND SPECIFICATIONS

Overview

The South Carolina Retirement Systems administers five (5) defined benefit pension plans that provide lifetime service retirement benefits, as well as disability benefits and death benefits to eligible members and/or their surviving beneficiaries. The Plans are specified below.

- The South Carolina Retirement System (SCRS) was established July 1, 1945, to provide retirement and other benefits for teachers and employees of the state and its political subdivisions. SCRS covers employees of public school districts, higher education institutions, and other participating local subdivisions of government.
- The Police Officers Retirement System (PORS) was established July 1, 1962, to provide retirement and other benefits to police officers and firefighters. PORS also covers peace officers, coroners, probate judges and magistrates.
- The Retirement System for Members of the General Assembly of the State of South Carolina (GARS) was established January 1, 1966, to provide retirement and other benefits to members of the General Assembly.
- The Retirement System for Judges and Solicitors of the State of South Carolina (JSRS) was established July 1, 1979, to provide retirement and other benefits to state judges and solicitors. JSRS also covers circuit public defenders.
- The National Guard Retirement System (NGRS) was established July 1, 1975, to provide supplemental retirement benefits to members who served in the South Carolina National Guard.

The State Treasurer is the custodian of public funds for the State of South Carolina and the defined benefit pension funds administered by the South Carolina Retirement Systems. State funds are managed and invested by the Office of State Treasurer (“State Treasurer”) while pension funds are administered and accounted for by the South Carolina Retirement Systems (“Retirement System”) and invested by the Retirement System Investment Commission (“Commission”).

As custodian, the State Treasurer is coordinating with other stakeholders in the review, evaluation, and selection of global custodial banking services and securities lending services. These stakeholders are : 1) the Office of the State Treasurer, which invests public funds for the state of South Carolina and manages a Local Government Investment Pool; 2) the Retirement System Investment Commission, which is responsible for investing the assets of five defined benefit pension plans operating under the law; and 3) the South Carolina Retirement Systems, which administers the five pension plans, provides financial accounting and reporting for the pension trust funds and is the official book of record for these pension funds. The State Treasurer is seeking a global custodian and securities lending agent(s) who are best able to meet the general and specific duties and responsibilities of each stakeholder in managing, investing, and accounting of funds.

We invite your organization to visit State of South Carolina at www.treasurer.sc.gov, www.retirement.sc.gov and www.rsic.sc.gov for all relevant information regarding the Office of the State Treasurer, Retirement Systems, and the Investment Commission, accordingly.

Investment Structure and Asset Pools

Office of the State Treasurer: The Office of the State Treasurer is responsible for the management of the State General Account and the Local Government Investment Pool (LGIP). As of June 30, 2011, the General Account and the LGIP had a market value of \$7.3 billion and \$2.7 billion, respectively. The table below enumerates the account structure of the General Account and LGIP.

Account Name	Investments	Securities Lending Participation
GENERAL DEPOSIT-BLOCK TRADING	Fixed Income	No
GENERAL FUND	Fixed Income	Yes
ORDINARY SINKING FUND	Fixed Income	Yes

INSURANCE RESERVE FUND	Fixed Income	Yes
STATE INVESTMENT POOL	Fixed Income	Yes
LONG TERM POOL	Fixed Income	Yes
TREASURY FUND	Fixed Income	Yes
EDUCATIONAL IMPROVEMENT ACT OF 1984	Fixed Income	No
TREASURER - LOCAL GOVT INV POOL	Fixed Income	Yes
FED STUDENT LOAN RESERVE FUND	Fixed Income	No
AGENCY OPERATING FUND	Fixed Income	No
TUITION - PREPAID PROGRAM	Fixed Income	Yes
TUITION - NIB	Fixed Income	No
LTDI TRUST FUND	Fixed Income	Yes
SCRHI TRUST FUND	Fixed Income	Yes
SCTO - CASH MANAGER	Available Cash; REPO BALANCE	No

South Carolina Retirement Systems: As of June 30, 2011, the Retirement Systems had a market value of \$26 billion. The Systems are invested in multiple asset classes. The table below lists the investment structure to date.

Account Name	Account Type	Investments	Sec Lending Participant
TIMES SQUARE CAPITAL MANAGEMENT	Manager Directed	Common Stocks	Yes
PYRAMIS (FIDELITY)	Manager Directed	Common Stocks	Yes
TURNER INVESTMENTS	Manager Directed	Common Stocks	Yes
TSW	Manager Directed	Common Stocks	Yes

INTEGRITY	Manager Directed	Common Stocks	Yes
ARONSON	Manager Directed	Common Stocks	Yes
RUSSELL SM-MID CAP TRANSITIONS	Manager Directed	Equities - Transition Account	No
RUSSELL LARGE CAP TRANSITIONS	Manager Directed	Equities - Transition Account	No
DIMENSIONAL FUND ADVISORS	Commingled	Emerging Markets Equity	No
SCHRODERS	Commingled	Emerging Markets Equity	No
CAPITAL INTERNATIONAL	Commingled	Emerging Markets Equity	No
WILLIAM BLAIR	Commingled	Emerging Markets Equity	No
LSV ASSET MANAGEMENT	Commingled	Emerging Markets Equity	No
ABERDEEN	Commingled	Emerging Markets Equity	No
RUSSELL - OVERLAY	Manager Directed	Futures; Currency FX; US T-Bills; TBA's; Available Cash; Daily VM's paid from this account	No
RUSSELL - SWAPS	Manager Directed	One Account that will post all SWAP trades in all asset classes and with different counter-parties	No
RUSSELL - BARCLAYS COLLATERAL		Broker Pledged Collateral held by BNYM	No
RUSSELL - MORGAN STANLEY COLLATERAL		Broker Pledged Collateral held by BNYM	No
RUSSELL - CREDIT SUISSE COLLATERAL		Broker Pledged Collateral held by BNYM	No
RUSSELL - JP MORGAN COLLATERAL		Broker Pledged Collateral held by BNYM	No
RUSSELL - DEUTSCHE BANK COLLATERAL		Broker Pledged Collateral held by BNYM	No
RUSSELL - UBS COLLATERAL		Broker Pledged Collateral held by BNYM	No
RUSSELL - BNP PARIBAS COLLATERAL		Broker Pledged Collateral held by BNYM	No
RUSSELL - MERRILL LYNCH		Broker Pledged Collateral held by BNYM	No
RUSSELL - SOCIETE' GENERALE		Broker Pledged Collateral held by BNYM	No
AQUILINE CAPITAL MANAGEMENT	Ltd Partnership	Aquiline Financial Services Fund LP	No
PANTHEON USA	Ltd Partnership	Pantheon USA Fund VII, LP	No
PANTHEON EUROPE	Ltd Partnership	Pantheon Europe Fund V (GLOBAL)	No
APAX EUROPE VII	Ltd Partnership	APAX Europe VII Fund (GLOBAL)	No
BRIDGEPOINT EUROPE IV	Ltd Partnership	Bridgepoint Europe IV, LP	No

CAROUSEL CAPITAL PART'S FUND III LP	Ltd Partnership	Carousel Capital Partners III, LP	No
CRESTVIEW PE	Ltd Partnership	Crestview Capital Partners LP	No
PAUL CAPITAL PARTNERS PE	Ltd Partnership	Paul Capital Partners IX LP	No
WARBURG PINCUS PE	Ltd Partnership	Warburg Pincus X LP	No
TRUEBRIDGE CAPITAL PE	Ltd Partnership	CVE Endowment Fund I LP	No
CLAYTON, DUBILIER & RICE PE	Ltd Partnership	Clayton Dubilier & Rice VIII LP	No
LEXINGTON PARTNERS PE	Ltd Partnership	Lexington Capital Partners LP	No
GOLDMAN SACHS MEZZ	Ltd Partnership	GS Mezzanine Partners V LP	No
SQUARE 1 VENTURES PE	Ltd Partnership	Square 1 Ventures LP	No
NORTHSTAR CAPITAL PE	Ltd Partnership	Northstar Mezzanine Partners V LP	No
NEUBERGER BERMAN	Ltd Partnership	NB Secondary Oppty II	No
WELSH CARSON	Ltd Partnership	Welsh Carson & Stowe XI LP	No
VENTURE INVESTMENT MANAGERS LP	Ltd Partnership	Venture Investment Managers LP	No
INDUSTRY VENTURES	Ltd Partnership	Industry Ventures Fund V LP	No
TRUEBRIDGE CAPITAL II	Ltd Partnership	CVE Endowment Fund I LP	No
AQUILINE CAPITAL MANAGEMENT II	Ltd Partnership	Aquiline Financial Services Fund LP	No
AZALEA CAPITAL	Ltd Partnership	The Azalea Fund III, L.P.	No
LEXINGTON PARTNERS VII	Ltd Partnership	Lexington Capital Partners LP	No
RANIERI - SC CONDUIT	Ltd Partnership	SC Financing Conduit LLC	No
INDUSTRY VENTURES VI	Ltd Partnership	SC Private Equity LP	No
CAROUSEL CAPITAL PARTNERS IV	Ltd Partnership	SC Private Equity LP	No
TRUEBRIDGE 2 SIDECAR	Ltd Partnership	CVE Endowment Fund I LP	No
AQUILINE CO-INVEST	Ltd Partnership	Aquiline Financial Services Fund LP	No
AZALEA SIDECAR	Ltd Partnership	The Azalea Fund III, L.P.	No
LEXINGTON II SIDECAR	Ltd Partnership	Lexington Capital Partners LP	No
AQUILINE II CO-INVEST	Ltd Partnership	Aquiline Financial Services Fund LP	No
RANIERI - SC CO-INVESTMENT PARTNERSHIP	Ltd Partnership	Ranieri	No
TORCHLIGHT	Ltd Partnership	ING Clarion Debt Opportunity Fund III	No
US REIF COLUMBIA	Commingled Fund	US REIF Columbia	No
LONESTAR	Ltd Partnership	LONESTAR	No
CARLYLE	Ltd Partnership	Carlyle	No
OCH-ZIFF	Ltd Partnership	OCH-ZIFF	No
GREYSTAR	Ltd Partnership	Greystar	No
LOOMIS SAYLES GLOBAL FIXED INCOME.	Commingled Fund	Loomis Collective Investment Trust	No
MONDRIAN GLOBAL FIXED INCOME	Commingled Fund	Mondrian Global Fixed Income	No
WAMCO GLOBAL FIXED INCOME	Commingled Fund	Western Asset Global Multi-Strategy	No

LOOMIS SAYLES HIGH YIELD	Commingled Fund	Loomis Sayles High Yield Inv Trust	No
PIMCO FIXED	Manager Directed	Fixed Income Securities	Yes
BLACKROCK FIXED	Manager Directed	Fixed Income Securities	Yes
POST - HIGH YIELD	Manager Directed	Fixed Income Securities	Yes
PENN - HIGH YIELD	Manager Directed	Fixed Income Securities	Yes
JAMISON EATON & WOOD	Manager Directed	Fixed Income Securities	Yes
STRATEGOS	Manager Directed	Fixed Income Securities	Yes
POST LIMITED TERM HIGH YIELD	Manager Directed	Fixed Income Securities	Yes
CAP GUARDIAN	Commingled Fund	Emerging Markets Fixed Income Fd	No
TCW FIXED INCOME TRANSITION	Manager Directed	Fixed Income-Transition Account	Yes
MARINER FIXED INCOME TRANSITION	Manager Directed	Fixed Income-Transition Account	Yes
PIMCO FIXED INCOME TRANSITION	Manager Directed	Fixed Income-Transition Account	Yes
BLACKROCK TRANSITION	Manager Directed	Fixed Income-Transition Account	Yes
BRIDGEWATER	Commingled Fund	Pure Alpha Fund II Series CXLI	No
MORGAN STANLEY	Commingled Fund	Thirteen (12) Funds as of 08/31/2009	No
GAM PURE ALPHA STRATEGY	Commingled Fund	GAM USA Inc	No
EN TRUST PURE ALPHA STRATEGY	Commingled Fund	Deutsche Bank (Cayman) Limited	No
GROSVENOR PURE ALPHA STRATEGY	Commingled Fund	Grosvenor Pure Alpha Strategy Fund	No
GOTTEX MKT NEUTRAL PLUS PORT ALPHA	Commingled Fund	GOTTEX Market Neutral Plus	No
WL ROSS	Commingled Fund	Absolute Recovery Hedge Fund LP	No
LOOMIS SAYLES CREDIT L/S	Commingled Fund	L/S FUND	No
CHILTON	Hedge Fund	Chilton Investment Company	No
BRIDGEWATER - MAJOR MARKETS II	Hedge Fund	Bridgewater	No
MORGAN STANLEY TRANSITION	Manager Directed	LP Fund Transition Account	No
AVENUE CAPITAL	Ltd Partnership	Avenue Capital LP	Yes
ANGELO GORDON	Ltd Partnership	Angelo Gordon LP	No
SANKATY	Ltd Partnership	Sankaty Credit Opportunities IV	No
SELENE	Ltd Partnership	Selene Residential Mortgage LP	No
DE SHAW OPPORTUNITY	Ltd Partnership	DE Shaw Strategic Partnership	No
WL ROSS - WHOLE LOANS (PIIP)	Ltd Partnership	WL Ross PIPP Fund	No
SELENE II	Ltd Partnership	Selene Residential Mortgage LP	No
AVENUE CAPITAL US FUNDS	Ltd Partnership	Avenue Special Situations Fund VI	No

STRATEGIC PARTNERSHIP- TRANSITION		Transition Account	No
MS - HIGH YIELD FIXED INCOME			No
MS - HEDGE FUNDS			No
MS - REAL ASSETS			No
MS - PRIVATE MARKETS			No
MS - OPPORTUNISTIC CREDIT			No
MS - CASH & OTHER			No
TCW - HIGH YIELD FIXED INCOME			No
TCW - HEDGE FUNDS			No
TCW - REAL ASSETS			No
TCW - PRIVATE MARKETS			No
TCW - OPPORTUNISTIC CREDIT			No
TCW - CASH & OTHER			No
MARINER - HIGH YIELD FIXED INCOME			No
MARINER - HEDGE FUNDS			No
MARINER - REAL ASSETS			No
MARINER - PRIVATE MARKETS			No
MARINER - OPPORTUNISTIC CREDIT			No
MARINER - CASH & OTHER			No
MARINER - SHORT DURATION			No
JPM - HIGH YIELD FIXED INCOME			No
JPM - HEDGE FUNDS			No
JPM - REAL ASSETS			No
JPM - PRIVATE MARKETS			No
JPM - OPPORTUNISTIC CREDIT			No
JPM - CASH & OTHER			No
APOLLO - HIGH YIELD FIXED INCOME			No
APOLLO - HEDGE FUNDS			No
APOLLO - REAL ASSETS			No
APOLLO - PRIVATE MARKETS			No
APOLLO - OPPORTUNISTIC CREDIT			No
APOLLO - CASH & OTHER			No
APOLLO - SHORT DURATION			No
APOLLO - CORE FIXED INCOME			No
GS - HIGH YIELD FIXED INCOME			No
GS - HEDGE FUNDS			No
GS - REAL ASSETS			No

GS - PRIVATE MARKETS			No
GS - OPPORTUNISTIC CREDIT			No
GS - CASH & OTHER			No
GS - SHORT DURATION			No
GS - GTAA			No
DE SHAW - HIGH YIELD FIXED INCOME			No
DE SHAW - HEDGE FUNDS			No
DE SHAW - REAL ASSETS			No
DE SHAW - PRIVATE MARKETS			No
DE SHAW - OPPORTUNISTIC CREDIT			No
DE SHAW - CASH & OTHER			No
RESERVOIR - HIGH YIELD FIXED INCOME			No
RESERVOIR - HEDGE FUNDS			No
RESERVOIR - REAL ASSETS			No
RESERVOIR - PRIVATE MARKETS			No
RESERVOIR - OPPORTUNISTIC CREDIT			No
RESERVOIR - CASH & OTHER			No
GSO - HIGH YIELD FIXED INCOME			No
GSO - HEDGE FUNDS			No
GSO - REAL ASSETS			No
GSO - PRIVATE MARKETS			No
GSO - OPPORTUNISTIC CREDIT			No
GSO - CASH & OTHER			No
GSO - CORE FIXED INCOME			No
LH - HIGH YIELD FIXED INCOME			No
LH - HEDGE FUNDS			No
LH - REAL ASSETS			No
LH - PRIVATE MARKETS			No
LH - OPPORTUNISTIC CREDIT			No
LH - CASH & OTHER			No
ENT-HIGH YLD FXD INC			No
ENT-HEDGE FUND			No
ENT-REAL ASSETS			No
ENT-PRIVATE MARKETS			No
ENT-OPPORTUNISTIC CR			No
ENT-CASH & OTHER			No
GSN-HIGH YLD FXD INC			No

GSN-HEDGE FUND			No
GSN-REAL ASSETS			No
GSN-PRIVATE MARKETS			No
GSN-OPPORTUNISTIC CR			No
GSN-CASH & OTHER			No
BKS-HIGH YLD FXD INC			No
BKS-HEDGE FUND			No
BKS-REAL ASSETS			No
BKS-PRIVATE MARKETS			No
BKS-OPPORTUNISTIC CR			No
BKS-CASH & OTHER			No
RAN-HIGH YLD FXD INC			No
RAN-HEDGE FUND			No
RAN-REAL ASSETS			No
RAN-PRIVATE MARKETS			No
RAN-OPPORTUNISTIC CR			No
RAN-CASH & OTHER			No
AVE-HIGH YLD FXD INC			No
AVE-HEDGE FUND			No
AVE-REAL ASSETS			No
AVE-PRIVATE MARKETS			No
AVE-OPPORTUNISTIC CR			No
AVE-CASH & OTHER			No
GMO STRATEGIC OPPORTUNITY	Commingled Fund	GMO Strategic Opportunity Allocation	No
PUTNAM GLOBAL TACTICAL ASSET	Commingled Fund	Putnam Global	No
BRIDGEWATER GLOBAL TACTICAL ASSET	Commingled Fund	Bridgewater All Weather Portfolio	No
GMO MULTI-STRATEGY	Commingled Fund	GMO Multi-Strategy Fund	No
SCRS INTERNAL CASH	Cash	Various	No
SCRS FIXED INCOME POOL - MTA	Fixed Income	Various	Yes
SCRS SHORT DURATION -1 TO 3	Fixed Income	Short Duration Bonds	Yes
SCRS INTERNAL FI - SEC LENDING	Cash	Various	No
SEC LENDING REVENUE	Cash	Various	No
SOUTH CAROLINA RETIREMENT SYSTEM	PLAN	UNITS of the MTA	No
RETIREMENT - 2% CASH ACCOUNT	Cash	Other Short-Term Investments	No

RETIREMENT CASH - NIB	Cash	Tri-Party REPOS	No
POLICE OFFICERS RETIREMENT TRUST	PLAN	UNITS of the MTA	No
POLICE - 2% CASH ACCOUNT	Cash	Other Short-Term Investments	No
POLICE CASH - NIB	Cash	Tri-Party REPOS	No
JUDGES & SOLICITORS OF STATE OF SC	PLAN	UNITS of the MTA	No
JUDGES & SOLICITORS - 2% CASH ACCOUNT	Cash	Other Short-Term Investments	No
JUDGES CASH - NIB	Cash	Tri-Party REPOS	No
MEMBERS OF THE GENERAL ASSEMBLY	PLAN	UNITS of the MTA	No
GENERAL ASSEMBLY - 2% CASH ACCOUNT	Cash	Other Short-Term Investments	No
GEN ASSEMBLY CASH - NIB	Cash	Tri-Party REPOS	No
NATIONAL GUARD RETIREMENT SYSTEM	PLAN	UNITS of the MTA	No
NATIONAL GUARDS - 2% CASH ACCOUNT	Cash	Other Short-Term Investments	No
NAT GUARDS CASH - NIB	Cash	Tri-Party REPOS	No
SCRS - CASH MANAGER	Internally Managed	Available Cash; REPO BALANCE	No
SCRS - RESIDUAL ASSETS	Internally Managed	Residual Assets - Terminated Accounts	No
MCM - DAILY GLOBAL ALPHA I	Commingled Fund	<i>Fund Liquidated 05/1/2009</i>	
BENSON (WELLS CAPITAL)	Manager Directed	<i>Manager Terminated 7/22/10</i>	
BATTERYMARCH	Terminated		
PZENA	Terminated	<i>Manager Terminated 08/25/08</i>	
WCM	Manager Directed	<i>Manager Terminated 6/22/10</i>	
LEGG MASON	Manager Directed	<i>Manager Terminated 6/22/10</i>	
CLARIVEST	Manager Directed	<i>Manager Terminated 6/21/10</i>	
BGI S&P ALPHA TILTS	Terminated	<i>Fund Liquidated 08/1/2008</i>	
RUSSELL 2000 INDEX	Terminated	<i>Fund Liquidated 07/22/2008</i>	
STATE STREET S&P 500 FLAGSHIP	Terminated	<i>Fund Liquidated 07/22/2008</i>	
BGI EAFE	Terminated	<i>Fund Liquidated 10/20/2008</i>	
TCW PRIVATE EQUITY	Ltd Partnership	<i>Transferred to RSOF6751152</i>	
TCW-CRESCENT MEZZ PE	Ltd Partnership	<i>Transferred to RSOF6751142</i>	
DE SHAW	Commingled Fund	<i>Transferred to RSOF6751622</i>	
FRONTPOINT	Commingled Fund	Frontpoint Multi-Strategy Fund	
MARINER	Commingled Fund	<i>Transferred to RSOF6751222</i>	
MS STRATEGIC PARTNER	Commingled Fund	<i>Transferred to Various SP Accounts</i>	
JP MORGAN STRATEGIC PARTNERS	Commingled Fund	<i>Account Not Used</i>	

GOLDMAN SACHS STRATEGIC PARTNERS	Commingled Fund	<i>Account Not Used</i>	
TCW STRATEGIC PARTNER	Commingled Fund	<i>Transferred to RSOF6751142</i>	
MARINER STRATEGIC PARTNER	Commingled Fund	<i>Account Not Used</i>	
DE SHAW OPPORTUNISTIC	Ltd Partnership	Transferred to RSOF6751652-REOPENED	
CREDIT AGRICOLE GLOBAL FIXED INCOME	Commingled Fund	<i>Closed 9/6/11</i>	
KAPLAN	Terminated		
SC TRANSITION A/C	Terminated		
SC TRANSITION	Terminated		
WELLINGTON MANAGEMENT	Terminated		
SANFORD C BERNSTEIN & CO	Terminated		
FLIPPEN BRUCE & PORTER	Terminated		
ALLIANCE	Terminated		
APPLEGATE	Terminated		
SANDS	Terminated		
SC TRANSITION A/C 2	Terminated		
US EQUITY TRANSITION	Terminated		
CVC EUROPE V	Terminated	<i>Investment Mandate revoked</i>	

General Service Requirements

The Office of the State Treasurer requires master custody services such as: plan/fund accounting, safekeeping, trade processing, asset servicing, on-line internet access, monthly accounting reports, support of annual GASB reports, corporate actions and proxy processing, and monthly accounting reconciliation with investment managers. All stakeholders are also interested to learn more about your firm's capabilities in the areas of performance measurement and analytics, drill down or fund look through, investment guideline compliance monitoring, risk analytics, alternative investment support, securities lending, and end of day short term cash sweeps. The stakeholders would like to keep track of all investments via advanced, user-friendly internet platform. A more robust reporting engine would be ideal. The custody bank is required to provide support for regulatory and GASB 28, 40, 53, etc. reporting requirements. Please note that State of South Carolina utilizes SAP G/L for the maintenance of accounting and investment records. The Retirement System prefers to have a general ledger interface to expedite the transfer of records and the gain efficiencies.

Performance measurement should include rate of return calculations (time weighted and internal rate of return), universe & style group comparisons, portfolio characteristics relative to a benchmark, portfolio attribution, and risk adjusted rate of return statistics – Treynor ratio, Information ratio, Jensen's Alpha, Downside Risk Analysis and other relevant measures. Please note that all level of analytics and return calculations should be available at the total fund, asset class, composite, manager/portfolio levels.

Another objective is to improve risk management and the investment oversight of the plans and/or funds. Consolidated reporting at the aggregate and asset class level for both custodied and non-custodied accounts is essential to effectuate a more robust risk management and investment oversight platform. Drill down or shadow accounting would be critical to both commingled funds/partnerships and mutual funds. Weekly "not in bank" asset collateral pricing is required and consolidated reporting of all cash balances both custodied and non-custodied accounts. The Investment Commission would like to fully understand your alternative investment administration support services for private equity, hedge funds, fund of funds, overlay, commodities, real estate, derivatives, and other investible asset classes. Your ability to provide solutions around capital call management and document management services would be given important consideration. In addition, the Investment Commission and the Retirement System use QED for limited investment portfolio management tracking of the internally managed cash/fixed-income accounts. Information feeds are necessary to be uploaded to QED.

The stakeholders would like to review your organization's securities lending program. The stakeholders want to understand how your organization mitigates risks from securities lending and the underlying risk/reward trade-off in participating in

your program.

The stakeholders realize that there are costs associated with a conversion or transition to a new service provider. The stakeholders do not want to incur such costs if a decision is made to move to a new custodian solution. Most importantly, the stakeholders expect a competitive fee structure for all participating plans or asset pools.

The stakeholders' requirements hinge on seven crucial elements: Commitment and Experience, Stability of Core Custody and Accounting Systems, Proactive Investment Manager Reconciliation Process, Smart and User Friendly On-line Interface, Robust Performance and Analytical Tools, Alternative Investment Support, and Intelligent Client Servicing. We believe that a best in class, best practice and partnership approach is beneficial to the State of South Carolina.

The State Treasurer's Office has engaged Callan Associates to assist and provide guidance in the Custody Search and Due Diligence process. Your organization's participation, effort and commitment of resources are greatly appreciated. When responding to this request, we encourage you to describe the ways in which you believe your organization's service capability is unique or would add particular value. Please be succinct in your answers and, if certain services cannot be provided, please so state where appropriate.

IV. TECHNICAL RESPONSE - INFORMATION FOR OFFERORS TO SUBMIT

INFORMATION FOR OFFERORS TO SUBMIT -- GENERAL

Offeror shall submit a signed Cover Page and Page Two. Offeror should submit all other information and documents requested in this part and in parts II.B. Special Instructions; III. Scope of Work; V. Qualifications; VIII. Bidding Schedule/Price Proposal; and any appropriate attachments addressed in section IX. Attachments to Solicitations.

In addition to information requested elsewhere in this solicitation, offerors should submit the following information for purposes of evaluation.

Please indicate which proposal you are participating in (check all that apply):

- Custody with Securities Lending**
- Custody with No Securities Lending**
- Stand Alone Securities Lending**

NOTE:

(A) Firms electing to submit a bundled (custody with securities lending) response should complete Custody and Safekeeping Services, Securities Lending Services and the Cost Proposal both Custody and Securities Lending Costs/Fees.

(B) Firms electing to submit a custody only bid should complete the Custody and Safekeeping Services and the Cost Proposal for Custody and Related Fees Only.

(C) Firms electing to submit a securities lending only bid should complete Securities Lending Services and the Cost Proposal for Securities Lending Costs and Fees Only.

CUSTODY AND SAFEKEEPING SERVICES

A. Experience

- 1) State your firm's lines of business. Where does custody of retirement plans fit within the organization as a service or product offering?
- 2) List the office location (primary and secondary) from which the work is to be delivered.
- 3) Please provide the number of tax-exempt clients and the aggregate market value as of June 30, 2011.
- 4) What is the approximate revenue contribution of your Institutional Trust and Custody Business to overall company revenue in percentage terms?
- 5) Are there any current organizational issues (i.e., mergers, acquisitions, personnel changes, business concerns, etc.) at your institution that we should know about? Have there been any organizational issues over the last three years?
- 6) Describe in detail any potential conflicts of interest your firm may have in the management of the Funds/Plans account, or in the alternative, state that no potential conflicts exist.
- 7) Describe the objectives of your firm with respect to future growth, commenting on new products or services, additional resources, and size limitations. Explain your firm's goals and desires for expansion, particularly how such goals pertain to accepting new client business and the quality of service to all clients. Is there a limit to the number of new clients your firm will accept? At what point will your firm need to add additional staff?
- 8) Provide the number of your organization's clients as categorized in the following matrix. Report aggregate values of their total assets under custody in US\$ millions for periods specified.

Total Tax Exempt Trust and Custody Clients Only

	Total Number of Clients	Asset Value (US\$ millions)
2006		
2007		

2008		
2009		
2010		
2011 (YTD)		

- 9) Provide the number of your organization's clients as categorized in the following matrix. Report aggregate values of their total assets under custody in US\$ millions for periods specified.

Public Fund Custody Clients Only

	Total Number of Clients	Asset Value (US\$ millions)
2006		
2007		
2008		
2009		
2010		
2011 (YTD)		

- 10) Provide the number of **tax-exempt trust and custody accounts**, including global custody clients, gained and/or lost for the periods listed in the following matrix. Report corresponding market values in US\$ millions as of initiation date for clients gained and termination date for clients lost.

Total Trust and Custody Clients Only

	Clients Gained (Number)	Clients Gained (US\$ millions)	Clients Lost (Number)	Clients Lost (US\$ millions)
2006				
2007				
2008				
2009				
2010				
2011 (YTD)				

- 11) List and describe all pending or threatened litigation, regarding Custody Services, against your organization. List and describe all agency supervision associated with the pending or threatened litigation. What has been your experience with regard to litigation or agency supervision over the past five years?
- 12) Provide your organization's client distribution as specified in the following table. Report aggregate market values of total assets under custody in US\$ millions as of June 30, 2011.

Tax-Exempt Client Asset Size Distribution

Distribution	Number of Clients	Number of Plans	Aggregate Market Value (US\$ millions)
<i>Taft Hartley-Union</i>			
Below \$500 million			
\$500+ million to \$1 billion			

Distribution	Number of Clients	Number of Plans	Aggregate Market Value (US\$ millions)
\$1+ billion to \$5 billion			
\$5+ billion and Up			
<i>Corporate</i>			
Below \$500 million			
\$500+ million to \$1 billion			
\$1+ billion to \$5 billion			
\$5+ billion and Up			
<i>Public Fund</i>			
Below \$500 million			
\$500+ million to \$1 billion			
\$1+ billion to \$5 billion			
\$5+ billion and Up			
<i>Endowments & Foundations, etc.</i>			
Below \$500 million			
\$500+ million to \$1 billion			
\$1+ billion to \$5 billion			
\$5+ billion and Up			
TOTAL			

B. Client Servicing

- 1) What is your approach to client servicing and what would be the most distinct element of your client servicing approach that the FUNDSFunds would benefit from and consider exceptional relative to the custody industry?
- 2) How do you propose to staff for the Funds both from a client servicing perspective and actual daily service deliverables point of view? Would you be able to provide biweekly conference calls if so desired?
- 3) How will you oversee quality control and client satisfaction for the Funds?
- 4) What is the turnover rate for the past three years of the client servicing staff to be assigned to the Funds?
- 5) Please provide the names and bios including experience of the client servicing team members as follows and as specified in the table below:
 - Management Sponsor
 - Client Servicing Team
 - Custody and Accounting
 - Trade Processing and Securities Settlement, including Cash and Expense Reconciliation

Name	Responsibility	Location	Number of Client Relationships	Years with Bank	Years Experience and Credentials

- 6) How is contact handled generally? Single point of contact?
- 7) Does the team handle other public fund clients, with a similar configuration as that of Funds? Please list other clients handled by the team.
- 8) Discuss the working relationship and coordination between client servicing team and various operational staff.
- 9) Do you have a dedicated unit for Public Funds? Please describe your structure.
- 10) Does the client servicing staff (i.e., relationship manager and accountants) maintain a “procedures manual” for each client? What is the typical content of such a manual?
- 11) How are requests for special reports treated?
- 12) Please discuss opportunities, which your financial institution offers to clients for training and continuing education, and whether those educational opportunities would be available to the Funds.
- 13) Are you able to provide different levels of training and education including on-site at a minimum of 8 hours per year in Columbia, South Carolina.
- 14) Please provide tangible examples of “working partnership w/ clients” to develop best in class service and best practice

initiatives for clients.

- 15) Indicate how customer satisfaction is monitored, and whether clients are provided with the ability to participate in the annual evaluations of their support group as well as overall service performances. If available, the custodian must provide the results of its most recent customer evaluation (name of customer may be deleted).
- 16) Describe fully your support structure and services offered to client managed investment portfolios and operations.
- 17) What is your procedure for handling complaints about the accuracy of your reports and analysis?

C. Risk and Insurance

- 1) Please address any substantive issues raised by independent auditors in your SSAE 16 and/or SAS 70 and issues published in your Form 10-Q. Provide a copy of the most recent annual report, Form 10-Q and SSAE 16 or SAS 70. Please label appropriately.
- 2) Provide the following data and explain its implication.

**Capital Base
June 30, 2011**

Capital Requirements	Actual	Current Requirements
Tier 1 Capital Ratio		
Total Capital Ratio		
Leverage Ratio		
Tangible Common Equity		

- 3) Provide your organization’s current short term and long term credit rating.
- 4) Please provide summary detail on the Stress Test that you recently conducted under the guidance of federal regulators. In addition, please provide guidance on how you intend to meet Basel III in terms of capital adequacy and liquidity.
- 5) What is the nature and size of any “off balance sheet items” in your annual report and what are the three critical areas that pose the most at risk exposure to the bank?
- 6) Describe the various types of insurance coverage and indemnification provided to protect clients of service(s) proposed. Each description should include:
 - Risk Coverage
 - Carriers
 - Levels
 - Limits
 - Deductibles
 - Expiration
- 7) Please describe any pending or threatened litigation against your organization. Is there any agency supervision? What has been your experience with regard to litigation or agency supervision over the past five years?
- 8) Does your organization subcontract any of the services required by the Funds? Kindly state contract vendor name and for which service a subcontractor would be used (e.g., subcustody network, pricing, accounting & reporting, internet delivery, securities lending, performance measurement, proxy, etc.).
- 9) Describe your business continuity and disaster recovery plans, including pandemic planning. When was the most recent test done? Indicate the date, scope, and results of the last testing of such emergency plan(s) and promptly report to the Funds the results of any test conducted subsequent to your response to this RFP.
- 10) What will be the recovery time(s) and service level for critical custodial services in the case of a major disaster?

D. Systems, R&D and Technology

- 1) Please provide the Technology, R&D and Systems budgets (in actual US\$ terms) specific to trust and custody services over both the past three and next three years.
- 2) Are custody systems shared by other areas of the bank? Are there any time or resource constraints applicable to any shared systemic usage?
- 3) Provide a brief description of the information delivery system or workstation for client interface. Describe the levels of service, if any.
- 4) Is the above information delivery system subcontracted or in-house? If subcontracted, please specify the vendor name and release number, including the description of the relationship and how access to the source code is defined.
- 5) What data is available in your organization’s on-line delivery system (i.e., assets, transactions, corporate actions, pending trades, receivables, accruals, compliance checking, cash positions & management and forecasting, performance, analytics, etc.)?
- 6) What information, current and historical, is provided and available on-line in raw data elements? Indicate when and how this information is available and accessible.
- 7) What technical support and client service resources will be dedicated to the Funds account for the purposes of

- installing, upgrading, supporting, troubleshooting, and maintaining your on-line client information delivery products?
- 8) Is the main on-line delivery in Windows 2000, NT, XP, VISTA, Windows 7, Linux, MAC OS (Snow Leopard/Lion), and/or Internet delivery? Since when?
 - 9) Identify all hardware and/or software required of users to access your reporting systems.
 - 10) What is the operational functionality of both full web enabled thin client and/or cloud computing client applications?

Functionality	Data Feed/Mart (Specify Protocol / Format / Frequency)	Available in Web Enabled - Thin Client (Yes or No)	Date Introduced	Available in Cloud Computing (Yes or No)	Date Introduced, Beta Test or Not Available
Investment Accounting					
Assets at Cost, Amortized Cost, Fair Value and Transaction Reports (Trade date, full accrual)					
Financial Reporting Compliance with GASB 25, 28, 40, 53, & 62 when implemented					
Security Level Information					
Cash Positions					
Cash Flow Module					
Net Asset Value					
Daily Pricing					
Income Tracking Report					
Corporate Actions					
Proxy Notification and Reminders, including Reporting					
Class Actions					
Trading Cost Analysis					
Daily Performance					
Basic Performance Measurement					
Advanced Analytics – Universe Comparison, Attribution and Characteristics					
Investment Compliance and Monitoring Service					
Document Manager					
Securities Lending					
Market Information					
Custom Reporting					
Scheduler					
Instruction Processing (i.e., wires, capital calls, etc.)					
Others: (Specify)					

- 11) Is information access done “real time on-line” or nightly batch download for the on-line systems?
- 12) Can we access your Internet deliverable (thin client) and test-drive the application? If yes, please provide the site name

and appropriate password.

- 13) How current is your available on-line information and how frequently is it updated (i.e., real time – 5 to 20 minute delay, intraday (twice daily), end of day, or nightly batch load for next day morning access)? How many hours per day and days per year is it available?
- 14) Can clients retrieve on-line information in a customized reporting format? If so, describe your custom reporting flexibility and limitations. Does the format support Dynamic Data Export (DDE) such that it is compatible with Excel or other popular PC-based software?
- 15) What is your vision over the next five years in terms of your technology and processing capabilities that will ensure your competitiveness and existence?
- 16) Describe in full, your T+1 and Straight Through Processing (STP) initiatives, including enhancements to your current processing environment.
- 17) Are you operating in a “continuous processing” environment, wherein you can accommodate after hours trading and are you able to “price and value at will” at any given time of day?
- 18) Please describe your “Cloud Computing” initiatives and how you envision the next evolution of your applications to meet the challenge over the next five years.
- 19) Is your custody and accounting platform able to interface with various investment accounting systems?

E. Trade Processing, Settlement and Custody

- 1) Are you able to meet the following functions?
 - Accept daily instructions from investment managers and the Funds.
 - Advise investment managers of daily changes in cash equivalent balances.
 - Immediately advise investment managers of additions or withdrawals from account.
 - Notify investment managers of tenders, rights, fractional shares or other dispositions of holdings.
 - Resolve any problems that investment managers may have relating to custodial account, including security pricing differences.
 - Safekeeping of securities.
 - Interest and dividend collection.
 - Process all investment manager transactions.
 - Collect proceeds from maturing securities.
 - Disburse all income or principal cash balances as directed.
 - Daily feed of beginning of day holdings and cash balances.
 - Provide monthly statements by investment manager account and consolidated statement of all assets on a plan and total trust levels.
- 2) What is distinct about your custodial capabilities that we should know about for both domestic and international (equities and fixed income) securities?
- 3) What is distinct about your safekeeping capability in the areas of derivatives, structured instruments and non-traditional asset classes?
- 4) Please describe your ability to safekeep physicals, including vaulting capabilities.
- 5) Briefly describe the method and frequency of reconciling the custodian’s positions with its depositories and sub-custodians and managers.
- 6) What securities have been misplaced or lost during the last three years? If any have been misplaced, describe the circumstance(s) and what was done to correct the problem.
- 7) Briefly describe the procedures used to ensure that physical securities are properly registered, transferred and in general, held, delivered and/or received in good deliverable form. Include any second party banks in the clearing of such securities.
- 8) State the value of assets held (as of June 30, 2011) at Depository Trust Company and Federal Reserve and the length of the direct participant relationship with the custodians.
- 9) State the value of assets for basic international depositories, such Euroclear, EuroNext and Clearstream, as of June 30, 2011.
- 10) What was the trade volume (number and market value size) that you processed for the year ending June 30, 2011, and failed trades for US securities, and of that trade volume what was the level of failed trades in both numbers and percentages?

Trades	Volume (Number)	Total Market Value in US\$ millions	Fail Rate (%)
Purchases			
Sales			

- 11) What was the trade volume (number and market value size) that you processed for the year ending June 30, 2011, and failed trades for non-US securities?

Trades	Volume (Number)	Total Market Value in US\$ millions	Fail Rate (%)
EAFE			
Emerging			

- 12) Briefly describe your policy and procedures on failed trades for both domestic and foreign securities and the steps that will be taken to minimize trade failures.
- 13) Is your system capable of producing a report which shows all failed trades across all of a client's investment manager accounts at any given point in time?
- 14) Describe your "DK" procedures. How much time elapses until client notification? Describe the Custodian's policy regarding restitution of lost interest for the Funds on a failed trade.
- 15) Does your organization employ actual or contractual settlement date? It is the requirement of the Funds to have a contractual settlement. Is this requirement acceptable?
- 16) Specify the countries or jurisdictions for which you employ contractual settlement of trades.
- 17) Do you subcontract global custody to another provider? Please describe. To how many countries do you provide a subcustody network?
- 18) List all depositories, agents, and sub-custodian banks used in each country, including the U.S., on behalf of clients in the format described in the following chart. Identify those which are affiliated with your company. For each country, indicate whether you use a central depository or physical delivery. Also, please indicate whether assets are held in the beneficial owner's name or are commingled.

Country	Sub-custodian Bank	Hired or Established	Ownership Structure (Direct or Sub-Contract)	Depository /Clearing Agent	FX Execution Restricted to Sub-Custodian (Yes or No)	Average Annual Fail Rate Sales + Purchases
ex. Japan	Bank of Tokyo	1987	subcontract	N/A	No	<5%

- 19) Do you employ SEC 17f-5 and 17f-7 in the review and contracting arrangements with your sub-custody network? Please explain your role as Custody Manager and tracking of sub-custodians and the inherent risks associated with such arrangements. Please specify any limitations you make regarding your contracts with your sub-custodians.
- 20) Are you electronically linked with your sub-custody network and depositories? Please describe the core platform.

F. Income Collection

- 1) Describe the custodian's standard policies on cash crediting and debiting, including cut-off deadlines for all securities, both domestic and international.
- 2) Describe your procedures for ensuring that interest and dividends (domestic and international) are paid.
- 3) Will payments be credited in same day funds or clearinghouse funds for domestic and international securities?
- 4) When and in what instances do you rescind contractual income collections? What is/are your policy(s) for both domestic and international markets?
- 5) Do you track late collections of income? Can you produce a tracking report detailing outstanding claims? Do you notify clients of failures to collect or late collections of income?
- 6) Please describe your tax reclaim procedures for ADRs and international securities. Are you able to guarantee 100% relief?
- 7) What is tax relief at source? Specify countries with whom you have such an arrangement.
- 8) What percentage of tax reclaims for the last three years ending December 31, 2010, was your organization able to reclaim?
- 9) The Funds are qualified as a government agency exempt from U.S. federal income taxes under section 115 of the Internal Revenue Code (the "Code"), as a pension plan qualified under section 401(a) of the Code. In order to maximize tax benefits under U.S. tax treaties with various foreign jurisdictions or, where tax treaties offer no special relief for the Funds, under the domestic laws of some jurisdictions, Funds may be classified as a government agency in some jurisdictions, a pension scheme in other jurisdictions, and a tax exempt charity in still other jurisdictions. Can

you assist the Funds to determine which classifications would be best to use in each foreign jurisdiction where the Funds have an investment in order to maximize tax benefits for the Funds, through either relief at source or tax reclaims? If so, describe how you would accommodate and handle such multiple classifications for the Funds.

- 10) There is growing concern regarding the requirement for an Independent Tax Agent in certain countries in which the Plans are invested. Please describe how you support the Registration Process, designation of an Independent Tax Agent and preparation of the Global Power of Attorney for the Plans. How do you ensure that this is not a burden to the Plans?
- 11) Related to the previous question, identify the countries with whom you have formulated a solution for Independent Tax Agent requirements, including distinct policies. Who is the normal contracted Independent Tax Agent assisting clients like South Carolina?
- 12) Discuss how your firm calculates interest and dividend receivables (U.S. and non-U.S.) and then reconciles its independent calculations against actual receipts, at both an aggregate "all clients" level and at an individual portfolio level. Describe relevant timing, controls and reconciliation reporting made available to clients. Differentiate between your internal functions and those of your subcustodian banks.

G. Corporate Actions, Proxy Voting Support and Class Action Claims Filing

- 1) Describe the structure of your dedicated unit for corporate actions, proxy voting support, and class action claims filing.
- 2) Specific to proxy actions, can you support proxy voting by the investment managers, third party vendor, or client? Please answer the following:
 - a. Briefly describe the custodian's corporate action procedures for domestic and foreign securities, including providing proxy notification, monitoring, etc. Include a list of the various sources the custodian uses for corporate action announcements.
 - b. How would Plans access all proxy notification or voting matters?
 - c. Do you have the capabilities to transfer holding information on a daily, weekly or monthly basis to a third party?
 - d. Do you have the capability to monitor upcoming international votes?
 - e. How do you address the share blocking issues with global securities?
 - f. How do you address potential premiums paid for voting securities in certain markets?
 - g. How do you account for all possible shares being voted?
 - h. Are you able to recall shares on loan prior to record date to participate in the proxy process?
- 3) If the custodian, or its sub-custodian or its depository makes a mistake on a corporate action for which it received information and proper instructions that results in a loss to a client, describe the custodian's procedures for reimbursing the Funds.
- 4) What is distinct about your proxy notification and proxy voting support service, whether in-house or subcontracted to a third-party?
- 5) For foreign securities, describe the custodian's procedures for notification and processing of "blocked" shares during proxy voting periods. Do you offer segregated accounts to facilitate proxy voting in any markets?
- 6) How does the custodian handle class action suits both domestic and international? How quickly is security class action information updated in your system?
- 7) Is class action monitoring and filing of claims performed in-house or subcontracted? What is the extent of limitation of your service? Be very specific.
- 8) Listed below are the Plans intended monitoring requirements specific to class actions. Please provide a complete description of your capabilities to support these requirements. Include procedures manuals in a separate document if necessary. If you are not able to support all of these requirements, describe how you can support a third party vendor.
 - a. A copy of the complaint and detail as to the venue, attorneys, claims administrators assigned, etc.
 - b. A loss simulation engine providing various damage estimates, including those valued in accordance with National Association of Public Pension Attorneys (NAPPA) criteria.
 - c. Public Access to Court Electronic Records (PACER) access.
 - d. Automatic loading of the Plans trade data and calculating loss estimates, providing alerts when designated thresholds have been exceeded.
 - e. Handling the filing of claim notices and other documents in connection with such proceedings.
 - f. Periodically reconciling the data on securities class actions filed with the Plans exposure to identify where a proof of claim must be filed and then verify that it has been timely filed.
 - g. Tracking rejection of claims, determining whether additional action is required and then taking that action.
 - h. Reconciliation of funds received with claims made and allocating them to applicable investment funds and portfolios.
 - i. A client accessible system for monitoring class action litigation and bankruptcy proceedings affecting the portfolio of securities of the Plans. It must be available through a secure internet application.
 - j. A client accessible system to handle and track history of securities held during the periods that are subject to proceedings.

k. A client accessible system able to advise South Carolina of significant dates and deadlines, as well as the status of any actions taken, with respect to such proceedings including but not limited to opt-out elections in class actions litigation, deadlines for filing claims and deadlines for filing bankruptcy notices or claims.

- 9) Do you have the capability to load 10 years of transaction and holdings history to support class action suits?
- 10) Are you willing to file all claims with class periods that predate the conversion using data supplied by a third party service provider?

H. Accounting and Reporting

- 1) What are your investment manager reconciliation policies and procedures prior to issuing audited statements to clients? Is this proactive, reactive, or is the onus with the investment manager to reconcile to your information?
- 2) Do you have built-in interfaces with the investment managers (separate and commingled) of the Funds? Please specify for each manager.

Funds Investment Managers	Phone/ Fax	On-line/ Internet	VPN	STP – SWIFT/IS O	Monthly Formal Recon? Yes or No
Domestic Equities:					
International Equities:					
Domestic Fixed Income:					
International Fixed Income:					
Cash/Short Term:					

- 3) Describe your organization’s trust and plan accounting capability (include system name and year developed).
- 4) Is your system maintained in-house, or subcontracted with a third-party? If subcontracted, please specify the vendor name and release number, including the description of the relationship and how access to the source code is defined.
- 5) Does your organization have a general ledger accounting system in a full accrual trade date multi-currency basis?
- 6) Please describe cost basis types maintained in your accounting platform.
- 7) Please provide a complete description of the general ledger system and the accounting fields (asset and transaction buckets, debit and credit tables, etc.) available.
- 8) The Funds consider the custodian as the “book of record” of the sub-ledgers for assets and transactions. Do you accept this responsibility? Please describe.
- 9) What are the future or planned enhancements to your current accounting and reporting system? If planned changes or enhancements are envisioned, what are the advantages to clients?
- 10) Enumerate all data vendors utilized by your institution for pricing, fixed-income (i.e., swaps) and mortgage factors, corporate actions, derivatives, etc. Specify primary, secondary and tertiary sources, especially the pricing of alternative investments.

Pricing Sources	For what type of Securities, Instruments or Asset Class	Specify if Primary or Secondary	Daily Feeds (Yes or No)

- 11) What types of reports are available to clients? List both standard and non-standard reports. Please provide samples.
- 12) Are you able to generate accounting and reporting information for GASB 25, 28, 40 and 53 purposes? Please describe and provide sample reports.
- 13) Does your organization provide training in the interpretation and generation of accounting reports during the initial stages of conversion and on going?
- 14) How many business days following the end of a reporting period are fully audited reports delivered in hard copy? Via electronic delivery (i.e., on-line, PC download, CD, multimedia, etc.)?

Report Type <i>Sample Only</i>	# of Days Audited (Hardcopy)	# of Days Audited (On-line)	# of Days Unaudited (Hardcopy)	# of Days Unaudited (On-line)
Asset Statement				
Transactions				
Corp. Actions				
Pending Trades				
Income				
Securities Lending				
Performance				
Risk Analytics				

- 15) Can the Funds be assured that audited statements will be available on the 10th business day (as required by the Funds) after month end? Please explain.
- 16) Describe the basis for monthly audited reports. Are the asset holdings and transactions based on settlement date accounting, settlement date accounting with pending trade adjustments, or trade date accounting?
- 17) Do you have the capability to generate trade cost analysis reports? Is this a standard service?
- 18) What is distinct about your derivatives processing and valuation capabilities that the Funds should be aware of beyond line item tracking? Provide detail of capabilities and support.
- 19) Is the processing of exchange traded and OTC derivative instruments such as futures, swaps, and options done within the main accounting system? Is there a separate module or system dedicated to handling such securities?
- 20) How does your organization handle GASB 53 requirements specific to commingled funds, real estate, private equity, absolute return, and OTC derivatives?
- 21) Are the general classifications for GASB 53 within GAAP guidelines as determined by an independent third party vendor (i.e., E&Y, Deloitte, PWC, etc.)?
- 22) How do you handle security/cash transfers between accounts, specifically between custodied accounts and non-custodied accounts such as commingled funds? How does the client know that the cash balances and positions are in sync?
- 23) Describe special procedures for the processing, valuing and reporting of Securities Held Elsewhere, such as real estate, commodities, alternative investments, private equity, and absolute return strategies (hedge funds).
- 24) Related to the previous question, are you able to track these types of investment vehicles utilizing a "Shadow Accounting" approach?
- 25) Is your firm capable of providing shadow accounting of detailed positions held within third-party commingled vehicles and prime brokerage accounts? Please describe.
- 26) Describe fully your clients' ability to use ad hoc query tools to access portfolio information for past dates other than prior month-ends.
- 27) Specific to commingled funds, do you have the ability to capture the plan's pro-rata share of holdings for use in terms of monitoring and analytics?
- 28) Are outside vendors or software employed to handle real estate and alternative investments? If not, how did your organization achieve the in-house expertise?
- 29) Specific to alternative investments, do you have capabilities to drill down to company (security) or partnership level in terms of monitoring? Kindly enumerate and delineate by types of alternative investments such as hedge funds, distressed, private equity, venture capital, real estate, absolute strategies, convertibles, senior secured debt, etc.
- 30) How is expense monitoring and reporting provided to clients? Is this module integrated into the accounting system? Please describe.
- 31) Do the Funds have direct access to the accountant(s) for inquiries and problem resolution? Does the client servicing officer or relationship manager need to be involved before the Funds can have direct access to the accountant(s)? What are your policies?

I. Cash Management (Short Term Investment Management)

- 1) To the extent that the Funds would use STIFs managed and offered by the Custodian, please describe:
 - a) What STIFs are available?
 - b) What are the investment philosophies of each?
 - c) Who is the investment advisor?
 - d) Do they comply with and are they registered as OCC Reg. 9 or SEC rule 2a7 compliant?
 - e) AM Best rating

- f) Exposure limits
 - g) Credit Quality guidelines
 - h) Average maturity
 - i) Derivatives policy
 - j) Floating rate note policy
- 2) Have any of your short term investment vehicles ever “broken the buck” or experienced losses?
 - 3) For each of these available vehicles, provide the net return for the past five years.
 - 4) For each of these available vehicles, provide the market value as of June 30, 2011.
 - 5) For each of these available vehicles, provide the relevant cut-off times for both purchases and redemptions.
 - 6) For each of the available vehicles, is there any difficulty with same day transactions?
 - 7) What is your daily compensation and overdraft policy?
 - 8) Overdrafts can occur because of the failure of the custodian to deliver the requisite foreign currency to settle a trade, differing settlement standards (asset class and countries), sub-custodian error, inability to recall securities that are out on loan, errors in trade processing and cash position monitoring, failure to communicate and reconcile with the manager daily, and/or a trade fail that emanates from the custodian. Does your firm automatically apply overdraft charges regardless of the party in error? Please describe your policy.
 - 9) Related to the question above, if custody related overdrafts occur, does the Funds have the right to receive reimbursement equal to what your overdraft charges would be on a daily basis that the overdraft position is open or unresolved?
 - 10) Does your organization have the capability to provide a cash availability projection report? How many days is the cash projection (i.e., 5 days, 10 days, 30 days, 60 days or 90 days)?
 - 11) Please describe the availability of any additional cash management services such as:
 - a) remote deposit service
 - b) positive pay with a payee verification service
 - c) mobile device access.

J. Foreign Exchange Capabilities

- 1) Describe your Foreign Currency (FX) management capabilities. Be sure to discuss the following:
 - a. How does your organization demonstrate the competitiveness of your foreign exchange and how does your firm ensure that custodial clients achieve best execution? What documentation or analysis would your organization provide to the Plans that demonstrates such?
 - b. Is your organization willing to disclose both explicit and implicit costs of FX Trades?
 - c. Is your organization willing and able to provide a “time-stamped” FX trade and disclose at what price your firm valued the FX trade?
 - d. Does your organization flag off-market transactions (considered to be 10% or greater variance) automatically?
 - e. Are off-market transactions reviewed independently and the reasons for the price indicated in the review process?
- 2) Please describe how your organization handle standing instructions, normal course FX settlement for buys/sells, FX netting, and pre-negotiated FX rates.
- 3) Fully describe your ability to support an agent or principal third-party foreign exchange program where all eligible foreign exchange transactions would be directed away from the custodian.
- 4) Has your firm been investigated for any issues related to FX trading? If so, please explain.
- 5) The Plans reserve the right to allow managers to execute any and all FX trades with third party brokers. What different FX execution options can you provide to both the Plans and its investment managers beyond custody FX execution venues (i.e., Street FX, Pre-Negotiated FX, Electronic FX Execution Platforms, etc.)?
- 6) Does your organization charge a penalty or administrative cost for currencies executed by a third-party other than the custodian bank?
- 7) Will your firm use a competitive bidding structure to execute FX transactions? Will your organization be able to provide performance reporting or best execution reports for FX transactions?
- 8) Is interest paid on uninvested balances in foreign country accounts? What types of short term vehicles or accounts are available?
- 9) For global markets, the interest penalty for cash overdrafts is substantial. Discuss the policies and procedures for assessing overdraft fees, including but not limited to, documents provided, frequency of charges, overdraft rates determination, and overdraft claims and collection process from brokers/managers. Describe your ability to set up procedures to allow for client review and approval of charges for foreign cash overdrafts. (Reminder: confine your response to methodology only, not specific numbers)

K. Performance, Investment Guideline Compliance and Risk Analytics

- 1) What are the types of analytics and performance measurement currently available to clients for the asset classes listed

below? (For example, BARRA Analytics, global attribution, style analysis, portfolio characteristics, universe comparisons, TUCS, optimizations, Yield Book, Venture Economics, Private I, trading cost analysis, etc.) Include a description of how the external provider's system can be integrated with your records and the controls you can institute to ensure and validate the completeness, accuracy and integrity of the data and information generated by the system.

- Domestic Equity Analytics
 - Fixed-Income and Global Bond Analytics
 - International Equity Analytics
 - Overlay (Currency, Equity and Fixed) Analytics
 - Derivatives
 - Commodities
 - Real Estate
 - Private Equity
 - Absolute Return Strategies
 - Commingled Funds and Mutual Funds
- 2) Are there different levels of performance measurement and analytics services? If there are different service levels, describe whether they reside in one performance measurement module/system or multiple modules/systems.
 - 3) Are you able to calculate both gross and net of fees performance? How about lag and non-lag performance measurement calculations? Please describe the methodology employed.
 - 4) Are you able to assist the Funds with the monitoring and reporting of risk in the portfolio? Do you offer multiple levels of risk management reporting/analytics? If so, please state what services are included in your fee proposal and what services are available for an additional fee. Is your software or application able to produce reports for scenario testing, full bore risk analysis, and Value at Risk (VAR)? Please provide a sample report.
 - 5) List all indices, benchmarks and universe returns available to the Funds. Are returns available on-line? How far back do you carry historical returns and name the frequency (daily, monthly)? Do you have the ability to load prior months and/or years returns? Do you have the ability to accommodate custom benchmarks? Is there a limit on how many custom benchmarks a client can have?
 - 6) Describe in detail your attribution analysis and peer group comparison capabilities.
 - 7) For private equity and all partnership investments, can you provide continuously updated access to valuation, fees and historic performance data, permitting it to be easily aggregated and disaggregated according to portfolio fund, company, investment strategy, industry, geography, manager and vintage year, and desktop access to this data via a nationally recognized software product designed specifically for the tracking of private equity investments? Please describe.
 - 8) Please provide a complete description of your capabilities for monitoring required compliance with in the Patriot Act, Anti-Money Laundering, and OFAC SDN List. Are you able to identify companies that have been invested that are fined by OFAC?
 - 9) Please describe your organization's offering with respect to corporate governance tools and support to clients. What services are available?
 - 10) If you are subscribing to private equity tracking software, will you provide administrative and technical support for the use of the software? Will you be responsible for loading historic cash flows and performance data into the software product? Describe the plan for accomplishing this conversion.
 - 11) How do you handle hedge funds within your accounting, reporting and performance platform?
 - 12) Are there separate risk and control systems, as well as a dedicated group, for derivatives and risk management?
 - 13) Does the system integrate guideline compliance into the automated trading process and actively monitor transactions and portfolio composition?
 - 14) Provide a description of the different levels of compliance monitoring (i.e., basic, intermediate or advanced) you provide and advise which services are included in your fee proposal and which are available for an additional fee.
 - 15) Is compliance monitoring performed for all asset classes? Is it performed daily? Is it on a Post-Trade, Pre-Settlement basis? Is it available on-line?
 - 16) How are clients and investment managers notified of a violation or breach in the investment policy and guidelines?
 - 17) Does the compliance monitoring system allow for tracking of potential violations and generation of periodic reports?
 - 18) Relative to the above on-line system, can it continuously monitor the following:
 - Duration bands or maturity limits
 - Restricted security types
 - Percentage sector limits
 - Geographical restrictions
 - Issuer concentration limits
 - Credit quality and diversification limits
 - Prohibited securities (per Illinois legislation such as Public Act 95-616)
 - Non-dollar allocation limits
 - Naked currency exposure and basket hedge
 - Realized gains/loss limits for taxable clients

- Subsector diversification limits (i.e., percent limits per SIC code)
- Cash flow variability standards for selected products (i.e., CMOs)
- Monitor leveraged transactions
- Stress testing and potential effects in market prices and interest rates
- Gap analysis and duration reviews
- Collateralization (relative to naked exposures)
- Monitor unhedged positions
- Calculate value at risk
- Underlying positions for covered calls
- Naked call exposures

- 19) Describe the type of risk measurement model that you utilized (Parametric – factor/risk bucket vs. individual security; Full Valuation – historical vs. Monte Carlo)
- 20) Differentiate the specific components of the risk factors that you measure as listed below:
- Risk factors set at the individual equity level
 - Risk factors set at the individual bond level
 - Risk factors set at the equity factor level
 - Risk factors set at the bond factor level
- 21) Describe the risk measurement methodology for all asset classes as listed below:
- Venture Capital, limited partnerships and real estate
 - Mortgage backed securities (especially CMOs)
 - Derivatives (such as options, index futures, options on index futures, currency forwards, swaps, etc.)
 - Warrants and convertibles
 - Emerging market equities
 - Non-Dollar denominated securities
- 22) Specific to fixed-income portfolios, please describe your ability to handle:
- Key rate durations
 - Yield curve principal components (i.e., shift, twist, butterfly movements)
 - Credit spread risk
 - Volatility risk

L. Conversion Process

- 1) Describe your organization's formal transition planning process as it would apply to this contract.
- 2) Given a notification of engagement by the end March 2012 and a targeted conversion of July 1, 2012, please provide a transition calendar.
- 3) Describe your communication with the staff of the Funds during the conversion process.
- 4) Is training provided during the initial stages of conversion and ongoing? Please provide a structure for both the Funds.
- 5) What would be a reasonable parallel processing for the asset transfer?
- 6) On what date would you commence parallel processing in order to develop history, test procedures, and establish entitlements/accruals given a full conversion by July 1, 2012?
- 7) How do you conduct the transfer of securities and cash from a prior custodian and its sub-custodians to control the risk of loss of assets and assure that all are received and accounted for properly?
- 8) What is your policy to make a client whole if an asset was not transitioned or failed to be accounted for after the conversion date? Who pays the client?
- 9) What should the Funds look out for, and what are areas of concern and any heightened level of sensitivity during the conversion period? Please discuss how tax reclaims, reregistration, accruals, etc. are handled during the conversion period.
- 10) How will you handle class action filings and income due related to settlement periods under prior custodians and settlements that cross over from the prior custodian to the new custodial contract?
- 11) How will you handle open tax reclaims related to reclaims filed by prior custodian?
- 12) How should we handle securities out on loan during the conversion process? What should we consider in terms of unwinding without a loss, novation, substitution, recall, etc.?
- 13) Describe the type of training on systems, accounting, performance modules, etc. that will be provided during the conversion period?
- 14) Describe your process for accommodating client's requests for additional data feeds. Provide information about time lines for implementing such requests and associated fees, if any.

M. Other Services (For Consideration and Review)

- 1) The State Treasurer requires the custody bank to maintain \$50 million of US Treasuries in escrow with the Federal Reserve to meet the State cash requirements. Are you able to meet this additional requirement?
- 2) A key initiative of the State Treasurer is to improve services and improved access by local public institutions in their participation in the LGIP. Provide a general description of your transfer agency services or participant/shareholder services, history, milestones and overall capability.
- 3) Describe the typical client interface model and on-line/and electronic interfaces that support transfer agency client requirements
- 4) The Treasurer’s Office and the Investment Commission utilize QED for investment accounting purposes. Describe the investment accounting platform that your firm offers with equal or better capability than QED.
- 5) Describe the investment accounting capability provided to investment manager clients (include system name and year developed, programming language, server platform, etc.).
- 6) Is the system maintained in-house or subcontracted or service bureau arrangement with a third party? If subcontracted, specify the vendor name and release number, including the description of the relationship and how access to the source code is defined.
- 7) Is the accounting system able to handle income, securities out on loan, corporate actions, derivatives (futures and options), FX overlay, currencies (base and local) and alternative investments? Please provide details.
- 8) Describe the functionality of the cash module within the investment accounting platform.
- 9) Is the investment accounting platform able to cut daily NAVs? Describe the process and methodology.
- 10) What are the future or planned enhancements to the investment accounting and reporting system? If planned changes or enhancements are envisioned, what are the advantages to clients?
- 11) Specific to Fund Administration Services, briefly describe the support services available for the following administrative functions, including but not limited to:
 - SEC Compliance
 - Tax and IRS Compliance
 - CFO Certification
 - CCO Support
 - Tax Return Reporting and Recordkeeping, including 1099’s and K-1s
 - Performance Reporting
 - Expense Administration
 - Preparation of Financial Statements and related Reports
 - Dividend and Capital Gains Analysis and Projections
 - Board Reporting
 - Blue Sky Administration
 - Proxy Administration
 - Transfer Agency
 - Private Equity and Real Estate
 - Absolute Return Strategies
- 12) Provide the number of your organization’s **SEC registered fund of fund clients** as categorized in the following matrix. Report aggregate values of their total assets under administration in US\$ millions for periods specified.

Total SEC Registered Fund of Fund Clients

Year End	Total Number of Clients	Asset Value (US\$ millions)
2006		
2007		
2008		
2009		
2010		
2011YTD		

N. References

Please provide a list of three public fund client references of similar size with contact information. Indicate the major ancillary services (alternative investment support, securities lending, etc.) provided to them.

SECURITIES LENDING SERVICES

Securities lending will be utilized primarily to generate incremental return. The Funds have a very risk-averse posture. The Funds require a fully indemnified program specific to operational risk and borrower default. Additional levels of indemnification beyond operational risk and borrower default are also welcome, including collateral reinvestment risk if reinvestment is included. Daily reporting should include internet access to information about its securities lending program, including security level loans outstanding, shares on loan, days out on loan, term and open trades, borrowers for each block of securities lent, collateralization levels, earnings (top 25 securities sorted by earnings), cash collateral reinvestment and other daily, weekly and monthly reporting requirements at the security and aggregate levels.

On a daily basis, the Funds require full transparency to loans, counterparties, rebates/fees, collateral posted, and collateral investments, including information specific to NAV (fair market value), credit, risk and liquidity risks.

The following questions should be answered in full. Please tailor your response for each item, specifically in the areas of risk and return, relative to your proposed approach.

A. General Information

- 1) State your firm's lines of business. Where does securities lending fit within the organization as a service or product offering?
- 2) What is the approximate revenue and profit contribution of your Institutional securities lending business to overall company (as defined by the top of the organizational chart) revenue and profit in percentage terms?
- 3) Are there any current organizational issues (i.e., mergers, acquisitions, personnel changes, business concerns, etc.) about your institution that we should know about? Describe.
- 4) Furnish a copy of your firm's Ethics Statement and Code of Conduct, specifically developed for securities lending services.
- 5) The Funds require a SSAE 16 or SAS 70 report covering your organizations securities lending function. Please verify that your firm can fulfill this requirement. List substantive issues raised by independent auditors in your SSAE 16 or SAS 70 and issues published in your Form 10-K if filed. Provide a copy of the most recent annual report, Form 10-Q and SSAE 16 or SAS 70 and label appropriately. Please indicate whether there have been any substantive changes in internal controls since the date of your SSAE 16 or SAS 70 report.
- 6) Describe the various types of insurance coverage and indemnification provided to protect your securities lending clients. Each description should include:
 - Risk Coverage
 - Carriers
 - A.M. Best Rating
 - Levels
 - Limits
 - Deductibles
 - Expiration
 - Dishonesty Coverage
- 7) List and describe all pending or threatened litigation against your organization in reference to custodial asset servicing. List and describe all agency supervision associated with the pending or threatened litigation. What has been your experience with regard to litigation or agency supervision over the past five years?
- 8) How much of the expressed Security Lending collateral was unable to be returned to client base on security failure in the past 3 years?" State in \$ and %.
- 9) Does your organization subcontract any of the securities lending services required by the Funds? Provide contract vendor name and which service, functions or deliverables they support. If so, describe indemnification process
- 10) Has your organization or its officers or principals been under any litigation or investigation by any regulatory authority within the last three years relative to securities lending services? Explain.
- 11) How many years has your firm been providing securities lending services to tax-exempt organizations either as an agent, principal, or both?
- 12) Provide a sample securities lending agreement on an agent basis only.
- 13) Furnish a copy of your standard Borrower's Agreement specific to Securities Lending done on an agency or principal basis.

- 14) The Funds require that the securities lending agent act as a fiduciary for the securities lending function. Please verify that your firm is able to do this.

B. Capabilities

- 1) Describe your strengths in domestic equity lending, fixed-income and/or international lending (as applicable).
- 2) What is the primary form of lending your firm offers - agent, principal, or both? Describe. What is the percentage breakdown between agent and principal lending from a total client basis?
- 3) Is your firm a NASD/FINRA member, a primary reporting dealer or a bank? Is your securities lending operation registered as an investment adviser (i.e., SEC, FSA, etc.)?
- 4) Discuss why or why not securities lending is considered a leverage transaction.
- 5) Discuss how your organization employs arbitrage and non-traditional transactions for your securities lending agent program.
- 6) Does your organization have any capacity limitations? What determines the limit on the deals, transactions and lending activities in which your firm engages?
- 7) Disclose how many clients or aggregate asset size your organization can effectively handle and discuss why.
- 8) How is collateral reinvestment management handled and what is the role and function of the credit analysis team?
- 9) Does the securities lending group have a dedicated credit analysis team or part of a larger pool within your organization?
- 10) How is enterprise risk management deployed to assess borrower credit and cash collateral reinvestment credit analysis?
- 11) How does your securities lending staff avoid infringing on an investment manager's responsibilities, specifically recall of securities?
- 12) How does your firm manage the coordination of trade settlements, corporate actions, dividend collection, etc. with the custodian bank? Does your firm provide guarantees?
- 13) Explain how your securities lending program is T+1 and STP processing ready. Discuss how your securities lending program is in compliance with industry standards.
- 14) How does your organization measure the intrinsic value of any securities that are loaned out? Provide actual examples for each of the following types: Large Cap Equity, Small Cap Equity, Governments (Specials and General), Corporate Bonds, High Yield Bonds, Global Bonds and International Equity.
- 15) Does your organization have an Internet based auction lending capability? If so, describe – including inception, extent of applications, competitive bidding process, etc.

C. Organization

- 1) Provide the following information for your securities lending business:

Name of Organization _____
 Business Address _____
 Primary Contact _____
 Address _____
 Phone, Fax, Email _____
 Type of Firm _____
 Bank _____
 Bank Holding Company _____
 Trust Company _____
 Bank Affiliate _____
 Investment Manager _____
 Investment Manager Affiliate _____
 Broker/Dealer _____
 Broker/Dealer Affiliate _____
 Others: (Specify) _____

- 2) Provide names, brief profiles and biographies of individuals who are responsible for the lending function and the cash collateral reinvestment function. If your program can be truncated by asset class, (e.g. equity, fixed-income, international, etc.), delineate the professional staff as such.
- 3) What are the compensation arrangements for the key professionals dedicated to providing securities lending services? Check all that apply.
 ___ Base Salary
 ___ Performance Bonus (Cash, Stock, Cash + Stock, etc.)
 ___ Commission Only
 ___ Profit Sharing Arrangement
 ___ Other: _____
- 4) Provide the incentive basis for performance bonuses. What are the targets and how are they aligned with corporate performance, securities lending performance or individual trade performance?

5) Submit a breakdown of persons dedicated to providing securities lending services for each of the following categories:
(Do not double-count)

Operations/Administration	_____
Credit and Liquidity Analysis	_____
Risk Mgmt/Compliance/Legal	_____
Asset/Liability	_____
Lending/Trading	_____
Non-Cash Collateral Management	_____
Cash Reinvestment	_____
Tax Specialist	_____
Currency Management	_____
Marketing/Client Servicing	_____
Others	_____
TOTAL	_____

6) Provide a five-year personnel turnover for the following categories.

Additions	2011	2010	2009	2008	2007
Operations/Administration	_____	_____	_____	_____	_____
Credit Analysis	_____	_____	_____	_____	_____
Risk Mgmt/Compliance/Legal	_____	_____	_____	_____	_____
Asset/Liability	_____	_____	_____	_____	_____
Lending/Trading	_____	_____	_____	_____	_____
Non-Cash Collateral Management	_____	_____	_____	_____	_____
Cash Reinvestment	_____	_____	_____	_____	_____
Tax Specialists	_____	_____	_____	_____	_____
Currency Management	_____	_____	_____	_____	_____
Marketing/Client Servicing	_____	_____	_____	_____	_____
Others	_____	_____	_____	_____	_____
TOTAL	_____	_____	_____	_____	_____

Departures/Terminations 2011	2010	2010	2009	2008	2007
Operations/Administration	_____	_____	_____	_____	_____
Credit Analysis	_____	_____	_____	_____	_____
Risk Mgmt/Compliance/Legal	_____	_____	_____	_____	_____
Asset/Liability	_____	_____	_____	_____	_____
Lending/Trading	_____	_____	_____	_____	_____
Non-Cash Collateral Management	_____	_____	_____	_____	_____
Cash Reinvestment	_____	_____	_____	_____	_____
Tax Specialists	_____	_____	_____	_____	_____
Currency Management	_____	_____	_____	_____	_____
Marketing/Client Servicing	_____	_____	_____	_____	_____
Others	_____	_____	_____	_____	_____
TOTAL	_____	_____	_____	_____	_____

D. Risk

1) How does your firm manage the following risks?

- Borrower/Counterparty Risk and Default
- Collateral Investment Risk
- Interest Rate Risk
- Credit Spread Risk
- Liquidity Risk
- Trade Settlement Risk
- Operational Negligence
- Sovereign Risk
- Currency Fluctuation Risk

2) Has your organization experienced any losses due to operational negligence, collateral reinvestment and/or security specific reinvestments, and/or broker default since the inception of your securities lending program? Describe. What

was the recourse provided to clients and the level of dialogue to explain (resolve) the issues?

- 3) How does your organization conduct asset/liability (gap) analysis, specifically the duration of the loan and cash investments?
- 4) Does your firm stress test your securities lending program? Describe the methodology and procedures utilized for stress testing, including the frequency of testing.
- 5) Specify the weighted average duration mismatch between lending and reinvesting for the following quarters. (Provide separate answers for each lending pool or separate accounts offered in your program.)

Year	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
2006				
2007				
2008				
2009				
2010				
2011 (YTD)				

- 6) How quickly (# of days) can your firm shorten the duration or gap between investments and liabilities (loans) as requested by the client for whatever reason?
- 7) Describe your recall procedures and how substitution is utilized.
- 8) Describe your buy-in procedures and in what instances does your firm communicate with clients the relative impact of such buy-in to the underlying value of a security.
- 9) What is your firm's sell fail history, due to security lending for the following asset types -- U.S. Government, international equities, international fixed income, U.S. large cap & small cap equities and corporate bonds over the last three-years as specified below?

YEAR	US Government	International Equities	International Fixed Income	US Large and Small Cap Equities	Corporate Bonds
2006					
2007					
2008					
2009					
2010					
2011 (YTD)					

- 10) Can your program ensure the protection of voting rights by consistently recalling the stock prior to proxy record date? If so, describe the process.
- 11) Does your program accommodate a dividend reinvestment plan for stocks or REITS? Explain.
- 12) What additional safeguards are offered by your firm to its lending participants?
- 13) If a client wished to withdraw from your firm's securities lending program, what notice period is required to ensure 100% on the dollar payoff?
- 14) What are the specific redemption policies for direct lending (custody clients) that your firm has enforced and the underlying rationale behind the policies and guidelines?
- 15) How does your organization propose to address issues related to prohibited transactions based on DOL ERISA guidelines specific to lending to non-US registered borrowers and the acceptance of non-US\$ collateral within the context of the Funds?

E. Borrower Consideration

- 1) Describe how credit analysis is performed and with what frequency the individual borrowers are reviewed.
- 2) Are your risk adjusted credit limits based on securities borrowed?
- 3) How do you ensure that your risk exposure to a borrower is not "watered down" by business relationship?
- 4) What is the maximum value of assets that can be lent to a single approved borrower?
- 5) Describe the process for approving and monitoring borrowers. Who is responsible for the credit review of borrowers and how often it is done?
- 6) Provide a list of your current borrowers. Identify the top ten borrowers and the percentage these borrowers represent of the total program. Can a client restrict specific borrowers?
- 7) Does your Borrower's Agreement specify that "borrowing to manipulate a proxy" is restricted?
- 8) Does your firm proactively visit borrowers at least once a year?
- 9) Kindly state when was the last time your organization visited the top ten borrowers within your program and enumerate

accordingly.

- 10) Does your organization have compensation arrangements with borrowers beyond the normal form of negotiating rebates/fees that the Funds should know about?
- 11) Has your organization ever dismissed or penalized a borrower within your program? Please describe.

F. Collateralization

- 1) What collateralization percentage is required for each of the security types (domestic and international equities and fixed income)? What value (market value only, including accrued interest, etc.) is the basis for this percentage?
- 2) What is the “de minimus” policy?
- 3) How frequently does your firm mark to market the collateral? When is additional collateral requested (same day, next day)?
- 4) How far below the required collateralization percentage must the collateral dip before a margin call is made?
- 5) Is the mark to market process done by loan or security or in aggregate? Please describe both mark-up and mark-down process.

G. Indemnification

- 1) The Funds require full operational and borrower default indemnification within the securities lending program. Is your organization able to comply with this requirement? Describe your full operational and borrower default indemnification policy. Be sure to address the following:
 - Borrower files for bankruptcy for whatever reason.
 - Failure to recall securities before settlement date.
 - Failure to secure additional collateral and margin requirements.
 - Failure to receive dividends, distributions, and all economic benefits of ownership.
 - Immediate use of Non-Cash Collateral in lieu of Borrower Bankruptcy.
- 2) Does your firm provide additional types of indemnification beyond broker default (i.e., collateral, negligence, trade settlement, etc.)? If so, can your firm provide the Funds with these additional levels of indemnification? Describe.
- 3) Is your organization able to provide for total or partial collateral investment risk indemnification? Does your organization have clients with such arrangements? If so, please describe?
- 4) What are the specific limitations of your indemnification?
- 5) Does your firm have any pending lawsuits, legal claims or grievances by any client specific to your securities lending program? Please enumerate.

H. Lending Clients

- 1) Describe your current client base. How many clients participate in your lending program? Without disclosing client names, list as follows as of **June 30, 2011**.

Plan Sponsor Type	No. of Clients (Agent Relationship)	Lendable Base (Agent Relationship)
<i>Corporates</i>		
<i>Public</i>		
<i>Endowment and Foundations</i>		
<i>Taft-Hartley, Union</i>		
<i>Mutual Funds, Investment Manager's Commingled Funds</i>		
<i>Insurance Companies</i>		
<i>Others</i>		
TOTAL		

- 2) Provide the number of clients (all market segments) gained and/or lost for the periods listed in the following matrix. Report corresponding market values in US\$ millions as of initiation date for clients gained and termination date for clients lost.

Securities Lending Clients Only

	Clients Gained (Number)	Clients Gained (US\$ millions)	Clients Lost (Number)	Clients Lost (US\$ millions)
2006				

2007				
2008				
2009				
2010				
2011 (YTD)				

I. Lending Volume

- 1) What was the daily average dollar volume of securities loans outstanding for the last 12 months for each of the last three years? Specify in US\$ millions.

For the 6 months ending June 30, 2011

Asset Classes	Daily Avg. Lendable Base (US\$ millions)	Daily Avg. Out on Loan (US\$ millions)	Avg. Rebate Rate/Fees (bp)	Average Demand Spread (bp)	Average Reinvest Spread (bp)	Avg. Daily Spreads Net of Rebate (bp)
US Large Cap Equities						
US Mid & Small Cap Equities						
US Corp Bonds						
High Yield						
REITS						
US Govt Bonds						
TIPS						
Non-US Equity						
Non-US Fixed Income						

For the 12 months ending December 31, 2010

Asset Classes	Daily Avg. Lendable Base (US\$ millions)	Daily Avg. Out on Loan (US\$ millions)	Avg. Rebate Rate/Fees (bp)	Average Demand Spread (bp)	Average Reinvest Spread (bp)	Avg. Daily Spreads Net of Rebate (bp)
US Large Cap Equities						
US Mid & Small Cap Equities						
US Corp Bonds						
High Yield						
REITS						
US Govt Bonds						
TIPS						
Non-US Equity						
Non-US Fixed Income						

For the 12 months ending December 31, 2009

	Daily Avg.	Daily Avg. Out	Avg.	Average	Average	Avg. Daily
--	------------	----------------	------	---------	---------	------------

Asset Classes	Lendable Base (US\$ millions)	on Loan (US\$ millions)	Rebate Rate/Fees (bp)	Demand Spread (bp)	Reinvest Spread (bp)	Spreads Net of Rebate (bp)
US Large Cap Equities						
US Mid & Small Cap Equities						
US Corp Bonds						
High Yield						
REITS						
US Govt Bonds						
TIPS						
Non-US Equity						
Non-US Fixed Income						

J. Lending Process and Limits

- 1) Does your organization have an internal limit on how much of a client's portfolio of lendable assets can be lent on any given day? If so, please describe your policy.
- 2) Related to the question above, does your firm have an internal limit on how much of a client's lendable assets can be lent to a single borrower on any given day? What is the exposure limit? Is it possible that a single client can be exposed to a single borrower at any given time?
- 3) Does your organization have a lending limit policy for small cap securities? Please describe how your organization mitigates trade fails or other issues associated with the recall of small cap securities.
- 4) What types of limits or restrictions can be automated by your lending system (e.g. by security, by market cap, by short interest percent)?
- 5) Can a client limit lending on any specific security such as: 33 1/3 rule, maintain at least 100 shares, maximum of 25%, tradable lots per position, and/or client specific parameters per security? Please explain.
- 6) Can a client limit lending at a specific security level based on Intrinsic Value such as at least 50 bps of pure demand spread without reinvest, only on negative rebate levels, and/or earnings based on overnight reinvest only? Please explain.
- 7) Is your organization able to monitor for Reg. SHO within your program? Please describe for both domestic and international markets.
- 8) Is your organization able to monitor for "borrowing to manipulate a proxy" within your program? Please describe for both domestic and international markets.
- 9) Describe your allocation or queuing process and relevant entitlement methodology. Show calculations.
- 10) When, why and how does your firm intervene in the allocation or queuing process? Please describe.
- 11) How many lending pools does your firm have? Describe how client assets are assigned to the lending pools.
- 12) Are lending pools segregated by the following? Describe.

Collateral type _____
Plan Sponsor type _____
Asset Class (Equities, Bonds, US, etc.) _____

K. Systems and Technology

- 1) What system is utilized for lending securities? What version? Who updates the program? What is distinct with your current system? Is the system only for lending? How about the reinvesting?
- 2) Does your most recent SAS 70 report include the both lending and reinvesting functions?
- 3) Check if your securities lending system has the following.

Portfolio Management

- input and query on clients' portfolios
- availability of stock inquiry
- input of lending prohibitions
- input of client acceptable collateral

Lending Management

- automated allocation of loans in a fair manner using a parameter controlled allocation formula

- flexible loan amendment
- future dated input
- loan confirmation
- allocation of loan-to-cost centers
- price feed
- daily mark to market
- loan revaluation

Risk Exposure Management and Reporting

- Client credit exposure
- Liquidity constraints
- Redemption Shocks
- Interest rate risk
- Exposure to foreign exchange risk
- Market exposure
- Position/issue exposure
- Collateral exposure
- Total risk or exposure to the market
- stress testing
- gap analysis
- price feed on a real time basis
- exchange rate feeds, including cross currency, - real time

Trading Requirements

1. Input
 - Trade input
 - Trade amendments (price, rate, etc.)
2. Client Information
 - Client Trade history
 - Status (outstanding positions, risk exposure, credit allocated)
 - Credit Utilization
3. Inventory
 - Security availability
 - Firm's net long/short requirements
 - Trading desk's net short/long requirements
4. Collateral Management
 - Maximizing cash/non-cash spreads
 - Maximizing non-cash collateral utilization
 - Cash collateral reinvestment programs
5. Multi-currency
 - Will the system cope with trades that are in several different currencies?
 - Is risk measured in base or security currency?
 - Is fee or rebate income translated into base or reported in local?
 - Are exchange rate exposures on income reported in local?
6. Cross Currency
 - Monitors fee/rebate to be paid in security or collateral currency

Back Office

1. Trade maintenance
 - Rate changes
 - Margin Control
 - Clearance
 - Automated feeds
 - Settlement
 - Fail Management
 - Client confirmations
- Corporate Actions, dividends, and coupon maintenance
- Cash and collateral management

- Rebate and fee maintenance

L. Reporting

- 1) What types of reports are available for securities lending and are the reports available on-line via the Internet? Are the reports updated daily or monthly on-line or through the Internet?
- 2) Describe your firm's income source attribution analysis reporting capability. Can this be customized?
- 3) Is your firm able to provide internet access to information about your securities lending program, including loans outstanding, shares on loan, days out on loan, term or open trades, borrowers for each block of securities lent, collateral portfolio details, collateralization levels, earnings, and other weekly and monthly reporting requirements? If yes, provide samples.
- 4) Describe your firm's ability to report on companies likely to file proxies in the upcoming month based on historic record dates, and provide the number of shares the Funds have on loan.
- 5) On a daily basis, the Funds require full transparency to loans, counterparties, rebates/fees, collateral posted, and collateral investments, including information specific to NAV (fair market value), credit, risk and liquidity risks. Are you able to comply with this requirement and how?
- 6) Does your firm provide audit GASB 28 reports? If so, how frequent?

M. Collateral Reinvest Management

- 1) Provide a brief description of cash collateral reinvestment vehicles (REPO, overnight Treasury, STIF, commingled, customized, separate, 2a-7, etc.) utilized in the reinvestment of cash collateral applicable to the Funds. Furnish, as a separate attachment, the Investment Policies and Guidelines for all funds available for the reinvestment of cash collateral.
- 2) What is the fair market valuation policy for each of the above cash collateral reinvestment vehicles?
- 3) Are you able to handle separate cash collateral reinvestment accounts managed by the Funds or a third party? Explain how cash flow and communication would work.
- 4) Are you able to manage multiple separate account cash collateral reinvestment just for the Funds? If yes, what would be the minimum asset value size to achieve proper diversification and liquidity?
- 5) Please specify if the cash collateral reinvest vehicle are daily valued at market or based on amortized cost.
- 6) Do the cash collateral pools invest in paper or short term/to medium term debt instruments issued by borrowers in your program?
- 7) Did the collateral pools experience issuer default (i.e. Lehman, Sigma, Theta, etc.)?
- 8) Do the collateral pools have both liquidity risk issues and extension risk?
- 9) Does your organization have cash collateral pools dedicated to securities lending that conforms to a registered 2a-7 fund structure? Does your organization have a 100% full overnight option? Please describe.
- 10) Have any of your cash collateral reinvestment pools or separate accounts experienced losses (both realized and unrealized losses) during the financial crisis up to this point?
- 11) Are derivatives and/or structured vehicles employed in the cash reinvestment program? If yes, specify types and usage.
- 12) Do you rely solely on rating agencies in determining the credit quality of a security suitable for reinvestment of cash collateral?
- 13) If unrealized losses or highly illiquid vehicles exist in your program, will the Funds end-up owning a slice of the losses if they select your program? How will your firm going to protect the Funds and not subject the Funds to both realized and unrealized losses going forward?
- 14) If all your clients, at the same time, stop the program or do a "short fuse" termination today, will clients incur losses? If so, what is/are the redemption policies that your firm instituted recently? Please provide full disclosure.
- 15) Clearly state the gating and redemption procedures your firm instituted, enhanced, or codified regarding client's rights regarding securities lending exit or withdrawal from the program.
- 16) Does the vendor provide data to third parties such as Data Explorers, Equilend or Astec? If so, describe fee arrangements including any soft dollar compensation and whether this is shared with the beneficial owner. Also describe access the beneficial owner would have to these databases.

N. Conversion Process

- 1) Describe your organization's formal transition planning process as it would apply to securities lending program.
- 2) For example, given a notification of engagement by the end of March 2012 and a targeted conversion of July 1, 2012, please provide a transition calendar.
- 3) How should we handle securities out on loan during the conversion process? What should we consider in terms of unwinding without a loss, novation, substitution, recall, etc.?
- 4) What are the exit strategies that you would deploy specific to impairment, extension risk or cash collateral losses, including gating or redemption restrictions to avoid triggering events that could lead to losses?

O. References

Please provide a list of three public fund client references of similar size with contact information specific to securities lending services that you are contracted to provide.

MINORITY PARTICIPATION

Is the bidder a South Carolina Certified Minority Business? Yes No

Is the bidder a Minority Business certified by another governmental entity? Yes No

If so, please list the certifying governmental entity: _____

Will any of the work under this contract be performed by a SC certified Minority Business as a subcontractor? Yes No

If so, what percentage of the total value of the contract will be performed by a SC certified Minority Business as a subcontractor? _____

Will any of the work under this contract be performed by a minority business certified by another governmental entity as a subcontractor? Yes No

If so, what percentage of the total value of the contract will be performed by a minority business certified by another governmental entity as a subcontractor? _____

If a certified Minority Business is participating in this contract, please indicate all categories for which the Business is certified:

- Traditional minority
- Traditional minority, but female
- Women (Caucasian females)
- Hispanic minorities
- DOT referral (Traditional minority)
- DOT referral (Caucasian female)
- Temporary certification
- SBA 8 (a) certification referral
- Other minorities (Native American, Asian, etc.)

(If more than one minority contractor will be utilized in the performance of this contract, please provide the information above for each minority business.)

For a list of certified minority firms, please consult the Minority Business Directory, which is available at the following URL:<http://www.govoepp.state.sc.us/osmba/>

V. QUALIFICATIONS

QUALIFICATION OF OFFEROR

To be eligible for award of a contract, a prospective contractor must be responsible. In evaluating an Offeror's responsibility, the State Standards of Responsibility [R.19-445.2125] and information from any other source may be considered. An Offeror must, upon request of the State, furnish satisfactory evidence of its ability to meet all contractual requirements. Unreasonable failure to supply information promptly in connection with a responsibility inquiry may be grounds for determining that you are ineligible to receive an award.

In order to be qualified to receive award, you must meet the following mandatory minimum qualifications. All minimum qualifications must be met as of June 30, 2011.

A. Custody

1. If submitting a proposal, the offeror must have at least \$500 billion in tax-exempt trust/master custody assets as of June 30, 2011. This amount must include at least \$25 billion in international equity and fixed income.
2. As of June 30, 2011, the offeror must have provided custody services for a minimum of ten (10) years.
3. The account manager assigned must have had a minimum of five (5) years experience in the master trust/custody field with at least three (3) years experience at the responding firm. The transition team leader and his/her assistant must have worked together on at least three (3) prior major conversions of an account with market value in excess of \$5 billion consisting of multiple asset classes.
4. The offeror must be authorized to conduct a trust/custody business in the State of South Carolina.

B. Securities Lending

1. If submitting a proposal, the offeror must have at least \$100 billion in securities lending lendable base on an agency basis as of June 30, 2011.
2. As of June 30, 2011, the offeror must have provided securities lending services for a minimum of ten (10) years.
3. Will accept responsibility for securities lending program as a fully indemnified program specific to borrower and operational default.
4. The account manager assigned must have had a minimum of five (5) years experience in the securities lending field with at least three (3) years experience at the responding firm.

SUBCONTRACTOR -- IDENTIFICATION

If you intend to subcontract with another business for any portion of the work and that portion exceeds 10% of your price, your offer must identify that business and the portion of work which they are to perform. Identify potential subcontractors by providing the business name, address, phone, taxpayer identification number, and point of contact. In determining your responsibility, the state may evaluate your proposed subcontractors.

VI. AWARD CRITERIA

AWARD CRITERIA -- PROPOSALS

Award will be made to the highest ranked, responsive and responsible offeror whose offer is determined to be the most advantageous to the State.

EVALUATION FACTORS -- PROPOSALS

Offers will be evaluated using only the factors stated below. Evaluation factors are stated below in no particular order of importance. Once evaluation is complete, all responsive offerors will be ranked from most advantageous to least advantageous.

- Custody and Asset Servicing
- Accounting and Reporting
- Alternative Investment Support
- Performance Measurement and Risk Analytics
- Client Servicing
- Organization and Experience
- Financials and Risk
- Securities Lending
- Systems and Technology
- Costs and Other Fee Considerations

Office of the State Treasurer, with assistance from the Retirement Systems and the Investment Commission, seeks to retain the highest quality organization to provide trust/custody services in an open, fair, and competitive process. Through the selection process, the State Treasurer reserves its sole discretion in awarding the contract. The State Treasurer reserves the right: (i) not to select any proposal; (ii) to select any portions of a particular proposal for further consideration; (iii) to accept a proposal other than the lowest cost proposal submitted; or (iv) to reject any and all proposals received if such action is considered by the State Treasurer in its sole discretion to be in the best interests of participants. The State Treasurer seeks innovative ideas, presented in a complete custody service package, which can meet the requirements of both management and staff and help streamline and improve the way in which the Office of the State Treasurer, the Retirement Systems and the Investment Commission manages their operations.

VII. TERMS AND CONDITIONS -- A. GENERAL

ASSIGNMENT

No contract or its provisions may be assigned, sublet, or transferred without the written consent of the Procurement Officer.

BANKRUPTCY

(a) Notice. In the event the Contractor enters into proceedings relating to bankruptcy, whether voluntary or involuntary, the Contractor agrees to furnish written notification of the bankruptcy to the Using Governmental Unit. This notification shall be furnished within five (5) days of the initiation of the proceedings relating to the bankruptcy filing. This notification shall include the date on which the bankruptcy petition was filed, the identity of the court in which the bankruptcy petition was filed, and a listing of all State contracts against which final payment has not been made. This obligation remains in effect until final payment under this Contract. (b) Termination. This contract is voidable and subject to immediate termination by the State upon the contractor's insolvency, including the filing of proceedings in bankruptcy.

CHOICE-OF-LAW

The Agreement, any dispute, claim, or controversy relating to the Agreement, and all the rights and obligations of the parties shall, in all respects, be interpreted, construed, enforced and governed by and under the laws of the State of South Carolina, except its choice of law rules. As used in this paragraph, the term "Agreement" means any transaction or agreement arising out of, relating to, or contemplated by the solicitation.

CONTRACT DOCUMENTS and ORDER OF PRECEDENCE

(a) Any contract resulting from this solicitation shall consist of the following documents: (1) a Record of Negotiations, if any, executed by you and the Procurement Officer, (2) documentation regarding the clarification of an offer, if applicable, (3) the solicitation, as amended, (4) modifications, if any, to your offer, if accepted by the Procurement Officer, (5) your offer, (6) any statement reflecting the state's final acceptance (a/k/a "award"), and (7) purchase orders. These documents shall be read to be consistent and complimentary. Any conflict among these documents shall be resolved by giving priority to these documents in the order listed above. (b) The terms and conditions of documents (1) through (6) above shall apply notwithstanding any additional or different terms and conditions in either (i) a purchase order or other instrument submitted by the State or (ii) any invoice or other document submitted by Contractor. Except as otherwise allowed herein, the terms and conditions of all such documents shall be void and of no effect. (c) No contract, license, or other agreement containing contractual terms and conditions will be signed by any Using Governmental Unit. Any document signed or otherwise agreed to by persons other than the Procurement Officer shall be void and of no effect.

DISPUTES

(1) Choice-of-Forum. All disputes, claims, or controversies relating to the Agreement shall be resolved exclusively in the Court of Common Pleas for, or a federal court located in, Richland County, State of South Carolina. Contractor agrees that any act by the Government regarding the Agreement is not a waiver of either the Government's sovereign immunity or the Government's immunity under the Eleventh Amendment of the United State's Constitution. As used in this paragraph, the term "Agreement" means any transaction or agreement arising out of, relating to, or contemplated by the solicitation. (2) Service of Process. Contractor consents that any papers, notices, or process necessary or proper for the initiation or continuation of any disputes, claims, or controversies relating to the Agreement; for any court action in connection therewith; or for the entry of judgment on any award made, may be served on Contractor by certified mail (return receipt requested) addressed to Contractor at the address provided as the Notice Address on Page Two or by personal service or by any other manner that is permitted by law, in or outside South Carolina. Notice by certified mail is deemed duly given upon deposit in the United States mail.

EQUAL OPPORTUNITY

Contractor is referred to and shall comply with all applicable provisions, if any, of Title 41, Part 60 of the Code of Federal Regulations, including but not limited to Sections 60-1.4, 60-4.2, 60-4.3, 60-250.5(a), and 60-741.5(a), which are hereby incorporated by reference.

FALSE CLAIMS

According to the S.C. Code of Laws Section 16-13-240, "a person who by false pretense or representation obtains the signature of a person to a written instrument or obtains from another person any chattel, money, valuable security, or other property, real or personal, with intent to cheat and defraud a person of that property is guilty" of a crime.

FIXED PRICING REQUIRED

Any pricing provided by contractor shall include all costs for performing the work associated with that price. Except as otherwise provided in this solicitation, contractor's price shall be fixed for the duration of this contract, including option terms. This clause does not prohibit contractor from offering lower pricing after award.

NON-INDEMNIFICATION

Any term or condition is void to the extent it requires the State to indemnify anyone.

NOTICE

(A) After award, any notices shall be in writing and shall be deemed duly given (1) upon actual delivery, if delivery is by hand, (2) upon receipt by the transmitting party of automated confirmation or answer back from the recipient's device if delivery is by telex, telegram, facsimile, or electronic mail, or (3) upon deposit into the United States mail, if postage is prepaid, a return receipt is requested, and either registered or certified mail is used. (B) Notice to contractor shall be to the address identified as the Notice Address on Page Two. Notice to the state shall be to the Procurement Officer's address on the Cover Page. Either party may designate a different address for notice by giving notice in accordance with this paragraph.

PUBLICITY

Contractor shall not publish any comments or quotes by State employees, or include the State in either news releases or a published list of customers, without the prior written approval of the Procurement Officer.

PURCHASE ORDERS

Contractor shall not perform any work prior to the receipt of a purchase order from the using governmental unit. The using governmental unit shall order any supplies or services to be furnished under this contract by issuing a purchase order. Purchase orders may be used to elect any options available under this contract, e.g., quantity, item, delivery date, payment method, but are subject to all terms and conditions of this contract. Purchase orders may be electronic. No particular form is required. An order placed pursuant to the purchasing card provision qualifies as a purchase order.

SETOFF

The state shall have all of its common law, equitable, and statutory rights of set-off. These rights shall include, but not be limited to, the State's option to withhold for the purposes of set-off any moneys due to the Contractor under this contract up to any amounts due and owing to the state with regard to this contract, any other contract with any state department or agency, including any contract for a term commencing prior to the term of this contract, plus any amounts due and owing to the state for any other reason including, without limitation, tax delinquencies, fee delinquencies or monetary penalties relative thereto.

SURVIVAL OF OBLIGATIONS

The Parties' rights and obligations which, by their nature, would continue beyond the termination, cancellation, rejection, or expiration of this contract shall survive such termination, cancellation, rejection, or expiration, including, but not limited to, the rights and obligations created by the following clauses: Indemnification - Third Party Claims, Intellectual Property Indemnification, and any provisions regarding warranty or audit.

TAXES

Any tax the contractor may be required to collect or pay upon the sale, use or delivery of the products shall be paid by the State, and such sums shall be due and payable to the contractor upon acceptance. Any personal property taxes levied after delivery shall be paid by the State. It shall be solely the State's obligation, after payment to contractor, to challenge the applicability of any tax by negotiation with, or action against, the taxing authority. Contractor agrees to refund any tax collected, which is subsequently determined not to be proper and for which a refund has been paid to contractor by the taxing authority. In the event that the contractor fails to pay, or delays in paying, to any taxing authorities, sums paid by the State to contractor, contractor shall be liable to the State for any loss (such as the assessment of additional interest) caused by virtue of this failure or delay. Taxes based on Contractor's net income or assets shall be the sole responsibility of the contractor.

THIRD PARTY BENEFICIARY

This Contract is made solely and specifically among and for the benefit of the parties hereto, and their respective successors and assigns, and no other person will have any rights, interest, or claims hereunder or be entitled to any benefits under or on account of this Contract as a third party beneficiary or otherwise.

WAIVER

The State does not waive any prior or subsequent breach of the terms of the Contract by making payments on the Contract, by failing to terminate the Contract for lack of performance, or by failing to strictly or promptly insist upon any term of the Contract. Only the Procurement Officer has actual authority to waive any of the State's rights under this Contract. Any waiver must be in writing.

VII. TERMS AND CONDITIONS -- B. SPECIAL

CHANGES

(1) Contract Modification. By a written order, at any time, and without notice to any surety, the Procurement Officer may, subject to all appropriate adjustments, make changes within the general scope of this contract in any one or more of the following:

- (a) drawings, designs, or specifications, if the supplies to be furnished are to be specially manufactured for the [State] in accordance therewith;
- (b) method of shipment or packing;
- (c) place of delivery;
- (d) description of services to be performed;
- (e) time of performance (i.e., hours of the day, days of the week, etc.); or,
- (f) place of performance of the services. Subparagraphs (a) to (c) apply only if supplies are furnished under this contract. Subparagraphs (d) to (f) apply only if services are performed under this contract.

(2) Adjustments of Price or Time for Performance. If any such change increases or decreases the contractor's cost of, or the time required for, performance of any part of the work under this contract, whether or not changed by the order, an adjustment shall be made in the contract price, the delivery schedule, or both, and the contract modified in writing accordingly. Any adjustment in contract price made pursuant to this clause shall be determined in accordance with the Price Adjustment Clause of this contract. Failure of the parties to agree to an adjustment shall not excuse the contractor from proceeding with the contract as changed, provided that the State promptly and duly make such provisional adjustments in payment or time for performance as may be reasonable. By proceeding with the work, the contractor shall not be deemed to have prejudiced any claim for additional compensation, or an extension of time for completion.

(3) Time Period for Claim. Within 30 days after receipt of a written contract modification under Paragraph (1) of this clause, unless such period is extended by the Procurement Officer in writing, the contractor shall file notice of intent to assert a claim for an adjustment. Later notification shall not bar the contractor's claim unless the State is prejudiced by the delay in notification.

(4) Claim Barred After Final Payment. No claim by the contractor for an adjustment hereunder shall be allowed if notice is not given prior to final payment under this contract.

COMPLIANCE WITH LAWS

During the term of the contract, contractor shall comply with all applicable provisions of laws, codes, ordinances, rules, regulations, and tariffs.

CONTRACTOR PERSONNEL

The Contractor shall enforce strict discipline and good order among the Contractor's employees and other persons carrying out the Contract. The Contractor shall not permit employment of unfit persons or persons not skilled in tasks assigned to them.

CONTRACTOR'S OBLIGATION -- GENERAL

The contractor shall provide and pay for all materials, tools, equipment, labor and professional and non-professional services, and shall perform all other acts and supply all other things necessary, to fully and properly perform and complete the work. The contractor must act as the prime contractor and assume full responsibility for any subcontractor's performance. The contractor will be considered the sole point of contact with regard to all situations, including payment of all charges and the meeting of all other requirements.

CONTRACTOR'S LIABILITY INSURANCE

Please provide the nature, specifics and amounts of liability insurance that you will provide on order to fully protect the State's interests over the full term of the resulting contract and extensions, if any.

CONTRACTOR'S USE OF STATE PROPERTY

Upon termination of the contract for any reason, the State shall have the right, upon demand, to obtain access to, and possession of, all State properties, including, but not limited to, current copies of all State application programs and necessary documentation, all data, files, intermediate materials and supplies held by the contractor. Contractor shall not use, reproduce, distribute, display, or sell any data, material, or documentation owned exclusively by the State without the State's written consent, except to the extent necessary to carry out the work.

DEFAULT

(a) (1) The State may, subject to paragraphs (c) and (d) of this clause, by written notice of default to the Contractor, terminate this contract in whole or in part if the Contractor fails to:

- (i) Deliver the supplies or to perform the services within the time specified in this contract or any extension;
- (ii) Make progress, so as to endanger performance of this contract (but see paragraph (a)(2) of this clause); or
- (iii) Perform any of the other material provisions of this contract (but see paragraph (a)(2) of this clause).

(2) The State's right to terminate this contract under subdivisions (a)(1)(ii) and (1)(iii) of this clause, may be exercised if the Contractor does not cure such failure within 10 days (or more if authorized in writing by the Procurement Officer) after receipt of the notice from the Procurement Officer specifying the failure.

(b) If the State terminates this contract in whole or in part, it may acquire, under the terms and in the manner the Procurement Officer considers appropriate, supplies or services similar to those terminated, and the Contractor will be liable to the State for any excess costs for those supplies or services. However, the Contractor shall continue the work not terminated.

(c) Except for defaults of subcontractors at any tier, the Contractor shall not be liable for any excess costs if the failure to perform the contract arises from causes beyond the control and without the fault or negligence of the Contractor. Examples of such causes include (1) acts of God or of the public enemy, (2) acts of the State in either its sovereign or contractual capacity, (3) fires, (4) floods, (5) epidemics, (6) quarantine restrictions, (7) strikes, (8) freight embargoes, and (9) unusually severe weather. In each instance the failure to perform must be beyond the control and without the fault or negligence of the Contractor.

(d) If the failure to perform is caused by the default of a subcontractor at any tier, and if the cause of the default is beyond the control of both the Contractor and subcontractor, and without the fault or negligence of either, the Contractor shall not be liable for any excess costs for failure to perform, unless the subcontracted supplies or services were obtainable from other sources in sufficient time for the Contractor to meet the required delivery schedule.

(e) If this contract is terminated for default, the State may require the Contractor to transfer title and deliver to the State, as directed by the Procurement Officer, any (1) completed supplies, and (2) partially completed supplies and materials, parts, tools, dies, jigs, fixtures, plans, drawings, information, and contract rights (collectively referred to as "manufacturing materials" in this clause) that the Contractor has specifically produced or acquired for the terminated portion of this contract. Upon direction of the Procurement Officer, the Contractor shall also protect and preserve property in its possession in which the State has an interest.

(f) The State shall pay contract price for completed supplies delivered and accepted. The Contractor and Procurement Officer shall agree on the amount of payment for manufacturing materials delivered and accepted and for the protection and preservation of the property; if the parties fail to agree, the Procurement Officer shall set an amount subject to the Contractor's rights under the Disputes clause. Failure to agree will be a dispute under the Disputes clause. The State may withhold from these amounts any sum the Procurement Officer determines to be necessary to protect the State against loss because of outstanding liens or claims of former lien holders.

(g) If, after termination, it is determined that the Contractor was not in default, or that the default was excusable, the rights and obligations of the parties shall, if the contract contains a clause providing for termination for convenience of the State, be the same as if the termination had been issued for the convenience of the State. If, in the foregoing circumstances, this contract does not contain a clause providing for termination for convenience of the State, the contract shall be adjusted to compensate for such termination and the contract modified accordingly subject to the contractor's rights under the Disputes clause.

(h) The rights and remedies of the State in this clause are in addition to any other rights and remedies provided by law or under this contract.

ILLEGAL IMMIGRATION

(An overview is available at www.procurement.sc.gov) By signing your offer, you certify that you will comply with the applicable requirements of Title 8, Chapter 14 of the South Carolina Code of Laws and agree to provide to the State upon request any documentation required to establish either: (a) that Title 8, Chapter 14 is inapplicable to you and your subcontractors or sub-subcontractors; or (b) that you and your subcontractors or sub-subcontractors are in compliance with Title 8, Chapter 14. Pursuant to Section 8-14-60, "A person who knowingly makes or files any false, fictitious, or fraudulent document, statement, or report pursuant to this chapter is guilty of a felony, and, upon conviction, must be fined within the discretion of the court or imprisoned for not more than five years, or both." You agree to include in any contracts with your subcontractors language requiring your subcontractors to (a) comply with the applicable requirements of Title 8, Chapter 14, and (b) include in their contracts with the sub-subcontractors language requiring the sub-subcontractors to comply with the applicable requirements of Title 8, Chapter 14.

INDEMNIFICATION - THIRD PARTY CLAIMS

Notwithstanding any limitation in this agreement, and to the fullest extent permitted by law, Contractor shall defend and hold harmless Indemnitees for and against any and all suits or claims of any character (and all related damages, settlement payments, attorneys' fees, costs, expenses, losses or liabilities) by a third party which are attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property arising out of or in connection with the goods or services acquired hereunder or caused in whole or in part by any act or omission of contractor, its subcontractors, their employees, workmen, servants, agents, or anyone directly or indirectly employed by them or anyone for whose acts any of them may be liable, regardless of whether or not caused in part by an Indemnitee, and whether or not such claims are made by a third party or an Indemnitee; however, if an Indemnitee's negligent act or omission is subsequently determined to be the sole proximate cause of a suit or claim, the Indemnitee shall not be entitled to indemnification hereunder. Contractor shall be given timely written notice of any suit or claim. Contractor's obligations hereunder are in no way limited by any protection afforded under workers' compensation acts, disability benefits acts, or other employee benefit acts. This clause shall not negate, abridge, or reduce any other rights or obligations of indemnity which would otherwise exist. The obligations of this paragraph shall survive termination, cancelation, or expiration of the parties' agreement. This provision shall be construed fairly and reasonably, neither strongly for nor against either party, and without regard to any clause regarding insurance. As used in this clause, "Indemnitees" means the State of South Carolina, its instrumentalities, agencies, departments, boards, political subdivisions and all their respective officers, agents and employees.

LICENSES AND PERMITS

During the term of the contract, the Contractor shall be responsible for obtaining, and maintaining in good standing, all licenses (including professional licenses, if any), permits, inspections and related fees for each or any such licenses, permits and /or inspections required by the State, county, city or other government entity or unit to accomplish the work specified in this solicitation and the contract.

PAYMENT

Contractor will be paid based on negotiated fees or rates as specified in the Fee Section, as established by this RFP.

PRICE ADJUSTMENTS

(1) Method of Adjustment. Any adjustment in the contract price made pursuant to a clause in this contract shall be consistent with this Contract and shall be arrived at through whichever one of the following ways is the most valid approximation of the actual cost to the Contractor (including profit, if otherwise allowed):

(a) by agreement on a fixed price adjustment before commencement of the pertinent performance or as soon thereafter as practicable;

- (b) by unit prices specified in the Contract or subsequently agreed upon;
 - (c) by the costs attributable to the event or situation covered by the relevant clause, including profit if otherwise allowed, all as specified in the Contract; or subsequently agreed upon;
 - (d) in such other manner as the parties may mutually agree; or,
 - (e) in the absence of agreement by the parties, through a unilateral initial written determination by the Procurement Officer of the costs attributable to the event or situation covered by the clause, including profit if otherwise allowed, all as computed by the Procurement Officer in accordance with generally accepted accounting principles.
- (2) Submission of Price or Cost Data. Upon request of the Procurement Officer, the contractor shall provide reasonably available factual information to substantiate that the price or cost offered, for any price adjustments is reasonable.

PRICING DATA -- AUDIT -- INSPECTION

(a) Cost or Pricing Data. Upon Procurement Officer's request, you shall submit cost or pricing data, as defined by 48 C.F.R. Section 2.101 (2004), prior to either (1) any award to contractor or (2) execution of a change order or contract modification with contractor. Your price, including profit or fee, shall be adjusted to exclude any significant sums by which the state finds that such price was increased because you furnished cost or pricing data that was inaccurate, incomplete, or not current as of the date agreed upon between parties. (b) Records Retention. You shall maintain your records for three years from the date of final payment, or longer if requested by the chief Procurement Officer. The state may audit your records at reasonable times and places. As used in this subparagraph (b), the term "records" means any books or records that relate to cost or pricing data submitted pursuant to this clause. In addition to the obligation stated in this subparagraph (b), you shall retain all records and allow any audits provided. (c) Inspection. At reasonable times, the state may inspect any part of your place of business which is related to performance of the work. (d) Instructions Certification. When you submit data pursuant to subparagraph (a), you shall (1) do so in accordance with the instructions appearing in Table 15-2 of 48 C.F.R. Section 15.408 (2004) (adapted as necessary for the state context), and (2) submit a Certificate of Current Cost or Pricing Data, as prescribed by 48 CFR Section 15.406-2(a) (adapted as necessary for the state context). (e) Subcontracts. You shall include the above text of this clause in all of your subcontracts. (f) Nothing in this clause limits any other rights of the state.

RELATIONSHIP OF THE PARTIES

Neither party is an employee, agent, partner, or joint venturer of the other. Neither party has the right or ability to bind the other to any agreement with a third party or to incur any obligation or liability on behalf of the other party.

TERM OF CONTRACT -- EFFECTIVE DATE / INITIAL CONTRACT PERIOD

The effective date of this contract is the first day of the Maximum Contract Period as specified on the final statement of award. The initial term of this agreement is 5 years from the effective date. Regardless, this contract expires no later than the last date stated on the final statement of award. THE CONTRACT IS FOR 5 YEARS + 2 ADDITIONAL YEARLY EXTENSION/RENEWAL.

TERM OF CONTRACT -- TERMINATION BY CONTRACTOR

Contractor may terminate this contract by providing the Procurement Officer a one year notice of its election to terminate under this clause prior to any yearly anniversary of the start date as listed on the Intent to Award.

TERMINATION FOR CONVENIENCE

- (1) Termination. The Procurement Officer may terminate this contract in whole or in part, for the convenience of the State. The Procurement Officer shall give written notice of the termination to the contractor specifying the part of the contract terminated and when termination becomes effective.
- (2) Contractor's Obligations. The contractor shall incur no further obligations in connection with the terminated work and on the date set in the notice of termination the contractor will stop work to the extent specified. The contractor shall also terminate outstanding orders and subcontracts as they relate to the terminated work. The contractor shall settle the liabilities and claims arising out of the termination of subcontracts and orders connected with the terminated work. The Procurement Officer may direct the contractor to assign the contractor's right, title, and interest under terminated orders or subcontracts to the State. The contractor must still complete the work not terminated by the notice of termination and may incur obligations as are necessary to do so.

(3) Right to Supplies. The Procurement Officer may require the contractor to transfer title and deliver to the State in the manner and to the extent directed by the Procurement Officer: (a) any completed supplies; and (b) such partially completed supplies and materials, parts, tools, dies, jigs, fixtures, plans, drawings, information, and contract rights (hereinafter called "manufacturing material") as the contractor has specifically produced or specially acquired for the performance of the terminated part of this contract. The contractor shall, upon direction of the Procurement Officer, protect and preserve property in the possession of the contractor in which the State has an interest. If the Procurement Officer does not exercise this right, the contractor shall use best efforts to sell such supplies and manufacturing materials in a accordance with the standards of Uniform Commercial Code Section 2-706. Utilization of this Section in no way implies that the State has breached the contract by exercise of the Termination for Convenience Clause.

(4) Compensation. (a) The contractor shall submit a termination claim specifying the amounts due because of the termination for convenience together with cost or pricing data required for such claim. If the contractor fails to file a termination claim within one year from the effective date of termination, the Procurement Officer may pay the contractor, if at all, an amount set in accordance with Subparagraph (c) of this Paragraph.

(b) The Procurement Officer and the contractor may agree to a settlement and that the settlement does not exceed the total contract price plus settlement costs reduced by payments previously made by the State, the proceeds of any sales of supplies and manufacturing materials under Paragraph (3) of this clause, and the contract price of the work not terminated;

(c) Absent complete agreement under Subparagraph (b) of this Paragraph, the Procurement Officer shall pay the contractor the following amounts, provided payments agreed to under Subparagraph (b) shall not duplicate payments under this Subparagraph:

(i) contract prices for supplies or services accepted under the contract;

(ii) costs reasonably incurred in performing the terminated portion of the work less amounts paid or to be paid for accepted supplies or services;

(iii) reasonable costs of settling and paying claims arising out of the termination of subcontracts or orders pursuant to Paragraph (2) of this clause. These costs must not include costs paid in accordance with Subparagraph (c)(ii) of this paragraph;

(iv) any other reasonable costs that have resulted from the termination. The total sum to be paid the contractor under this Subparagraph shall not exceed the total contract price plus the reasonable settlement costs of the contractor reduced by the amount of payments otherwise made, the proceeds of any sales of supplies and manufacturing materials under Subparagraph (b) of this Paragraph, and the contract price of work not terminated.

(d) Contractor must demonstrate any costs claimed, agreed to, or established under Subparagraphs (b) and (c) of this Paragraph using its standard record keeping system, provided such system is consistent with any applicable Generally Accepted Accounting Principles.

(5) Contractor's failure to include an appropriate termination for convenience clause in any subcontract shall not (i) affect the state's right to require the termination of a subcontract, or (ii) increase the obligation of the state beyond what it would have been if the subcontract had contained an appropriate clause.

VIII. COST PROPOSAL

Based upon the information provided in this request for proposal, state your annual fee for the next five years for the proposed contract with the Office of the State Treasurer. Please provide three separate fee quotes for custody with securities lending, custody without securities lending, and standalone securities lending only.

CUSTODY AND RELATED FEES

A. Please provide an annual flat fee for custody services required by the Funds. The flat fee should be quoted in a flat dollar (in US dollars) basis.

If the function of securities lending is allowed: (Please note that the Funds are asking “if your organization is given the mandate” to lend securities and not to net the revenue stream generated from securities lending to the flat dollar fee.)

SC General Account and LGIP	Flat Dollar Fee
1 st Year	
2 nd Year	
3 rd Year	
4 th Year	
5 th Year	

SC Retirement Systems	Flat Dollar Fee
1 st Year	
2 nd Year	
3 rd Year	
4 th Year	
5 th Year	

If the function of securities lending is not allowed: (Please note that the Funds are asking “if your organization is not given the mandate” to lend securities.)

SC General Account and LGIP	Flat Dollar Fee
1 st Year	
2 nd Year	
3 rd Year	
4 th Year	
5 th Year	

SC Retirement Systems	Flat Dollar Fee
1 st Year	
2 nd Year	
3 rd Year	
4 th Year	
5 th Year	

B. What are the short term investment vehicles you propose as applicable to either the Retirement Systems or the General Account/LGIP? What is the total expense ratio, including management fees? (Specify: Sweep Options, Late Day Cash, Overnight, FDIC approved, 2a-7 funds, and US Government Only.)

C. What are the overdraft charges for domestic and international transactions?

D. What is the proposed Securities Lending Revenue Sharing Arrangement or Split, including the level of indemnification provided?

E. Identify the services included in the flat fee stated in Item A and based on the current investment structure of the Funds:

a) Custody Services for all Asset Types (i.e., domestic and international)? **yes** ___ **no** ___

If **no**, what are the charges?

Safekeeping	\$ _____	charge or fee
Asset Servicing	\$ _____	charge or fee
Transaction Processing	\$ _____	charge or fee

Do the custody services include? (please check)

___ Power of Attorney Support
 ___ Global Tax Agent Support
 ___ Country Regulatory Registration
 ___ Tax-Exempt Filing Assistance
 ___ Market Guide

b) Multicurrency Full Accrual Trade Date Accounting and Reporting? **yes** ___ **no** ___

If **no**, what are the charges?

Standard reports	\$ _____	charge or fee
Customized reporting	\$ _____	charge or fee

c) Accounting - Monthly Valuation? **yes** ___ **no** ___

If **no**, what are the charges?

Per portfolio	\$ _____	charge or fee
Per Asset Level, Fund or Composite	\$ _____	charge or fee

d) Daily On-line/Internet services? **yes** ___ **no** ___

If **no**, what are the charges?

_____	\$ _____	charge or fee
_____	\$ _____	charge or fee

e) Contractual Settlement and Auto credit program? **yes** ___ **no** ___

If **no**, what are the charges?

Domestic	\$ _____	charge or fee
International	\$ _____	charge or fee
ADR's	\$ _____	charge or fee

f) Transition, conversion, and reregistration costs? **yes** ___ **no** ___

If **no**, what are the charges?

\$ _____	charge or fee
\$ _____	charge or fee
\$ _____	charge or fee

g) Penalty costs? **yes** ___ **no** ___

If **no**, what are the costs?

Third-party FX trades	_____	per trade
Third-party Sec lending	_____	based administration fee
Others: (specify)	_____	transactions (see below)

Specific to support for Third Party Securities Lending Programs (If fees are different than those delineated below list additional fees)

Third party	\$ _____	charge or fee
Annual third party collateral custody fee (based on Cash Collateral NAV)	\$ _____	charge or fee
Third party purchases/sales transactions – DTC Manual	\$ _____	charge or fee
Third party purchases/sales transactions – DTC Electronic	\$ _____	charge or fee
Third party purchases/sales transactions – Euroclear Manual	\$ _____	charge or fee
Third party loans/loan returns – DTC and FED book entry manual processing	\$ _____	charge or fee
Third party loans/loan returns – DTC and FED book electronic	\$ _____	charge or fee

delivery

Third party marks – DTC SPO – Flat monthly fee – manual \$ _____ charge or fee

Third party marks – DTC SPO – Flat monthly fee – electronic \$ _____ charge or fee

Third party marks – DTC SPO – FED book entry – manual \$ _____ charge or fee

processing (each way)

Third party marks – DTC SPO – FED book entry – electronic \$ _____ charge or fee

processing (each way)

Third party outgoing wires \$ _____ charge or fee

Third party incoming wires \$ _____ charge or fee

Third party Cash Monitoring system fees \$ _____ charge or fee

Third party DDA fees (monthly per DDA) \$ _____ charge or fee

Third party Cash Monitoring installation fees \$ _____ charge or fee

Third party technology/programming development time \$ _____ charge or fee

(hours) INCLUDED in core/transition

Third party technology/programming development time hourly \$ _____ charge or fee

rate after included quantity

Third party monthly file maintenance fee (24/7/365 \$ _____ charge or fee

monitoring, support and maintenance)

Any additional clarification of third party support (bundled \$ _____ charge or fee

program support with all applicable limits (# lenders, etc.) and

clarifications)

Any/All other charges (explain). \$ _____ charge or fee

h) Out-of-pocket expenses? **yes** ___ **no** ___

If **no**, what are the charges?

Wire transfer \$ _____ charge or fee

Courier service \$ _____ charge or fee

Telex charges \$ _____ charge or fee

Computer processing \$ _____ charge or fee

Staff training \$ _____ charge or fee

Stamp duty \$ _____ charge or fee

Registration \$ _____ charge or fee

Others: (specify) \$ _____ charge or fee

i) Corporate Actions – both Domestic and International?

Voluntary/Mandatory \$ _____ charge or fee

Involuntary \$ _____ charge or fee

Others: \$ _____ charge or fee

j) Proxy notification? **yes** ___ **no** ___

If **no**, what are the charges?

Reporting: \$ _____ charge or fee

On-line Access: \$ _____ charge or fee

Others: _____ \$ _____ charge or fee

k) Class Action – both Domestic and International? **yes** ___ **no** ___

If **no**, what are the charges?

Reporting \$ _____ charge or fee

On-line Access \$ _____ charge or fee

Legal Filings \$ _____ charge or fee

Others: _____ \$ _____ charge or fee

l) The Funds require a minimum of 40 hours for training and continuing education for keeping clients abreast of new developments within your organization and the trust/custody/securities lending/fund administration industry?

yes ___ **no** ___

If **no**, what are the fees or charges?

\$ _____ charge or fee

\$ _____ charge or fee

\$ _____ charge or fee

m) Investment compliance checking **yes** ___ **no** ___

If **no**, what are the fees or charges?

Basic (Software Solution Only)	\$ _____	charge or fee
Intermediate (Monthly Outsource)	\$ _____	charge or fee
Advance (Daily Full Outsource)	\$ _____	charge or fee
Others: (specify)	\$ _____	charge or fee

n) Independent Derivatives Processing and Valuation **yes** ___ **no** ___

If **no**, what are the fees or charges?

Valuation and Reporting:	\$ _____	charge or fee
Processing:	\$ _____	charge or fee
Collateral Management	\$ _____	charge or fee
Others: _____	\$ _____	charge or fee

o) Performance Calcs **yes** ___ **no** ___

If **no**, what are the fees or charges?

Monthly return calculation	\$ _____
Daily return calculation	\$ _____
Historical data download	\$ _____
Gross and Net of Fees	\$ _____
Lagged and Non-Lagged	\$ _____
IRR and Time Weighted	\$ _____
Others: _____	\$ _____

p) Performance Measurement and Analytics **yes** ___ **no** ___

If **no**, what are the fees or charges?

Benchmark/Index	\$ _____
Peer Group/Universe Comp	\$ _____
Portfolio Characteristics	\$ _____
Risk-Adjusted Return Calcs	\$ _____
Historical data download	\$ _____
Executive Board Reports	\$ _____
Drill Down Commingled funds	\$ _____
Customized benchmarks/universes	\$ _____
Bond Analytics	\$ _____
Attribution	\$ _____
Trading cost analysis	\$ _____
Others: (specify)	\$ _____

Specific to Performance Tools, are any of the following included? **yes** ___ **no** ___

BARRA Analytics	\$ _____
Vestek	\$ _____
Style Analyzer	\$ _____
TUCS	\$ _____
BondEdge	\$ _____
BlackRock Solutions	\$ _____
Wilshire Analytics	\$ _____
Yield Book	\$ _____
Others: (specify)	\$ _____

q) Advanced Risk Analytics **yes** ___ **no** ___

If **no**, what are the fees or charges?

Value at Risk (VaR)	\$ _____
Stress Testing	\$ _____
Scenario Analysis	\$ _____
Others: (specify)	\$ _____

r) Data Interface with 3rd Party Providers **yes** ___ **no** ___

If **no**, what are the fees or charges?

Fund Consultants	\$ _____
Actuary	\$ _____

External Auditors	\$ _____
Eagle Systems	\$ _____
Nottingham	\$ _____
3 rd Party Class Action Agent	\$ _____
3 rd Party Tax Reclaim Agent	\$ _____
3 rd Party Proxy Voting Service	\$ _____
Others: (specify)	\$ _____

s) G/L Interface or Data Upload **yes** ___ **no** ___

If **no**, what are the fees or charges?

SAP G/L Module	\$ _____	charge or fee
QED II (Investment Acctg)	\$ _____	charge or fee
Others (specify)		

t) Corporate Governance Tools? **yes** ___ **no** ___

If **no**, what are the fees or charges?

\$ _____	charge or fee
\$ _____	charge or fee
\$ _____	charge or fee

u) Alternative Investment Support

– Private Equity, Hedge Funds, Real Estate, Commodities, etc.? **yes** ___ **no** ___

If **no**, list the service and associated charge.

Basic Line Item Reporting	\$ _____	charge or fee
Reporting and Monitoring	\$ _____	charge or fee
Full Drill Down (Holdings)	\$ _____	charge or fee
Full Outsource Support	\$ _____	charge or fee
Shadow Accounting	\$ _____	charge or fee
Distributions	\$ _____	charge or fee
Capital Calls	\$ _____	charge or fee
Document Management	\$ _____	charge or fee
Others: (specify)	\$ _____	charge or fee

Specific to alternative inv. support, are any of the following included? **yes** ___ **no** ___

Burgiss Group	
Informant	\$ _____
Archivist	\$ _____
Others: (specify)	\$ _____
SunGard Investran	\$ _____
Private Edge	\$ _____
Venture Economics	\$ _____
Hedge Fund Administration	\$ _____
Hedge Fund Transparency	\$ _____
Others: (specify)	\$ _____

v) Document Management and Library Maintenance ? **yes** ___ **no** ___

If **no**, what are the fees or charges?

_____	\$ _____	charge or fee
_____	\$ _____	charge or fee

w) Specify other charges and fees not included in the proposed FLAT FEE. If a charge or fee is in direct response to a particular RFP question, identify both section and question.

_____	\$ _____	charge or fee
_____	\$ _____	charge or fee
_____	\$ _____	charge or fee

F. You are required to provide the following information. Provide an estimate of fees/costs that the Funds will incur annually based on the assumptions specified on the future investment structure as discussed in the Introduction of the RFP. Utilize your organization's schedule or methodology, namely: traditional asset based, account based and transaction charges. State assumptions. Enumerate all charges.

SC Retirement Systems and SC Investment Commission

Account Fees	# of Accounts	Fees	Pro-Forma Cost
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		
Custody Fees	Market Values	Fees	Pro-Forma Cost
Domestic Equities			
Separate Accounts	\$2,120,554,029.40		
Commingled/Line Items			
International Equities			
Separate Accounts			
Commingled/Line Items	\$1,240,730,614.24		
Domestic Fixed Income			

Separate Accounts	\$1,844,223,833.37		
Commingled/Line Items			
Global Fixed-Income			
Separate Accounts	\$2,086,118,121.44		
Commingled/Line Items	\$3,124,395,969.92		
Real Estate			
Direct/Separate Accounts			
Commingled/Line Items	\$133,323,297.30		
Private Equity			
Direct/Separate Accounts			
Commingled/Line Items	\$1,050,435,850.00		
Derivatives/Overlay			
Direct/Separate Accounts	\$1,418,499,978.10		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts			
Commingled/Line Items	\$6,240,590,569.23		
Commodities			
Direct/Separate Accounts			
Commingled/Line Items			
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	\$6,280,953,860.07		
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	\$626,215,553.83		
Transition Accounts			
Direct/Separate Accounts	\$60,362,992.54		
For International Securities	Corresponding Market Values in US\$ as of June 30, 2011		
Australia	\$8,089,803.90		
Austria			
Belgium			
Bahamas			
Belgium			
Bermuda			
Brazil	\$646,456.99		
British Virgin Islands			
Canada	\$43,304,810.89		
Cayman Islands			
China			
Colombia			
Cote d'Ivoire			
Cyprus			
Czech Republic			
Denmark			
European Union			
Finland			
France	\$54,960,992.09		
Germany	\$2,676,807.32		
Greece			

Hong Kong	\$594,876.17		
Hungary			
India			
Indonesia			
Ireland			
Israel			
Italy	\$281,763.85		
Japan	\$14,219,261.58		
Liberia			
Luxembourg			
Malaysia			
Marshall Islands			
Mexico			
Netherlands			
New Zealand	\$313,660.55		
Norway			
Panama			
Peru			
Philippines			
Poland			
Portugal			
Puerto Rico			
Russian Federation			
Singapore			
South Africa			
South Korea			
Spain	\$1,176,137.34		
Sweden	\$510,569.65		
Switzerland			
Taiwan			
Thailand			
Turkey			
UK	\$45,275,191.28		
Transactions	Annual Volume	Fees	Pro-Forma Cost
Domestic Depository Trades (DTC/Fed Book)	22,206		
Domestic Non-Depository Trades	3,038		
Physicals	1		
Principal Payments	2,333		
Maturities	121		
Dividend/Income Receipts	5,413		
Tax Reclaims			
Wires	589		
Capital Calls	60		
Options/Futures	1,054		
Swaps	1,034		
3 rd Party FX	654		
Custody FX Trades	48		
Proxy Notification			
Corporate Actions (Splits, Voluntary/Involuntary)	456		

Class Action Filings	55		
Other International Transactions --			
Australia	1		
Austria			
Belgium			
Bahamas			
Bermuda			
Brazil			
British Virgin Islands			
Canada	26		
Cayman Islands			
China			
Colombia			
Cote d'Ivoire			
Cyprus			
Czech Republic			
Denmark			
Egypt			
European Union (Euroclear)	42		
Finland			
France			
Germany			
Greece			
Hong Kong			
Hungary			
India			
Indonesia			
Ireland			
Israel			
Italy			
Japan			
Korea			
Liberia			
Luxembourg			
Malaysia			
Marshall Islands			
Mexico			
Netherlands			
New Zealand			
Norway			
Panama			
Peru			
Philippines			
Poland			
Portugal			
Puerto Rico			
Russian Federation			
Singapore			
South Africa			
South Korea			
Spain			

Sweden			
Switzerland			
Taiwan			
Thailand			
Turkey			
UK			
Others: (Enumerate)			
Global Custody – Support Power of Attorney Global Tax Agent Country Registration Tax-Exempt Filing Market Guide			
On-line or Internet Access User Interface Subscription Assets/Holding Cash Transactions Standard reports Customized reporting Executive/Board reporting Income Inquiry Reports Corporate Actions Reporting Terminal charge Communication software CPU connect time Others: (specify)			
Contractual Settlement and Auto Credit Domestic International ADRs			
Transition & Conversion Reregistration Scrip Fees Etc.			
Penalty Costs Third Party FX Third Party Seclending Etc.			
Out of Pocket Wire Transfer Courier Service Telex Charges Computer processing Staff Training Stamp Duty Reregistration Others:			
Corporate Actions Voluntary/Mandatory Involuntary			

Proxy Notification Reporting On-line Access Others			
Class Action Reporting On-line Access Legal Filings Others:			
Investment Guideline Compliance Basic Intermediate Advance (See below accounts)			
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		

Independent Derivatives Processing and Valuation Reporting Pricing Processing Collateral Management			
Performance Measurement Monthly Return Calcs Historical Data Download Gross/Net of Fees Lagged and Non-Lagged IRR Time Weighted Portfolio Characteristics Peer Comparison Portfolio Attribution (see below accounts)			
Number of Plans	5		
Domestic Equities			
Separate Accounts	7		
Commingled/Line Items	0		
International Equities			
Separate Accounts	0		
Commingled/Line Items	3		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items	0		
Global Fixed-Income			
Separate Accounts	2		
Commingled/Line Items	6		
Real Estate			
Direct/Separate Accounts	0		
Commingled/Line Items	6		
Private Equity			
Direct/Separate Accounts	0		
Commingled/Line Items	27		
Derivatives/Overlay			
Direct/Separate Accounts	2		
Hedge Funds/Absolute Returns			
Direct/Separate Accounts	0		
Commingled/Line Items	9		
Commodities			
Direct/Separate Accounts	0		
Commingled/Line Items	0		
Strategic Partnerships			
Direct/Separate Accounts			
Commingled/Line Items	27		
Cash Accounts			
Direct/Separate Accounts	0		
Commingled/Line Items	13		
Transition Accounts			
Direct/Separate Accounts	2		

Advanced Risk Analytics VaR Testing Stress Testing Scenario Testing Etc.			
Data Interface with 3rd Party Providers Fund Consultants Actuary External Auditors Eagle Systems Nottingham Class Action Agent Tax Reclaim Agent Proxy Voting Agent Others:			
Vaulting Services Specify –			
Corporate Governance Tools Specify –			
Alternative Investment Support Basic Line Item Reporting/Monitoring Full Drill Down Full Outsource Shadow Accounting Distributions Mgmt. Capital Call Mgmt. Document Mgmt. Others:			
Document Management and Library Maintenance Specify-			
Other Costs (enumerate)			
TOTAL ESTIMATED COSTS			

**Office of the State Treasurer
General Account and LGIP**

Account Fees	# of Accounts	Fees	Pro-Forma Cost
GENERAL ACCOUNT			
Number of Funds	11		
Domestic Fixed Income			
Separate Accounts	7		
Commingled/Line Items			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
LGIP			
Number of Funds	1		
Domestic Fixed Income			
Separate Accounts	1		
Commingled/Line Items			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items			
Custody Fees			
	Market Values	Fees	Pro-Forma Cost
GENERAL ACCOUNT			
Domestic Fixed Income			
Separate Accounts	\$7,203,194,725.84		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	\$49,095,798.00		
LGIP			
Domestic Fixed Income			
Separate Accounts	\$2,680,080,581.35		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items			
Transactions			
	Annual Volume	Fees	Pro-Forma Cost
GENERAL ACCOUNT			
Domestic Depository Trades (DTC/Fed Book)	1,846		
Domestic Non-Depository Trades	197		
Physicals			
Principal Payments	3,101		
Maturities	403		

Dividend/Income Receipts	1,819		
Tax Reclaims			
Wires	1,303		
Capital Calls			
Options/Futures			
Swaps			
Proxy Notification			
Corporate Actions (Splits, Voluntary/Involuntary)	37		
LGIP			
Domestic Depository Trades (DTC/Fed Book)	461		
Domestic Non-Depository Trades	253		
Physicals			
Principal Payments			
Maturities	379		
Dividend/Income Receipts	617		
Tax Reclaims			
Wires	149		
Capital Calls			
Options/Futures			
Swaps			
Proxy Notification			
Corporate Actions (Splits, Voluntary/Involuntary)	1		
Others: (Enumerate)			
On-line or Internet Access User Interface Subscription Assets/Holding Cash Transactions Standard reports Customized reporting Executive/Board reporting Income Inquiry Reports Corporate Actions Reporting Terminal charge Communication software CPU connect time Others: (specify)			
Contractual Settlement and Auto Credit Domestic International ADRs			
Transition & Conversion Reregistration Scrip Fees Etc.			
Penalty Costs Third Party FX			

Third Party Seclending Etc.			
Out of Pocket Wire Transfer Courier Service Telex Charges Computer processing Staff Training Stamp Duty Reregistration Others:			
Corporate Actions Voluntary/Mandatory Involuntary			
Proxy Notification Reporting On-line Access Others			
Class Action Reporting On-line Access Legal Filings Others:			
Investment Guideline Compliance Basic Intermediate Advance (See below accounts)			
Funds	12		
Domestic Fixed Income			
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Independent Derivatives Processing and Valuation Reporting Pricing Processing Collateral Management			
Performance Measurement Monthly Return Calcs Historical Data Download Portfolio Characteristics Peer Comparison Portfolio Attribution (see below accounts)			

Funds	12		
Domestic Fixed Income			
Separate Accounts	8		
Commingled/Line Items			
Internally Managed			
Cash Accounts			
Direct/Separate Accounts			
Commingled/Line Items	4		
Internally Managed			
Data Interface with 3rd Party Providers Fund Consultants Actuary External Auditors SAP G/L QED II Class Action Agent Tax Reclaim Agent Proxy Voting Agent Others:			
Corporate Governance Tools Specify –			
Other Costs (enumerate)			
TOTAL ESTIMATED COSTS			

SECURITIES LENDING COSTS AND FEES

- A. Explain your methodology for calculating a client’s income and splitting methodology.
- B. What is your organization’s proposal for the revenue sharing arrangement and/or the split of security lending income?
- C. Is the split also applicable to negative income if it occurs? What are the limitations of your proposal specific to losses?
- D. Are you able to accept a “clawback” feature wherein if losses materialize; both Funds and lending agent’s revenues would be utilized to extinguish such losses or shortfall?
- E. Are you able to accept a “agent zero split” feature wherein if losses materialize the whole revenue split would be 100% to the client’s favor for cash buffering purposes until losses are extinguished?
- F. Does your firm charge a management fee (bp) plus expense ratios for each type of collateral reinvestment fund, separate accounts or collateral reinvestment fund? If so, specify the fee and if fees are deducted before or after the split.
- G. If lending on an agency basis is allowed for all mandates, please provide your proposed securities lending income split:
Funds ___% Bank ___%
- H. If you are proposing additional indemnification beyond operational and broker default for agency-basis lending, kindly specify.
 - ___ Borrower/Counterparty Risk and Default (Inability to Recall, Failure to deliver Income, Failure to post adequate margins, etc.)
 - ___ Collateral Investment Risk
 - ___ Credit Spread Risk
 - ___ Interest Rate Risk

- _____ Trade Settlement Risk
- _____ Operational Negligence
- _____ Currency and Sovereign Risk

- I. If your entity is willing to provide full or partial indemnification for collateral reinvestment risk, what would be the parameters of your bid proposal for securities lending splits and assets to lend?
- J. Specify administration, recordkeeping, and cash collateral reinvestment asset management fees for all types of cash collateral reinvestment vehicles, including separate accounts. Please note that the Funds utilize an Overnight Reinvestment Vehicle US Treasury Guidelines.
- K. Furnish a revenue estimate of the securities lending income for the Funds for one (1) year ending June 30, 2011 utilizing the holdings listed in the Attachment. (Please note that the estimate is backward looking and not forward looking into the future. Thus for the one-year estimate ending June 30, 2011, utilize the holdings provided in Attachment 1- Holdings June 30, 2011 and assume that the holdings are in a buy and hold strategy from July 1, 2010 to June 30, 2011.) Assume that collateral is reinvested in a separate account that utilizes the following guidelines, namely: (a) strictly intrinsic value lending with Overnight US Govt REPO reinvestment guideline; (b) Current Guidelines of Overnight US Govt REPO, and, (c) Straight SEC 2a-7 money market guideline. Provide calculations in the Attachment 2 - Securities Lending Calculation Worksheet.

NOTE: For entities submitting a proposal for securities lending only, all costs associated with the implementation and support of third party agency lending program to be incurred by the custodian and the Funds shall be borne by the third party lending institution.

OTHER SERVICES AND FEES

Please list any additional services not identified elsewhere in your proposal that will be provided, if requested by the Treasurer's Office, and the fees, if any, associated with such services.

IX. ATTACHMENTS TO SOLICITATION

LIST OF ATTACHEMENTS TO RFP

ATTACHMENT 1 - SPREADSHEET FILE IN WORKBOOK FORMAT: SC State Treasurer – Custody-Seclending Request for Proposal Oct-24-2011.xlsx. [SEE SEPARATE ATTACHMENT.]

ATTACHMENT 2- CALCULATION WORKSHEET: Securities Lending – Calculation Worksheet: SC Treasurer – Seclending Calculation Worksheet.docx. [SEE SEPARATE ATTACHMENT.]

NONRESIDENT TAXPAYER REGISTRATION AFFIDAVIT INCOME TAX WITHHOLDING

IMPORTANT TAX NOTICE - NONRESIDENTS ONLY

Withholding Requirements for Payments to Nonresidents: Section 12-8-550 of the South Carolina Code of Laws requires persons hiring or contracting with a nonresident conducting a business or performing personal services of a temporary nature within South Carolina to withhold 2% of each payment made to the nonresident. The withholding requirement does not apply to (1) payments on purchase orders for tangible personal property when the payments are not accompanied by services to be performed in South Carolina, (2) nonresidents who are not conducting business in South Carolina, (3) nonresidents for contracts that do not exceed \$10,000 in a calendar year, or (4) payments to a nonresident who (a) registers with either the S.C. Department of Revenue or the S.C. Secretary of State and (b) submits a Nonresident Taxpayer Registration Affidavit - Income Tax Withholding, Form I-312 to the person letting the contract.

The withholding requirement applies to every governmental entity that uses a contract ("Using Entity"). Nonresidents should submit a separate copy of the Nonresident Taxpayer Registration Affidavit - Income Tax Withholding, Form I-312 to every Using Entity that makes payment to the nonresident pursuant to this solicitation. Once submitted, an affidavit is valid for all contracts between the nonresident and the Using Entity, unless the Using Entity receives notice from the Department of Revenue that the exemption from withholding has been revoked.

Section 12-8-540 requires persons making payment to a nonresident taxpayer of rentals or royalties at a rate of \$1,200.00 or more a year for the use of or for the privilege of using property in South Carolina to withhold 7% of the total of each payment made to a nonresident taxpayer who is not a corporation and 5% if the payment is made to a corporation. Contact the Department of Revenue for any applicable exceptions.

For information about other withholding requirements (e.g., employee withholding), contact the Withholding Section at the South Carolina Department of Revenue at 803-898-5383 or visit the Department's website at: www.sctax.org

This notice is for informational purposes only. This agency does not administer and has no authority over tax issues. All registration questions should be directed to the License and Registration Section at 803-898-5872 or to the South Carolina Department of Revenue, Registration Unit, Columbia, S.C. 29214-0140. All withholding questions should be directed to the Withholding Section at 803-896-1420.

PLEASE SEE THE "NONRESIDENT TAXPAYER REGISTRATION AFFIDAVIT INCOME TAX WITHHOLDING" FORM (FORM NUMBER I-312) LOCATED AT:

<http://www.sctax.org/Forms+and+Instructions/withholding/default.htm>

OFFEROR'S CHECKLIST (JUN 2007)

OFFEROR'S CHECKLIST -- AVOID COMMON BID/PROPOSAL MISTAKES

Review this checklist prior to submitting your bid/proposal.

If you fail to follow this checklist, you risk having your bid/proposal rejected.

- Do not include any of your standard contract forms!
- Unless expressly required, do not include any additional boilerplate contract clauses.
- Reread your entire bid/proposal to make sure your bid/proposal does not take exception to any of the state's mandatory requirements.
- Make sure you have properly marked all protected, confidential, or trade secret information in accordance with the instructions entitled: SUBMITTING CONFIDENTIAL INFORMATION. **DO NOT** mark your entire bid/proposal as confidential, trade secret, or protected! **Do not** include a legend on the cover stating that your entire response is not to be released!
- Have you properly acknowledged all amendments? Instructions regarding how to acknowledge an amendment should appear in all amendments issued.
- Make sure your bid/proposal includes a copy of the solicitation cover page. Make sure the cover page is signed by a person that is authorized to contractually bind your business.
- Make sure your Bid/proposal includes the number of copies requested.
- Check to ensure your Bid/proposal includes everything requested!
- If you have concerns about the solicitation, do not raise those concerns in your response! **After opening, it is too late! If this solicitation includes a pre-bid/proposal conference or a question & answer period, raise your questions as a part of that process!** Please see instructions under the heading "submission of questions" and any provisions regarding pre-bid/proposal conferences.

Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Friday, March 23, 2012 10:00 AM
To: 'Abesamis, Bo'; Leidinger, Bill; gburke@callan.com; _WCC - Docket Assignment
Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; Hershel Harper; Tammy Nichols; Faith Wright; William Blume; Rebecca Gunnlaugsson
Subject: RE: Specific Pricing

Bo,

Please ask BNYM and State Street to be specific about their Universe Comparisons. For example, TUCS (which used to only offer very broadly defined asset classes and only quarterly results) is very different from BNY Mellon's monthly universe, which was far more timely and flexible. They used to also bundle their universe reporting with other tools like manager profiles and charting (graphing) capabilities. Inquire if these would still be bundled.

Thanks

Doug

From: Abesamis, Bo [mailto:abesamis@callan.com]
Sent: Thursday, March 22, 2012 4:58 PM
To: Leidinger, Bill; gburke@callan.com; _WCC - Docket Assignment
Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; Hershel Harper; Douglas W. Lybrand; Tammy Nichols; Faith Wright; William Blume; Rebecca Gunnlaugsson
Subject: RE: Specific Pricing

Bill,

I will do. Please note that Deutsche pricing is just for securities lending, there are no other a la carte services required from them. I will reach out to both BNY Mellon and State Street on a breakdown of fees. In actuality, the a la carte is in the Responses to the RFP Fee Section. I asked for both Flat Fee and An Actual Fee Calculation Worksheet.

Having said that, I will ask them to provide a recast Fee Calculation Worksheet again, with the following----

Custody and Asset Servicing
Accounting and Reporting, GASB Support
Performance Measurement, Monthly Return Calculations (Gross and Net)
Daily Performance
Universe Comparison
Attribution
Investment Compliance Monitoring
Commingled Fund Look Through or Drill Down of Not-Custodied Assets
Risk Analytics (VaR, Stress Testing, Scenario Testing)
Private Investment Support (Beyond Line Item Reporting, including Company Level Tracking, Capital Call Management, Doc Mgmt)
Hedge Fund Transparency and Administration
Transfer Agency Solution (General Account/LGIP)
Trade Execution

If I missed anything, please alert me before I start my query.

Thanks. BO

From: Leidinger, Bill [<mailto:Bill.Leidinger@sto.sc.gov>]

Sent: Thursday, March 22, 2012 1:05 PM

To: Abesamis, Bo; gburke@callan.com; _WCC - Docket Assignment

Cc: Condon, Bill; Raven, Dinah; Tahiliani, Shakun; McDermott, Mike; Harper, Hershel; Lybrand, Douglas; Tammy Nichols; Faith Wright; William Blume

Subject: Specific Pricing

Bo, I ask that contact BoNY Mellon, State Street and Deutsche Bank and ask them to specifically and separately price each service and tool that they have proposed to us. I believe this would best serve each and all of us as well as facilitate discussions and reach decisions regarding what each of us needs and is willing to pay for, especially in those instances where the particular service or tool would serve more than 1 of the 3 entities.

Thanks and let me hear from you about this.....Tomorrow I will get on the team structures for the reference checking.....Thanks much....Bill

William Leidinger
Chief of Staff
State Treasurer's Office
P.O. Box 11778
Columbia, SC 29201

(803) 734-5063 Office
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Ashleigh Hollins

From: Douglas W. Lybrand
Sent: Wednesday, February 01, 2012 12:51 PM
To: 'karen.wicker@sto.sc.gov'
Cc: Hershel Harper
Subject: Review of Custodial Services

Hi Karen:

Hershel Harper asked me to sign two forms and return them to you. One form is to certify I have no conflicts of interest. That is not a problem. The second form asks me to certify that 1) I will keep all information related to the review confidential. That is also not a problem. It also asks me 2) to certify that I have received the Advisory Review Panel Briefing Instructions. I have not received them. Will you please provide those instructions? Thanks.

Douglas W. Lybrand
803-737-7582