



Finance and Administration Committee

Agenda Item 3c

September 20, 2022

Item Name: State Street Bank Contract Extension

Program: Investment Office

Item Type: Action Consent

Recommendation

Approve an extension of the current Master Custodian State Street Bank contract for an additional five years.

Executive Summary

The current Master Custodian-State Street Bank contract will expire in 2023. Pursuant to Board of Administration Resolution No. 92-04B-2, the Investment Office submitted a justification for exemption from competitive bid to the Chief Operating Officer, which was approved. State Street Bank (SSB) provides a highly customized basket of services to CalPERS with a competitive fee structure. Approving an extension of the existing contract provides CalPERS with the opportunity to retain a performing contractor and favorable fee structure while relieving the need to renegotiate all of the contract terms that are already meeting CalPERS needs. The Investment Office is seeking approval from the board to extend the end date of the current contract for an additional five years.

Strategic Plan

The five-year extension of the Master Custodian-State Street Bank contract supports CalPERS Strategic Plan goal to strengthen the long-term sustainability of the pension fund. The contract extension will save staff time and resources and prevent the need to renegotiate fees which could lead to increased costs for CalPERS.

Background

In 1991, CalPERS initiated a Request for Proposal (RFP) for master custody services and subsequently entered into the first contract with State Street Bank & Trust. Through a series of successive contract awards beginning in 1992, SSB has provided CalPERS with master custody services. The provided services are of the highest service level and product quality at a competitive cost. SSB has worked for 31 years with CalPERS to understand the unique needs

of the Investment Office and has effectively delivered services to successfully support CalPERS.

SSB currently provides CalPERS with four major services: Master Custody Services (including Custody and Accounting), Investment Book of Record (IBOR), Investment Performance Platform (IPP) and Alpha Data Services (ADS). These complex services are highly integrated into CalPERS trading, risk, financial reporting, and operational platforms. CalPERS also realizes economies of scale on our fees as a result of using SSB across these services.

Since 1992, CalPERS has conducted competitive bid RFPs in 2000, 2005, 2010 and 2015. During the 2000 and 2005 RFP process, we received six competitive bids and SSB was selected. In 2010, three competitive bids were submitted and SSB was selected again. During the last RFP in 2015 SSB was the only submission, the RFP was cancelled, and the contract was awarded to SSB. There has been a steady decrease in the number of responses received and we anticipate that SSB would be the only qualified submission if another RFP is issued. Our peer, CalSTRS, conducted an RFP last year for similar services and only received a submission from 2 qualified firms, including SSB. After conducting a comprehensive evaluation of both firms' capabilities, they ultimately decided to remain with SSB. In addition, SSB provides custody and other services for many of the largest and most complex pension funds and asset owners similar to CalPERS. They include: Government Pension Investment Fund (GPIF Japan), CalSTRS (USA), Canada Pension Plan Investment Board (CPPIB Canada), Teacher Retirement System of Texas (TRS USA), New York City Employees Retirement System (NYCRS USA), Kuwait Investment Authority (KIA Kuwait), National Pension Service of Korea (NPS South Korea).

Over the last several years, the Investment Office has conducted extensive research on trading systems and published an RFP for Investment Performance Services, both of which are services included in the existing SSB contract. These RFPs concluded that SSB is still the most economical service provider and have the deepest knowledge of our business processes.

If an RFP is issued and awarded, CalPERS would need to negotiate the contract legal terms and conditions, the scope of services documents, and the fees. The amount of time required to negotiate these items is a significant use of both Investment Office and Legal Office resources. If the contract is extended, SSB has agreed to keep the terms constant except for new regulatorily required language and agreed to the equivalent of a 0.5% (50 basis point) fee increase over the next five-year term. In dollars this represents a \$84,000 per year increase. Given inflation at near 40-year highs, hovering in the 9% range, the fee proposal represents significant value for CalPERS. The Investment Office is requesting the board approve the extension of the current SSB contract beyond the standard five-year time horizon for an additional five years or until 2028.

Analysis

The extension of the current State Street Bank-Master Custodian contract includes the following analysis:

- Alternatively, the extension of the current contract would keep fees nearly constant at a nominal \$84,000 annual fee increase. This represents value to CalPERS over the next five-years given the current inflationary market.

- The extension of the current terms and conditions, services, and fees would result in a substantial savings of staff time and resources and facilitate a timely contract renewal.

Budget and Fiscal Impacts

If approved, SSB has agreed to a \$84,000 increase in annual fees over the next five-year time horizon. The Investment Office has the current budgetary resources to absorb these costs. If not approved, the Investment Office would need to renegotiate fees, which could lead to increased costs for CalPERS and the PERF.

Benefits and Risks

The extension (or denial of the extension) of the current Master Custodian contract with State Street Bank has the following benefits and risks:

- If approved, this will result in a substantial staff time and resource savings for both the CalPERS Investment Office and Legal Office.
- If approved, SSB has agreed to a fee proposal with Master Custodian fees increasing 0.5% per year which will result in a substantial savings to CalPERS compared to unknown fees as a result of an RFP.
- If not approved, legal terms and conditions as well as scope of services will be open to renegotiation which will result in increased staff time and resources for both CalPERS and SSB
- If not approved, fees will also be open to renegotiation which could result in increased fees to CalPERS.
- If both parties are not able to agree to terms and conditions timely, there is a risk that there may be a gap in Master Custodian services for CalPERS.

Attachments

Attachment 1 – Board Resolution No. 92-04B-2

Matt Flynn
Investment Director

Michael Cohen
Interim Chief Operating Investment Officer