# 5.0 TECHNICAL PROPOSAL

The Bidder shall provide a brief narrative (not exceeding 3 pages) outlining its technical approach and indicating its ability to comply with the requirements of Section 3. Include any differentiating factors relative to your competition. Include a description of any strategies that you employ that you may consider unique.

In addition, this section of the proposal should at a minimum contain the information identified below, including the Bidder’s answers to the questions presented. The questions below should be included in the proposal followed by its corresponding answer. For convenience, the questions in this section are included as an MS Word attachment to this RFP. The Bidder should include the level of detail it determines necessary to assist the selection committee in its review of the Bidder’s proposal.

* 1. **GENERAL INFORMATION**

5.1.1 Please provide background information on your organization including:

1. Ownership structure, including what percent is employee owned;
2. Relationship with any affiliated companies;
3. Any corporate structure changes over the past 3 years, including but not limited to, acquisitions, joint-ventures, mergers, etc. that have directly impacted the securities lending business or materially impacted the parent organization;
4. The year the securities lending business was founded;
5. How long your firm has been engaged in domestic and international securities lending; and
6. The regulatory bodies that govern the securities lending business and a description of any regulatory infractions over the past 5 years.

5.1.2 Describe your firm’s line of business and how securities lending fits within the Bidder’s overall corporate structure.

* + 1. What investments has your firm recently made in its security lending business? What is your organization’s strategy for growing your securities lending business? Is there lower margin business that you are likely to turn down? If so, please describe.
    2. Where is the securities lending group headquartered? Please list all additional locations that conduct securities lending operations and the functions performed at each of these locations.
    3. What is the approximate revenue and profit contribution of your securities lending business to the overall company revenue and profit in percentage terms? If securities lending is not its own line of business, what other business strategies fall under its line of business?
    4. Are there any current organizational issues or concerns? Please describe the personnel turnover in the securities lending business over the last five years.
    5. Describe how securities lending personnel are compensated. Provide the incentive basis for bonuses.
    6. Describe any pending litigation with respect to the securities lending business and your firm’s overall business.
    7. Provide a copy of the most recent SOC1 report. Is this report issued annually?
    8. Provide a description of the various types of insurance coverage (carriers, risk coverage, levels, limits, deductibles, expiration dates, etc.) in place to protect your securities lending clients.
    9. Provide an organization chart of the overall securities lending business including a description of the relationship to the Bidder’s overall organizational structure. Describe the Bidder’s risk management oversight of the securities lending business.
    10. Provide an organizational chart identifying the total number of professionals within the securities lending group by function and the key personnel within the securities lending team. Provide names and brief profiles for the individuals responsible for the lending function and the cash collateral reinvestment function. If applicable, provide details by asset class.
    11. Does your organization subcontract any of the securities lending services? If yes, provide details.
    12. Please provide the current number of clients, broken out by client type and lendable asset base.
    13. Disclose how many clients or aggregate asset size you can effectively handle and discuss why. Does your securities lending program have any capacity limitations?

5.1.16 Provide client turnover information for your firm’s securities lending clients for each of the last three calendar years ending December 31, 2017.

5.1.17 For each client gained, provide the following information:

* Name of client gained;
* Lending base (in $ million); and
* Date hired.

5.1.18 For each client lost, provide the following information:

* Name of client lost;
* Date hired;
* Date terminated;
* Lending base (in $ million);
* Background on the departure; and
* Indicate whether DOI may contact the client.

5.1.19 Include at least three, and up to five, references for large public, corporate, or sovereign wealth funds with similar lending pools to DOI.

5.1.20 Provide a detailed transition timetable including novation strategies.

5.1.21 Provide a summary of any and all problems that the Bidder anticipates during the transition or term of the contract. For each problem identified, the Bidder should provide its proposed solution.

Submit a copy of your standard securities lending contract. Note that the provisions of the agreement should be consistent with the provisions of the Standard Terms & Conditions and/or this RFP. If your standard agreement must be modified to conform to the New Jersey Standard Terms & Conditions and/or this RFP, please indicate that the proposed changes have been reviewed and approved by your legal representative.

* 1. **SECURITIES LENDING CAPABILITIES**
     1. Describe your lending philosophy explaining how you seek to maximize revenues for clients. Is the goal of the program to maximize intrinsic spreads? If so, how do you pursue this goal? Do you pursue maximizing utilization rates of general collateral as a strategy? If yes, please explain why you believe that this may be a robust strategy to pursue.
     2. In which geographic markets does your firm lend securities? Please differentiate by security type. What is the current estimated spread to Federal Funds rate in each country by security type?
     3. List any asset classes or security types that you do not lend.
     4. Please describe your use of term loans including how often they are used, how you decide whether to enter into a term loan, and any other factors you deem relevant.
     5. Do you employ a “fees for hold” arrangement within your securities lending program? Please describe.
     6. What policies and procedures do your traders follow in negotiation of rebate rates? How did your rebate rates compare to benchmark data over the past 12 months (please indicate the benchmark source)?
     7. Describe any tools or systems that you maintain to identify and compile borrower demand.

* 1. **SECURITIES LENDING RISK MANAGEMENT** 
     1. How do you manage the following risks?
        + Borrower/Counterparty Risk and Default Risk;
        + Collateral Reinvestment Risk;
        + Interest Rate Risk;
        + Credit Spread Risk;
        + Trade Settlement Risk;
        + Operational Negligence;
        + Sovereign Risk; and
        + Currency Fluctuation Risk;
     2. Describe how your firm manages risk related to indemnifications on a program-wide basis.
     3. Have you experienced any losses due to operational negligence, collateral reinvestment and/or security specific reinvestments, and/or borrower default since the inception of your securities lending program? If yes, please describe. What was the recourse provided to clients and the level of dialogue to explain (resolve) the issues?
     4. Have there been any other instances over the past five years where you incurred negative yields?
     5. Do you have a dedicated compliance officer and team monitoring the securities lending program? What are the roles and responsibilities? Please describe the reporting structure for the team.
     6. Do you lend to your affiliate(s)? If so, please provide detailed information on the compliance procedures in place to mitigate any conflicts of interests. Please demonstrate how you ensure that the affiliate(s) are not receiving preferential treatment relative to other approved borrowers.
     7. Do you have pre- and post-trade compliance systems to ensure compliance with fund guidelines?
     8. Do you have the ability to aggregate counterparty risk across both the lending side and the reinvestment side?
     9. How do you conduct asset/liability (gap) analysis, specifically the duration of the loan and cash investments? On what frequency? What are the underlying assumptions utilized for loan duration in the analysis?
     10. Do you stress test your securities lending program? Describe the methodology and procedures utilized for stress testing, including the frequency of testing.
     11. Specify the weighted average duration mismatch between lending and reinvesting for the following quarters. (Provide separate answers for each lending pool or separate accounts that you offer in your program.)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Calendar Year** | **1st**  **Qtr** | **2nd Qtr** | **3rd Qtr** | **4th Qtr** |
| 2015 |  |  |  |  |
| 2016 |  |  |  |  |
| 2017 |  |  |  |  |

* + 1. Describe your management of asset/liability duration mismatch. How is it controlled? Have any clients suffered losses due to this mismatch? Have any clients requested refund of losses suffered because of mismatch?
    2. Describe your management of quality mismatch. How is it controlled? Have any clients suffered losses due to this mismatch? Have any clients requested refund of losses suffered because of mismatch?
    3. Can your program ensure the protection of voting rights by consistently recalling the stock prior to proxy record date? If so, describe the process. Describe the firm’s ability to report on companies likely to file proxies in the upcoming month based on historic record dates, and the firm’s ability to provide updates to DOI on the number of shares it has on loan.
    4. What additional safeguards are offered by the firm to its lending participants?
  1. **SECURITIES LENDING COLLATERALIZATION**
     1. Although DOI shall only accept cash and cash equivalents as collateral, what other types of collateral does your program accept against loans? Where are these securities held in custody? Where are the collateral reinvestment securities held in custody? What is the percentage breakdown of the collateral types your program holds on average?
     2. What investment vehicles have you historically used for cash collateral reinvestment? Summarize quarterly performance for the last three calendar years through December 2017, of each vehicle, as well as the investment philosophy, investment guidelines and performance objectives for each vehicle.
     3. What are the minimum established collateralization levels by type of security? How far below the required collateralization percentage must the collateral dip before a margin call is made?
     4. What fees are charged for investment management/custody of collateral investments?
     5. With respect to collateralization, provide the following information:

Submit the collateralization level proposed for the DOI program by lendable asset type (e.g. US dollar denominated equities, international equities, U.S. Treasuries, etc.). Please note that in accordance with N.J.A.C. 17:16-5.4(b) in no event shall the required collateral level be less than 100 percent of the market value of the loaned securities.

* What value (market value only, including accrued interest, etc.) is the basis for this percentage?
* Indicate whether the daily mark-to-market collateralization differs from the initial collateralization level.
* When is additional collateral requested (same day, next day)?
  + 1. How is collateral reinvestment management handled? What is the role and function of the credit analysis team?
    2. Is the mark to market process done by loan or in aggregate by borrower? Please explain.
    3. Does your firm currently act as agent for programs wherein the client invests all or a portion of the collateral portfolio? Is so, please provide details. What is the typical percentage of the collateral portfolio managed by the lenders? Do these programs have a different revenue sharing split? If so, please provide details. Also provide details of any operational requirements and timelines for the lender under this scenario.
  1. **SECURITIES LENDING BORROWER CONSIDERATION**
     1. What part of the organization is responsible for the credit review and approval of counterparties? How many professionals exist within this group? Are the members of this team dedicated to the securities lending program? Who does the head of this group report to?
     2. Describe your credit analysis process for approving and monitoring the borrowers who participate in your securities lending program (both international and domestic). How are credit limits determined for borrowers? How often do you review the limits? Are credit limits set in conjunction with other areas of your organization? Have you ever dismissed or suspended a borrower within your program? Please describe.
     3. Furnish a copy of your standard Borrower’s Agreement(s) specific to Securities Lending done on an agency basis. Please indicate if your firm would be amenable to modifications which may be required by DOI. Please advise if this may impact your projected program utilization for the DOI program in any way.
     4. How do you risk adjust credit limits based on securities borrowed?
     5. Provide a list of your current approved borrowers and their credit rating, if applicable. Identify the top ten borrowers and the percentage these borrowers represent of the total program. Can a client restrict a program to specific borrowers?

* + 1. Identify any competitive advantages the firm has in dealing with broker/dealers and how this benefits your clients.
    2. Do you proactively visit borrowers? Please provide dates of the last time you visited the top ten borrowers within your program.
    3. Does your organization have compensation arrangements with borrowers beyond the normal form of negotiating rebates/fees? If so, please explain.
  1. **SECURITIES LENDING INDEMNIFICATION**
     1. Describe your full collateral, operational and borrower default indemnification offerings, and more specifically, the indemnifications your firm is offering in response to this RFP. Please reference each offered indemnification to the applicable section of the contract being submitted. Be sure to address the following:
* Borrower files for bankruptcy;
* 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;
* The timeframe for declaring borrower default upon a triggering event and the timeframe for reimbursement to DOI after such event.
  + 1. Do you provide additional types of indemnification beyond borrower default (i.e., collateral, negligence, trade settlement, etc.)? Does your proposal include the provision of additional levels of indemnification? If so, describe in detail.
    2. Do you have clients that you do not indemnify against borrower default? Does this have an impact on revenue sharing?
    3. Assuming full indemnification for collateral reinvestment risk related to collateral investment in repurchase agreements, operational risk and borrower default indemnification, what are the parameters of your bid proposal for securities lending splits and assets to lend? What are the specific limitations of your indemnification? Include a specific discussion on how your firm determines when the default has occurred, when the indemnification is effective and on what valuation date the amount of default is determined. Please provide an explanation of any scenario where you will not make a client whole on losses.
    4. Does the securities lending agreement specifically provide cash or securities in the event of a borrower default? If securities, are you responsible for re-purchasing loaned securities in the market after a borrower default, and what is the contractual timetable for doing so? Who bears the cost associated with security re-purchases?
    5. If you offer indemnifications, what changes to this policy do you foresee as a result of any pending regulations? Do you foresee proposing any fee increases or adjusted program splits if pending regulation makes it more expensive to offer indemnification?
    6. Please indicate who backs the indemnity provided to your clients and provide the following information related to this entity:

1. Credit rating;
2. Tier 1 capital ratio;
3. Tier 2 capital ratio; and
4. Leverage ratio;

6.6.8 Please provide the specific indemnity language for each type of indemnification you are offering with your bid. How do your firm’s indemnifications differentiate it from your competition?

* 1. **SECURITIES LENDING PROGRAM PROFILE** 
     1. Please provide the information in the tables below. In addition, please describe the characteristics of the reinvestment portfolio and the investment parameters that contributed to the reinvestment spread for each of the periods.

Calendar Year 2017

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Asset Classes** | **Daily Avg. Lendable Base**  **($ in m)** | **Utilization Rate**  **(%)** | **Gross Spread**  **(bps)** | **Intrinsic Spread**  **(bps)** | **Reinvestment Spread**  **(bps)** |
| U.S. Treasuries |  |  |  |  |  |
| U.S. Agencies |  |  |  |  |  |
| Corporates |  |  |  |  |  |
| Non-corporate fixed income |  |  |  |  |  |
| U.S. Equities |  |  |  |  |  |
| International Equities (please list by country) |  |  |  |  |  |

Calendar year 2016

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Asset Classes** | **Daily Avg. Lendable Base**  **($ in m)** | **Utilization Rate**  **(%)** | **Gross Spread**  **(bps)** | **Intrinsic Spread**  **(bps)** | **Reinvestment Spread**  **(bps)** |
| U.S. Treasuries |  |  |  |  |  |
| U.S. Agencies |  |  |  |  |  |
| Corporates |  |  |  |  |  |
| Non-corporate fixed income |  |  |  |  |  |
| U.S. Equities |  |  |  |  |  |
| International Equities (please list by country) |  |  |  |  |  |

Calendar year 2015

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Asset Classes** | **Daily Avg. Lendable Base**  **($ in m)** | **Utilization Rate**  **(%)** | **Gross Spread**  **(bps)** | **Intrinsic Spread**  **(bps)** | **Reinvestment Spread**  **(bps)** |
| U.S. Treasuries |  |  |  |  |  |
| U.S. Agencies |  |  |  |  |  |
| Corporates |  |  |  |  |  |
| Non-corporate fixed income |  |  |  |  |  |
| U.S. Equities |  |  |  |  |  |
| International Equities (please list by country) |  |  |  |  |  |

5.7.2 Please provide your market share in each of the asset classes above, and indicate the source of the information.

* 1. **SECURITIES LENDING PROCESS AND LIMITS**
     1. Do you have an internal limit on how much of a client’s portfolio of lendable assets can be lent on any given day? Describe your policy.
     2. Related to the question above, do you also 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. Do you 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. Describe your queuing or loan allocation system in detail. Do you provide equal opportunity to all participating clients to lend their securities? Is the queue pro-rated? Does the firm intervene in the allocation or queuing process, and if so, under what circumstances? Does the firm utilize entitlement credits? If so, describe specifically how and on what basis those credits are assigned. Is the maintenance of the queue audited regularly? Provide details on how DOI would rank within your current system.
     6. In adding new clients to your program, how do you ensure that the additional lendable assets do not have the impact of diluting utilization and/or earnings for existing clients?
     7. What is your process for allocating specials to a borrower when multiple lenders have the security available to lend?
     8. Do you have 24-hour lending capabilities? If not, please describe during which hours you operate.
     9. Are you able to monitor for “borrowing to manipulate a proxy” within your program? Please describe for both domestic and international markets.
     10. How many lending pools do you have? Describe the lending pools (e.g. collateral type, plan sponsor type, asset, calls, etc.) and how client assets are assigned to the lending pools.
     11. Please describe your views or philosophies on the trade-offs between program size and utilization rates.
     12. How often and in what asset classes are you generally faced with greater security supply than demand?
  2. **SECURITIES LENDING OPERATIONAL PROCEDURES**
     1. Does your firm currently have a relationship with State Street as custodian? If so, for how many clients and what is the lendable asset base?
     2. Does your firm have an executed “Third Party Lending Operational Procedures” Agreement between your client(s), State Street and your firm? Did your firm require any modifications to the standard agreement? If so, please describe the nature of the required modifications in detail.
     3. Please describe any operational difficulties your firm has encountered with State Street as custodian in detail.
     4. How do you manage the coordination of trade settlements, corporate actions, dividend collection, etc. with State Street? Do you provide guarantees?
     5. How much notice do you typically need in order to recall securities? How often do you encounter problems recalling securities by the target date? Describe your ability to reallocate loans. What specifically differentiates your firm from its competition in managing sell fails.
     6. What vendors/sources are used for pricing? Are loaned assets and collateral priced daily?
  3. **SECURITIES LENDING REPORTING**
     1. Provide an overview and samples of the types of reports that are available for securities lending and indicate whether the reports are available online via the internet. Are the reports updated daily? Is the data as of the previous business day or real time? How much report format flexibility is available? Are custom reports available?
     2. Are you 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 daily and monthly reporting requirements? If yes, provide samples.
     3. Does the firm provide an attribution analysis for its securities lending program? If so, please describe.
     4. Please describe the audit trail process provided to your securities lending clients.
     5. How do you support GASB reporting requirements?
  4. **SECURITIES LENDING SYSTEMS AND TECHNOLOGY**
     1. Do you have an Internet based auction lending capability? If so, describe, including inception, extent of applications, competitive bidding process, etc.
     2. What system(s) do you utilize for lending securities and collateral reinvestment? Are the systems proprietary or third party? What is distinct about your current system(s)? Is the system only for the lending business?
     3. Describe your business continuity and disaster recovery plans. Has your business ever experienced any business continuity issues related to securities lending? If so, please provide details. What will be the expected recovery times and service level for critical securities lending services in the case of a major disaster? How often are the plans tested?
  5. **CONVERSION**

5.12.1 Please provide a detailed conversion timeline including, but not limited to your approach for novating loans.

* 1. **FEES**
     1. Explain your methodology for calculating a client’s income and the proposed income split. Show sample calculations.

* + 1. Do you guarantee income? If yes, in what circumstances?
    2. Do you charge a management fee (bps) for collateral reinvestment? If so, specify the fee.
    3. Would you agree to a fee arrangement wherein you share only in the intrinsic revenue and not reinvestment income if you do not manage the cash collateral?
    4. What is your organization’s standard revenue sharing arrangement (principal) and the standard split of security lending income?
  1. **SECURITIES LENDING REVENUE PROPOSAL**
     1. Provide five (5) estimates of your program’s securities lending program revenue using assets held as of December 31, 2017 as shown in Exhibit 2. The tables in Exhibit 2 should be prepared for each of the three collateral reinvestment options in Section 3.1.9 and prepared on a look back basis utilizing the trailing twelve months from December 31, 2017. Revenue options #3 – 5 should be prepared using a weighted average maturity for the collateral portfolio of 60 days and a maximum security maturity of 13 months for the portion of the portfolio that is assumed to be managed by the agent.

List significant assumptions or comments that impact your lending estimate. What is the assumption on the lender risk weighting (RWA) and how would the revenue projections in each of the three scenarios by impacted by a change in the RWA.

* + 1. Please explain the methodology used for calculating the securities lending revenue. Please provide an example.
  1. **PRICE SCHEDULE**

The Bidder must submit its pricing using the format set forth in the State-supplied price schedules accompanying this RFP. Failure to submit all information required may result in the proposal being considered non-responsive. Each Bidder is required to hold its prices firm through award of the Contract and shall not increase such prices during the term of the Contract.

**Proposal prices must be typed or written in ink. Any price change (including “white-outs”) must be initialed.**