

# MONTANA

## BOARD OF INVESTMENTS

### BOARD ADOPTED POLICY

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POLICY NUMBER: 10.310

EFFECTIVE DATE: November 30, 2021

TITLE: Custodial Bank

SUPERSEDES: Governance Manual  
February 2021

BOARD ADOPTION: November 30, 2021

REVIEWED:

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#### I. Custodial Bank

- A. The Board recognizes that Section 17-6-101, MCA, authorizes central depository banking services.
- B. The purpose of this Policy is to:
  - 1. Acknowledge the complex and substantial role of the Custodial Bank, and therefore provide the following policy guidance.
  - 2. Acknowledge there is an associated custodial credit risk specific to the custodial bank relationship and the steps required to mitigate this risk.
    - a) Risk in this context is the event of failure of the depository financial institution in possession of the Board's assets whereby the state is not able to recover the value of the investments or collateral securities.
    - b) This risk is not limited only to the Custodial Bank; there may be sub-custodial banks particularly in foreign countries that may not be affiliates of the primary Custodial Bank.
- C. The Custodial Bank provides a range of services, including:
  - 1. Securities safekeeping and settlement services, including global and domestic U.S. custody.
  - 2. Global and domestic cash processing including foreign exchange.
  - 3. Securities accounting and reporting.
  - 4. Participant accounting (transfer agent accounting and reporting).
  - 5. Investment performance and analytics reporting.
  - 6. Custodial securities lending or non-custodial securities lending facilitation at the Board's option.
  - 7. Providing and maintaining a comprehensive online accounting system to account for the Board's entire portfolio and all transactions.

- D. Given the complex role, responsibility, and trust associated with the Board's Custodial Bank, the selection is prescribed as follows:
1. The Board acknowledges the selection process is governed by the State's procurement process through a formal request for proposal (RFP).
  2. The Board specifies the following *minimum* qualifications for respondents to the RFP:
    - a) Offeror must have been providing domestic and global master custody services for at least ten (10) years.
    - b) Offeror must have under custody at least \$1 trillion in assets at fair value, \$500 billion of which must include international foreign currency assets.
    - c) Offeror must have been providing domestic and global master custody services for at least ten (10) public or corporate pension funds, each with assets of at least \$10 billion, at fair value for a minimum of five (5) years.
    - d) Offeror must have provided securities lending services for public pension and non-pension funds for a minimum of ten (10) years, and the fair value of securities on loan must have averaged \$40 billion daily during the twelve (12) preceding months.
    - e) Offeror must be able to perform all procedures necessary to convert from the current Custodial Bank's system to the new Custodial Bank's system of record. Offeror must have completed transitions of at least five (5) public funds with diversified assets totaling at least \$25 billion at fair value.
    - f) Offeror must be able to provide participant (transfer agent) accounting (mutual fund type accounting) and be able to demonstrate to the Board's satisfaction its ability to provide such accounting.
    - g) Offeror must be able to provide on-line comprehensive securities accounting and be able to demonstrate to the Board's satisfaction its ability to provide such accounting.
    - h) Offeror must allow Board staff to customize reports and provide an electronic interface for such reports.
    - i) Offeror must be able to provide a direct interface between its securities accounting system and the Board's Financial Asset and Investment Management System (the Board's trade order management system).
    - j) Offeror must be able to provide assurance through a third party, in writing, that its internal control reviews are conducted in compliance with the Statement of Standards for Attestation Engagements Number 16 (SOC, Report on Controls at a Service Organization).
    - k) Offeror must have in place an internal audit staff who consistently evaluates all internal control systems and risks associated with master trust/custody services.
  3. In addition to the above minimum qualifications, the Offeror must be able to demonstrate to the Board's satisfaction:
    - a) Organizational resources, technology and staffing securities safekeeping, and core servicing securities.
    - b) Settlement, accounting and reporting cash, and exposure management.
    - c) Foreign exchange securities lending.
    - d) Comprehensive accounting system including transfer agency performance measurement and portfolio risk analysis transition and conversion.
- E. The Board acknowledges that the Custodial Bank will generally have investment and deposit options available to the Board. To mitigate risk:

1. Custodial Bank must demonstrate that it has sufficient financial strength to protect the interests of the Board.
  2. Must be rated at a minimum at the sixth (6<sup>th</sup>) highest investment grade rating by at least two (2) nationally recognized statistical rating organizations.
  3. For any cash balances held as deposits of Custodial Bank or sub-custodial banks, they are held in the name of the Board or its accounts and are incidental and only held for short periods while awaiting instructions or other disposition.
- F. The Board delegates to the Custodial Bank that it is to be the 'book of record', however, the Board reserves to itself its fiduciary responsibility to assure accurate records regarding both holdings and performance.
- G. The Board acknowledges and allows that some of its fiduciary assets are by their nature held elsewhere other than by the Custodial Bank and by cross-reference to Policy 30.400, directs and requires the Chief Investment Officer to set appropriate due diligence and control standards to provide for the prudent safeguarding of such assets as:
1. Index Funds.
  2. Private equity and real estate ownership interests.
  3. Any commingled funds held within managed accounts (these would include use of any ETF's or proprietary commingled funds in the form of an institutional trust vehicle).