



CITY OF HAMILTON
CORPORATE SERVICES DEPARTMENT
Financial Planning & Policy Division

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	January 19, 2015
SUBJECT/REPORT NO:	Custody Services - Authorization to Negotiate (FCS15006) (City Wide)
WARD(S) AFFECTED:	City Wide
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SUBMITTED BY:	Mike Zegarac General Manager Finance & Corporate Services Department
SIGNATURE:	

RECOMMENDATION

That the General Manager of Finance and Corporate Services, or designate, be authorized and directed to negotiate a five year contract with an option to renew for an additional five year period with Royal Bank of Canada Investor & Treasury Services (RBCITS) at the current or better pricing rate structure for Custody Services.

EXECUTIVE SUMMARY

Royal Bank of Canada Investor & Treasury Services (RBCITS) currently provides custody services for the City. A custodian, in general, is responsible for the execution of security transactions on behalf of the beneficial owner. Records are maintained, accounted for, audited and become the base for return calculations and are audited by the custodian's auditor. The responsibilities of RBCITS include the following:

1. Executing payments and delivery instructions for the City's investments, Trust investments and Master Trust pension plan investments.
2. Maintaining monthly accounting records of all accounts, their investments and reporting the same to the City or the City's designate.
3. Calculating returns on the City's investments in Reserve accounts, Future Fund, Trusts, and Master Trust pension plan.
4. Forwarding through their Corporate Actions group information on investments, including restructuring, shareholder proxy votes, and legal activities, if known, to the City staff.
5. Handling security lending of all securities on a fee split basis

The original custody agreement with Royal Trust was executed on October 7, 2002 and a letter agreement for securities lending was executed on January 6, 2003. After a series of transactions Royal Bank of Canada Investor & Treasury Services (RBCITS) holds successor rights to these agreements. These agreements do not have specified termination dates and notice periods from either party are required to terminate the agreements.

Over the last nine years (2005 to 2013) the City's average annual net cost and revenue for custody services, security lending revenue and benchmarking and compliance services from its contract with RBCITS of \$43,502 can be summarized in the table below:

Average Cost and Revenue

Total Basic Custody Fees (HST incl.) Col. A	Net Security Lending Revenue Col. B	Net Basic Custody (Cost) or Revenue Col. C=A+B	Benchmarking & Compliance Cost (HST incl.) Col. D	Net Cost All Services (HST incl.) Col. E=C+D
(\$117,160)	\$126,747	\$9,587	(\$59,195)	(\$43,502)

Throughout this period RBCITS has had annual meetings with City staff and the account servicing has been highly rated, reporting has been appropriate and accurate, and costs and services have been maintained at the original contract rates and standards.

Negotiation with the current service provider, RBCITS, is being recommended to secure a long term and stable relationship for custodial services and security lending services under a favourable pricing arrangement for high quality of services.

Based on existing investment account structure, balances and transactions, the annual net cost (costs net of security lending revenue) of a new contract with RBCITS is expected to be \$45,000 annually.

Alternatives for Consideration – See Page 5.

FINANCIAL – STAFFING – LEGAL IMPLICATIONS (for recommendation(s) only)

Financial: There is no financial impact for the recommendation seeking authorization to negotiate with RBCITS as the net cost is expected to approximate the average annual net cost of the current arrangement with RBCITS of \$43,502.

Staffing: Not issuing a Request for Proposal (RFP) will save the procurement and user department staff time required to develop the RFP document and to review the submissions.

Legal: City Legal Services Division will be required to review a new contract prior to execution.

HISTORICAL BACKGROUND (Chronology of events)

The original custody agreement with Royal Trust was executed on October 7, 2002 and a letter agreement for securities lending was executed on January 6, 2003. These agreements do not have a specified termination date and notice periods from either party are required to terminate the agreements. Royal Trust was acquired as a direct operating group of RBC bank on September 1, 1993. On January 1, 2006, RBC entered into an agreement with Dexia, a European Custodian, based on a 50/50 ownership and all contracts were honoured in both Canada and Europe under the newly named RBC Dexia. Recently, on July 27, 2012, RBC exercised a first right of refusal and bought out Dexia's operations. RBCITS is now a custody service which has North American and European Services to handle the increasing global nature of basic services and pension services.

Internal Audit Report 2013-18 Investments (AUD14011) which was approved by the Audit, Finance and Administration Committee at its meeting of May 12, 2014 contained observations about the arrangement with the current custodial service provider. This report seeks Council approval to negotiate with the current service provider and provides Council with some alternatives to be considered.

POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS

The requirement to seek Council direction is contained in Procurement Policy Section 4:5 (5) "Determining the Procurement Process" Section 4:5 (5) due to the sensitive nature and risk of financial loss when dealing with an incumbent vendor, Council direction is required as to the use of Direct Negotiation or another method.

RELEVANT CONSULTATION

City staff consulted with six municipalities as to which custodial service was being used. Three municipalities (Burlington, Toronto and Ottawa) use RBCITS, while three municipalities (Halton Region, Mississauga and York Region) use CIBC Mellon. Two municipalities recently transferred from RBCITS through direct negotiation or a limited RFP by inviting only RBCITS and CIBC Mellon. One municipality indicated that they

changed as CIBC was their banking agent and having CIBC Mellon as their custodian made that relationship cleaner. However, it took six months for total transfer and acceptable transition which would imply significant transition cost.

All municipalities were and are very concerned about having a long-term and stable relationship with their custody provider. Generally, they have at least five year contracts or five year contracts with an option to renew for a further five years.

ANALYSIS AND RATIONALE FOR RECOMMENDATION

The benefits of having a long-term and stable relationship for custodial services and security lending services have resulted in the request to negotiate new agreements.

In Canada, Trust companies were the primary custodian. The major banks acquired all Custodian/Trustees during the 1990s and early 2000s. The four large custodians in Canada are RBCITS, CIBC Mellon, State Street, and Northern Trust. Northern Trust limits its operations to pensions and has a limited profile in Canada and seems to have strength in Corporate Actions and does handle mid-size pension plans for the most part, but is large in the United States for pensions. State Street, a major bank in the United States, handles pensions and large public and private clients in the United States and in Canada, but are not involved with many smaller government, public or private operations. In looking at the market as a whole, RBCITS is the dominant participant at this time while CIBC Mellon is second and it is gaining some ground. State Street has been a stable participant gaining marginally while Northern Trust has remained the smallest participant specializing more in pension custody.

A review of six municipalities that use a custodian revealed that currently three use RBCITS and three use CIBC Mellon. Two municipalities have transferred to CIBC Mellon in the last four years from RBCITS for contract terms of at least five years with an option to renew for five additional years. The transferring municipalities did not have holdover (non-OMERS) pension plans. The two changes were handled by direct negotiation or a limited RFP.

City staff has been approached by CIBC Mellon over the past years. CIBC Mellon was pricing the contract on a percentage of assets which made CIBC Mellon more expensive and they did not indemnify security lending operations. As well, additional costs would be incurred for any transfer between a new custodian other than our current service provider, RBCITS, and the City's bank. RBC bank and RBCITS do not charge a transaction fee between their related entities.

City staff is aware of the effort involved to change custodial service providers based on a previous transfer from CIBC to RBCITS and experience from other municipalities. Considerable time and staffing costs were incurred in reconciling assets, adjusting statements, amending procedures and establishing relationships and protocols with new contacts. The time frame and staffing costs were very significant and can only be estimated in time at about six months and \$50,000. Due to the relative complexity of the Pension and Trust accounts, transition costs could increase the estimated cost significantly.

RBCITS has provided highly rated services to the City over the term of the contract and rates in the pricing structure of the original contract have remained intact.

Over the last nine years (2005 to 2013) the City's average cost and revenue for custody services and benchmarking and compliance charges from RBCITS can be summarized in the table below:

Average Cost and Revenue

Total Basic Custody Fees (HST incl.) Col. A	Net Security Lending Revenue Col. B	Net Basic Custody (Cost) or Revenue Col. C=A+B	Benchmarking & Compliance Cost (HST incl.) Col. D	Net Cost All Services (HST incl.) Col. E=C+D
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CIBC Mellon has shown in the past three years a significant commitment for adjusting their fees and upgrading their capabilities resulting in some new municipal government customers. Both RBCITS and CIBC Mellon are domestic custodians with the capacity to fulfil the City's needs for custody of City Funds, Trusts and Pensions.

City staff believes that negotiation with RBCITS at the current rates and service level would be the best option as it would offer the lowest cost for transition and lowest net annual costs. In addition, negotiation may generate cost savings or additional revenues through a new contract with RBCITS for a term of five years with an option to renew for an additional five years.

ALTERNATIVES FOR CONSIDERATION

Two alternatives to negotiating with RBCITS to be considered are simultaneous direct negotiation with RBCITS and CIBC Mellon for custodial services; and remaining on the existing contract with RBCITS.

Alternative 1: Simultaneous direct negotiation with RBCITS and CIBC Mellon. This alternative allows both custodians the opportunity to provide City staff with the benefits of their services, the ability of their products to meet our needs, competitive pricing structures and transition plans. The financial implications in terms of costs for custodial services and revenues for the security lending services are unknown at this time. Incremental costs over the recommended option, in terms of staff time during the negotiations, would be incurred. As well, transition costs estimated at \$50,000 and additional transaction fees estimated at \$15 each (or \$8,010 annually) would be incurred for a transfer to CIBC Mellon which may be offset by other savings in their pricing structure. City's Legal Services Division would be required to review the contract with the service provider selected.

Alternative 2: Remain on the existing contract with RBCITS. This alternative maintains status quo with RBCITS providing excellent service to the City under the existing pricing structure, no expiry date and options to cancel the contract with sixty days' notice by either party. The financial implications in terms of costs for custodial services and revenues for the security lending services are expected to remain unchanged at \$45,000 annually based on average transaction volumes and security lending revenue. In addition, there would be no disruption of service.

ALIGNMENT TO THE 2012 – 2015 STRATEGIC PLAN

Strategic Priority #2

Valued & Sustainable Services

WE deliver high quality services that meet citizen needs and expectations, in a cost effective and responsible manner.

Strategic Objective

- 2.1 Implement processes to improve services, leverage technology and validate cost effectiveness and efficiencies across the Corporation.

Strategic Priority #3

Leadership & Governance

WE work together to ensure we are a government that is respectful towards each other and that the community has confidence and trust in.

Strategic Objective

- 3.4 Enhance opportunities for administrative and operational efficiencies.