

# San Diego County Employees Retirement Association

## Securities Lending Guidelines

July 2010

The securities lending program will include the following types of loan collateral, short-term cash collateral investments, and loan terms:

1. **Securities eligible for lending.** Domestic and international equity and fixed income securities held by a bank custodian may be loaned.
2. **Compliance monitoring.** Except as specifically provided in these guidelines with respect to maintaining the required market value of collateral for loaned securities, compliance with these guidelines shall be determined as of the time of the investment of cash collateral.
3. **Collateral received.** Collateral received from borrowers should be delivered in the form of cash or government securities eligible for book entry in either the Federal Reserve System or the Participants Trust Company, or their respective successors.
4. **Cash collateral collective investments authorized.** Cash collateral may be invested in (a) any collective trust fund the assets of which are invested in compliance with these guidelines, is qualified for exemption from taxation under Internal Revenue Service Ruling 81 – 100, 1981-1 C.B. 326, or any successor ruling, regulation or similar pronouncement (the “qualified trust fund exemption”), and of which the current SDCERA bank custodian or securities lending agent is the trustee; or (b) if approved by the Portfolio Strategist. (1) any open-ended money market mutual fund managed by a registered investment advisor or (2) any short-term money market investment collective trust fund that has the qualified trust fund exemption and of which the current SDCERA bank custodian or securities lending agent is the trustee. No more than 10% of cash collateral may be invested in funds authorized in subsection (b) (2) of the preceding sentence.
5. **Cash collateral authorized portfolio investments.** All investments of cash collateral must be denominated in U.S. dollars. When the borrower of a SDCERA security delivers cash collateral to secure its obligations to redeliver the borrowed security, such cash collateral shall be invested in the following types of instruments in accordance with these guidelines:
  - 5.1. U.S. Government Securities and GSE Securities.
  - 5.2. Money market instruments including but not limited to commercial paper, master notes, time deposits, bank certificates of deposit and bankers’ acceptances.
  - 5.3. Repurchase agreement, either deliverable or tri-party, that are fully collateralized by collateral determined by bank custodian in its discretion, which collateral may include, but not be limited to, any of the following: U.S. Treasuries, U.S. Treasury STRIPS, Federal Agency Obligations, Mortgage Backed Securities, Agency REMICS/CMOs,

Commercial Paper, Corporates, Asset Backed Securities, Equities, Whole Loans, or any combination thereof. The market value of collateral received under any repurchase agreement must exceed the market value of the cash distributed by a margin of not less than two percent.

**5.4.** Fixed or floating rate debt obligations, including, but not limited to, automobile loans (including dealer inventory financing), credit card receivables, student loans, home equity, and residential and commercial mortgage issues. Any floating rate obligation must meet the following criteria:

**5.4.1** Interest must be based upon a coupon formula that resets at least quarterly.

**5.4.2** The coupon formula must be tied to one of the following: the Federal Funds Effective Rate, the U.S. prime lending rate, the three-month U.S. Treasury Bill rate, the one- or three-month London Interbank Offered Rate (LIBOR), or a published composite index for interest rates on commercial paper or certificates of deposit.

**5.4.3** The coupon formula must be based upon a constant spread relationship between the security coupon rate and the reference rate. Step up/down floaters are permitted. Prohibited floaters include, but are not limited to, complex derivative structures such as inverse floating rate notes, and defined range floating rate notes. No investment may be made in any instrument for which a negative coupon interest rate is possible. Zero coupon securities such as commercial paper, short term discount notes, original issue discount notes, and Treasury bills purchased at prevailing market yields are acceptable for purchase.

**5.5** All other fixed and floating rate obligations, including but not limited to, corporate and medium term notes.

**5.6** Derivative instruments, including but not limited to, futures contracts and options on futures, interest rate swaps, credit default swaps, total return swaps, and options on securities indices. Any individual derivative instrument cannot exceed applicable guideline limits and any derivative exposure, either singly or in aggregate, cannot cause the Fund to exceed applicable guideline limits. All derivative exposure will be measured on a net basis.

## **6.Maturity limits for individual cash collateral investments.**

**6.1** At the time of purchase, the expected final maturity of any individual fixed-rate instrument (expected, weighted-average life in the case of amortizing, fixed-rate investments) may not exceed 36 months.

**6.2** At the time of purchase, the expected final maturity of any individual floating-rate instrument (expected, weighted-average life in the case of amortizing, floating-rate investments) may not exceed seven years.

**7. Portfolio maturity limits for cash collateral investments.**

**7.1** The par value, dollar-weighted average maturity of the collective cash collateral investment portfolio may not exceed 120 days. For purposes of this calculation, the maturity of any floating rate obligation may be considered the remaining time to the instrument's next coupon reset. Additionally, for the purpose of this calculation, the weighted-average life of any amortizing, fixed-rate obligation may be substituted for the instrument's maturity.

**8. Minimum credit quality ratings for individual cash collateral investments.**

**8.1** Each instrument having a maturity at the time of purchase of less than 13 months must qualify as "first tier securities" within Rule 2a-7 under the Investment Company Act of 1940.

**8.2** Each instrument having a maturity at the time of purchase greater than 13 months must be rated at the time of purchase within the highest major, long-term rating category of an NRSRO (e.g., Moody's A3 or Standard & Poor's A-), or, if unrated, be determined to be of comparable quality by the Fund's trustee.

**9. Downgraded Securities.** If, subsequent to purchase, a security is downgraded by an NRSRO such that the security no longer meets the minimum rating requirements prescribed in Section 8 above, the securities lending agent must inform the Portfolio Strategist and/or Assistant Chief Investment Officer (ACIO) of the downgrade in writing or through electronic transmittal within 72 hours of the action. Upon receipt of this notice, the Portfolio Strategist/ACIO, or his/her designee, will conduct a review of the downgraded security and submit a recommended action to the Portfolio Strategist/ACIO within 72 hours of the receipt of written notice by the securities lending agent. Within 48 hours of the receipt of this recommendation, Portfolio Strategist/ACIO or his/her designee will instruct the securities lending agent how to administer the downgraded security.

**10. Initial collateral; market to market.** Loaned securities and initial collateral delivered by the borrow of SDCERA securities shall be marked to current market value at the close of each business day, as "business day" may be defined in an applicable securities lending authorization agreement between SDCERA and the securities lending agent.

**10.1 Domestic securities.** For purposes of this policy, domestic securities are securities denominated in U.S. dollars and whose primary trading markets are in the United States. The initial collateral delivered to secure a loan of domestic securities must have a market value of at least 102% of the initial market value of the loaned securities. If, while the loan is outstanding, the current market value of the collateral initially delivered by the borrower is less than 100% of the current market value of the loaned securities, the securities lending agent must require the borrower to deliver additional collateral to restore the value of the collateral to 102% of the market value of the loaned securities.

- 10.2 International securities.** For purposes of this policy, international securities are securities not denominated in U.S. dollars or whose primary trading markets are not in the United States. The initial collateral delivered to secure a loan of international securities must have a market value of at least 105% of the initial market value of the loaned securities. If, while the loan is outstanding, the current market value of the collateral initially delivered by the borrower is less than 105% of the current market value of the loaned securities, the securities lending agent must require the borrower to deliver additional collateral to restore the market value of the collateral to 105% of the current market value of the loaned securities.
- 10.3 Invested cash collateral.** When cash collateral is invested for the account of SDCERA, the borrower is not required to deliver additional collateral based on a drop in the market value of such investments except as provided in the applicable securities loan agreement.
- 11.** Loans must be callable by SDCERA or the lending agent so as to make timely delivery on the applicable trade settlement date if the loaned security is sold by a SDCERA portfolio. Any term loans that are not callable must be approved in advance by the Portfolio Strategist/ACIO, or his or her designee.

### **Restrictions**

- 1.** Collectively, the maturity limits established for individual securities and the weighted average limits for the entire cash collateral portfolio as specified in paragraphs [6.2] and [6.3] under the “Guidelines” section of this policy, respectively, coupled with the parameters defined for floating rate securities in paragraphs [5.4] under the same section, are intended to control the market value sensitivity of the portfolio to overall changes in interest rates. In addition to these parameters, the cash collateral portfolio will be constructed in a manner that will limit the sensitivity of the fair market value of the portfolio to changes in interest rates as follows:
- 1.1** “Change in interest rate” is defined as an instantaneous, parallel shift in yield curves affecting the entire term structure of interest rates, as indicated by the yields on U.S. Treasury securities, and the interest rate indices referenced in the section [2].
- 1.2** The fair market value sensitivity of the portfolio and individual investments will be calculated as the percentage change in the fair market value of the portfolio or investment per 1 basis point change in interest rates paid per annum. Additionally, the fair market value sensitivity limit will be applied to changes in interest rates of any and every magnitude (i.e., the ratio of the percentage change in the fair market value of the portfolio to a 1 basis point change in interest rates must remain within the specified limits if interest rates change by any amount).

- 1.3 The fair market value of the portfolio must not decline by more than .0035 percent per 1 basis point change interest rates.
2. The maximum market value of SDCERA securities on loan at any one time shall not exceed 30% of the market value of the total SDCERA investment portfolio.
3. No mortgages or mortgage-backed securities may be loaned in “dollar roll” transactions in which the identical borrowed securities are not returned to SDCERA.
4. On an annual basis, the lending agent will furnish a list of potential borrowers and corresponding dollar loan limits. The Portfolio Strategist/ACIO of his/her designee has the discretion to remove any name from the potential borrower list.
5. Securities lending agreements entered into by the securities lending agent will be covered by written contracts consistent with this policy and applicable law.
6. **Diversification requirements.**
  - 6.1 No more than 10% of total cash collateral investments may be made in issues of any one non-governmental entity. There are no concentration limits for U.S. Treasury and Agency securities. The single counterparty exposure on a repurchase agreement may not exceed 5% of the total cash collateral account unless those transactions are covered by an indemnification agreement that is sponsored by an organization that bears a long-term NRSRO rating of A- or better and is enhanced by acceptable collateral as specified by section 5.3 of the guidelines. For purposes of this requirement, counterparty includes the counterparty’s subsidiaries.
  - 6.2 Exclusive of approved money market funds, no more than 40% of cash collateral investment may be made in asset-backed commercial paper.
  - 6.3 Exclusive of approved money market funds, no more than 50% of cash collateral investments may be made in foreign debt obligations.
7. Investments in structured notes are prohibited with the exception of those listed in Section 5.43 of the guidelines.

## **Reports**

Staff will review the progress of the securities lending program, including an overall evaluation of the performance of the lender(s) and the program at least annually. This review will include a written report on the lending volume, income generated, and the most-recent maximum broker loan limits.