

SBCERS

Santa Barbara County Employees' Retirement System

DATE: August 28, 2024

TO: SBCERS BOARD OF RETIREMENT

FROM: SBCERS Investment Staff

RE: **Investment Operations: Vehicle & Securities Lending Education**

Recommendation

That the Board of Retirement receive and file the Investment Operations: Vehicle & Securities Lending Education presented by RVK's Jonathan Kowolik, BlackRock's Gene Meshechek and Bank of New York Mellon's Michael McInnes and Andrew Minc and approve the following recommendations:

- A. Authorize the SBCERS CEO to negotiate and execute a written agreement to expand the collateral investment guidelines applicable to SBCERS securities lending program consistent with the recommendations of BNY and RVK; and
- B. Authorize the SBCERS CEO to negotiate and execute a written agreement to implement securities lending for the following investment accounts:
 1. 401(a) Trust Plan Assets
 - i. BNY Mellon Russell 1000 Index Fund
 2. Other Post-Employment Benefits (OPEB) Trust Plan Assets
 - i. Blackrock Russell 3000
 - ii. Blackrock US Debt Fund; and
- C. Authorize the SBCERS CEO to negotiate and execute a written agreement with Artisan Partners to transfer separate account assets into a commingled fund or similar pooled investment vehicle with consistent investment parameters; or
- D. Take other action as appropriate.

Summary

This education focuses on investment vehicle types and securities lending. Jonathan Kowolik, Senior Consultant and Principal will discuss the factors that influence investment vehicle selection. There are six investment vehicle types that are used by institutional investors:

- Mutual Fund (MF),
- Exchange Traded Fund (ETF),
- Commingled Funds (CF)/Collective Investment Trusts (CITs),

- Limited Partnerships,
- Domestic (U.S.) Separate Accounts (SAs)
- Global (U.S. & Non-U.S.) Separate Accounts (SAs).

The investment vehicles have specific characteristics that affect the cost and complexity of administration. These factors involve administering tax regulations, financial reporting, custody arrangements, mandate flexibility, liquidity, and securities lending.

Securities lending is not exclusive to separate accounts and can be achieved indirectly through other vehicles like commingled funds, CITs or mutual funds. In both scenarios, direct or indirect, the revenues earned from securities lending accrue to the benefit of the investor.

Gene Meshechek, Global Head of Clients for BlackRock's Securities Lending Business will walk the Board through the basic mechanics of securities lending transactions and discuss what creates demand for securities lending. He will also discuss the risks inherent in lending and ways that firms can mitigate those risks.

Michael McInnes, Vice President of Securities Finance with Bank of New York Mellon, will present SBCERS' historical experience with securities lending. The performance review will cover annual revenue by year and by investment manager. He will also discuss the current SBCERS parameters for cash collateral and what additional enhancements may be considered to the program at this time that may enhance the revenue gained from the program while still keeping risk at a moderate level.

The presentation concludes with several recommendations for the Board to consider. The first recommendation would be to broaden the range of the collateral accepted for lent securities, including non-cash securities. This action would also allow for a longer maturity period on the collateral accepted. Implementation of this recommendation will increase the revenue generated by the program by increasing the yield on collateral held and increasing the overall opportunity set available to the program by increasing the range of potential borrowers.

The second recommendation is to expand the number of investment mandates participating in securities lending program. There are three commingled fund investments held in the County's OPEB plan and the 401(a) Pension Trust that are not participating in securities lending. A historical review comparing the performance of the lending funds vs. the non-lending funds indicate that the lending funds outperform non-lending funds by 3 – 5 basis points over longer time periods. Cumulatively, this would increase the assets exposed to securities lending by approximately \$69 million (OPEB) and \$433 million (401(a) Pension Trust) based on June 30, 2024, valuations.

The final recommendation is to direct staff and RVK to transfer the assets held in a separate account managed by Artisan Partners into a commingled fund with a similar mandate. This recommendation is based on the complexities of managing a separate account for international investments, the expertise required to implement, and the amount of time spent on fund administration for a single investment allocation. Examples of the additional burdens of a separate account for international equities include maintaining a separate tax preparation contract with

Price, Waterhouse, Coopers to administer country specific tax filing requirements, administering and tracking sanctions issued by the US Treasury Office of Foreign Asset Control (OFAC), and the enhanced financial reporting requirements for separate accounts. If staff is unable to identify a commingled vehicle option managed by Artisan Partners that is fee efficient and expects to generate a net return that is comparable to the existing separate account implementation, staff will return to the Board with a recommendation to perform a search for a new Non-US Growth Manager.

Attachments

- Investment Operations: Vehicle & Securities Lending Education