

CALSTRS

CALIFORNIA STATE TEACHERS'
RETIREMENT SYSTEM

**SECURITIES LENDING
PROGRAM
POLICY**

INVESTMENT BRANCH

APRIL 2014

G. Securities Lending Program Policy

EXECUTIVE SUMMARY

In accordance with the CalSTRS Investment Policy and Management Plan, IPMP, the California State Teachers' Retirement System Board has established a Securities Lending Program, SLP. The SLP is to be managed in a prudent manner for the sole benefit of its participants and beneficiaries in accordance with the California Constitution, the Teachers' Retirement Law and other applicable statutes. The SLP was designed to enable CalSTRS to use its existing asset base and investment expertise to generate a steady source of income. CalSTRS' size and presence in the capital markets make it a prime resource for securities lending. No investment instrument or activity prohibited by the IPMP shall be authorized for the Securities Lending Program.

This document is intended to summarize the fundamental objectives and considerations used in the investment, administration, and management of the SLP. These policies are designed to set boundaries for the structure and oversight of the management of the SLP, as well as to manage the risks associated with securities lending. CalSTRS believes that environmental, social, and governance, ESG, issues can affect the performance of our investments. As a result, the CalSTRS 21 Risk Factors have been developed as a tool that both internal and external investment managers are expected to use to assess the impact of ESG risk when making an investment on behalf of CalSTRS. Detailed procedures and guidelines for the SLP are maintained separately.

As with all other plan assets, these policies cannot be altered without explicit direction from the Board.

A flow chart (Exhibit 1) is included to provide the context for the policies within the general process of implementing the SLP. Words and terms that may be unfamiliar to the reader are referenced in the glossary.

SECURITIES LENDING PROGRAM POLICY

1. **Program Objectives:**

The strategic objective for the SLP is to assist CalSTRS in meeting its investment goals by generating incremental income through collateralized, low-risk, short-term loans using a portion of the lendable assets within the total investment portfolio. Monitoring and oversight of the implementation of the SLP shall come under the purview of the director of fixed income.

2. **Performance Objectives:**

There are no explicit goals with respect to the nominal amount of income generated by the SLP. The performance objective for the program is to achieve lending income commensurate with: 1) the market demand for the securities made available for lending and, 2) the return earned on the investment of the cash collateral within the SLP guidelines.

3. **Program Structure:**

The Securities Lending Program shall be designed to provide a balance between risk control and diversification and structured to take advantage of the benefits of both internal and external management in a prudent manner.

4. **Risk Management:**

- a. **Authorized Signers** – Authorization letters which specify who may transact business on behalf of CalSTRS shall be sent to the appropriate parties, initially at the time an account is opened, and then periodically to all Securities Lending counterparties with whom CalSTRS conducts business. Whenever a change in authorized signers occurs, the affected parties shall be notified within 24 hours in the event of termination, and as soon as possible in the event of a newly authorized signer(s).
- b. **Cash Collateral Portfolios** – Diversification within investment portfolios is critical in order to control risk and maximize returns. Minimum and maximum ranges, with respect to security types, credit exposure, and security maturity, shall be established for the Cash Collateral portfolios that are being managed both internally and externally. Such ranges shall be documented within the SLP guidelines and are subject to change as conditions warrant, as determined by the director of fixed income.
- c. **Authorization Limits** – Given that the trade activity for this program is governed by the investment and securities lending markets, no daily limits with respect to

the approval of trade activity within CalSTRS' internally managed Cash Collateral portfolio shall be established.

- d. **Trade Processing** – Prior to being released from Fixed Income, all transactions relating to the internally managed Cash Collateral portfolio shall be approved within the confines of SLP guidelines that require, at a minimum, a dual release for all fixed income trades. It should be noted that the staff person releasing the trade to the custodian must be from the Investment Operations unit, to ensure proper separation of duties.
- e. **Collateralization** – The collateral shall be marked-to-market daily in order to maintain the negotiated margin level. Given the dynamic nature of the securities lending markets, any nontraditional (traditional being defined as cash and U.S. Treasury and U.S. Agency securities denominated in U.S. dollars) collateral must be reviewed and approved by the director of fixed income.
- f. **Borrower Concentration** – Borrower diversification shall be reviewed in order to evaluate and control the borrower exposure within the SLP. Given the increasingly broad utilization of these firms throughout the SLP, this exposure is to be reviewed regularly, with CalSTRS reserving the right to exclude or limit any borrower from the SLP.
- g. **Counterparty Risk** – Each loan shall be collateralized by securities and/or cash delivered to CalSTRS' custodian/sub-custodian bank prior to or simultaneous with the release of CalSTRS' assets. To protect CalSTRS, the borrower must post collateral in the form of cash and/or other approved securities in an amount that exceeds the market value of the securities borrowed. The margin percentages shall be documented within the SLP guidelines and are subject to change as conditions warrant, as determined by the director of fixed income.

5. **Monitoring and Reporting:**

The following reports will be prepared and presented to the Board, unless otherwise stated, in order to facilitate visibility of compliance monitoring and reporting according to this document:

- a. **Securities Lending Status Report** – prepared by Operations and Fixed Income staff and presented to the chief investment officer and deputy chief investment officer (monthly)
- b. **Securities Lending Program Annual Report** – prepared by staff (annually)
- c. **Business Plan** – prepared by staff (annually)

6. **Delegation of Authority:**

The investment, administration and management of the Securities Lending Program is delegated to staff within the boundaries established by these policies and the processes described within the relevant investment guidelines.

7. **Board Review:**

The Board or the Investment Committee shall administer and review these policies periodically as it deems appropriate and in keeping with its fiduciary standards.

Adopted by the Teachers' Retirement Board on February 9, 1994

Revised to combine Credit Enhancement and Currency Management with Securities Lending into "Off Balance Sheet Programs" on September 11, 1996

Revised to reflect the internal management of a portion of the cash taken as collateral on January 7, 1998

Revised to separate Credit Enhancement, Currency Management and Securities Lending into their own Policies on May 5, 1999

Revised to reflect Board review but no Policy changes on May 1, 2002

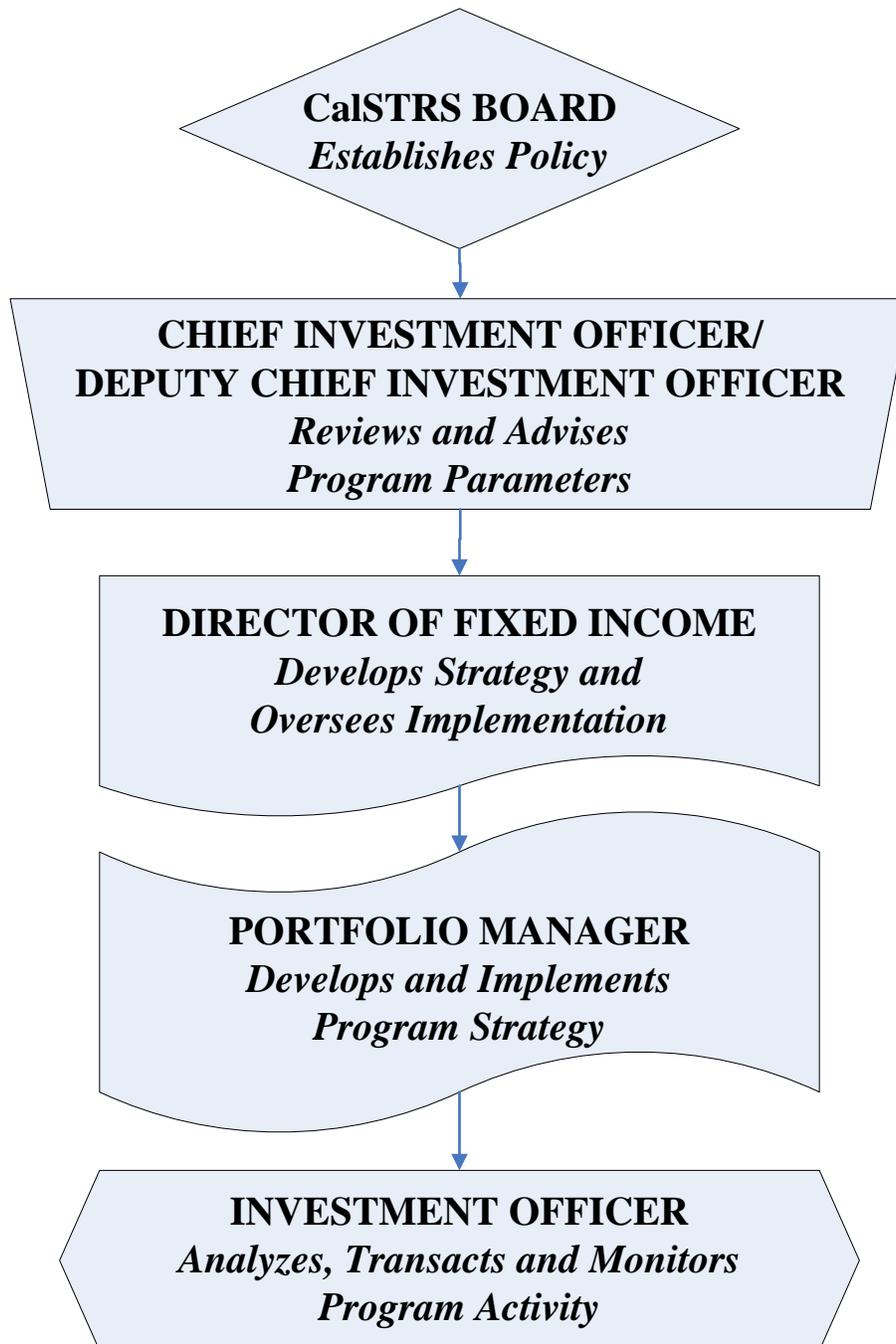
Revised to reflect new standard Policy format across the Unit on June 7, 2006

Revised to reflect Board review in keeping with the investment standard on July 12, 2012

Revised to add ESG language on April 4, 2014

California State Teachers' Retirement System
Securities Lending Program

PROGRAM IMPLEMENTATION FLOWCHART



GLOSSARY

AGENCY SECURITIES – Investments issued by federal corporations and federally sponsored corporations that are able to issue debt at a lower cost to such constituencies as farmers, homeowners, and students.

AGENT – An individual or organization who is authorized to act on behalf of another, called the principal.

ASSET/LIABILITY MANAGEMENT – The ability to manage the differences between your assets (which, in Securities Lending, are the securities in the cash collateral portfolio(s)) and the liabilities (which in Securities Lending are the outstanding loans).

BASIS POINT – One one-hundredth of a percent of yield; .0001 in decimal form.

BORROWER – An individual or organization who borrows securities in return for contracting into an obligation to return those securities together with a fee payment.

CASH COLLATERAL ASSET MANAGEMENT – Investment portfolio managers that are responsible for investing the cash taken as collateral from loans of securities. Each portfolio is diversified among different asset classes based on investment guidelines developed by CalSTRS and emphasizes safety of principal and adequate liquidity.

COLLATERAL – An asset, such as U.S. dollars or other liquid securities, which is pledged to a lender in the event that a loan payment cannot be met. The collateral may be appropriated from the borrower and sold in order to fulfill financial obligations.

COLLATERALIZED – A security that is secured by an asset.

COUNTERPARTY – An individual or organization on the opposite side of a loan.

CUSTODIAN – An agent, such as a broker or a bank, that stores a customer's investments for safekeeping.

LENDABLE ASSET – A security that has an established market or demand by borrowers, such as domestic and international equities and fixed income, in order to provide liquidity and facilitate investment strategies.

LENDER – An individual or organization that lends securities to a borrower.

LENDING TERMS – Specific requirements of a loan such as length of the loan, type of collateral, and rebate rate.

MARGIN LEVEL – The amount of cash or eligible securities the borrower will deposit when borrowing securities.

MARKED-TO-MARKET – An adjustment in the valuation of a security to reflect the current market values of the respective securities in the portfolio. This process is also used to ensure that margin accounts are in compliance with maintenance requirements.

NON-CORE INVESTMENT PROGRAM – A program that provides additional income to the Fund beyond the traditional asset classes within the investment office. The CalSTRS programs that fall into this category are: Credit Enhancement, Currency Hedging, Home Loan and Securities Lending.

PRINCIPAL – The major party in a transaction.

REBATE – The interest rate that the lender pays the borrower on the cash collateral.

RISK AVERSE – Investing conservatively, or avoiding risk unless adequately compensated for it.

SECURITIES LENDING – An agreement between a lender and a borrower to transfer ownership of a security temporarily in order to earn additional income. The lender retains ownership rights of the security and is entitled to any distributions that occur with respect to that security during the life of the loan, such as coupon and dividend payments. The borrower backs the agreement by delivering collateral to the lender, either in the form of cash, which is currently the dominant form of collateral in securities lending transactions, or other liquid securities, in an amount that exceeds the market value of the securities borrowed.

SHORT SELLING – The practice of selling a security that a seller does not own. Therefore, the seller must borrow the security in order to complete the transaction.

SPREAD INCOME – Difference between the yield on the investment of the cash and the interest (rebate) paid to the borrower.

UNITED STATES TREASURY SECURITIES – Debt issues of the U.S. Government, such as Treasury bills, notes and bonds.