

Securities Lending Considerations

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Securities Lending History

- The termination of the securities lending program with Deutsche Bank in February 2016 was a decision made following meaningful concerns related to the organizational uncertainties surrounding Deutsche Bank which were punctuated by multiple credit rating agency downgrades over time. TMRS was not alone in its decision to restrict or terminate Deutsche Bank due to concerns about the stability and legal issues of the organization.
- The plan in 2016 was to do a Securities Lending search process in conjunction with an expected Custodial RFP in 2017; however, with the implementation of the new Enhanced Asset Owner Services model at State Street, the need for a custodial RFP in 2017 was eliminated in the near term.
- The overall TMRS securities lending program with Deutsche Bank performed according to expectations. Program income was generated within proper risk parameters that augmented total plan investment performance for the overall TMRS portfolio.
- Although Deutsche Bank continues to face some organizational challenges, they have not had any program failures or major issues we are aware of since our exit from the program.

Benefits & Challenges

Benefits:

- Increased investment income and yield enhancement, offsetting other expenses or augmenting investment performance.
- Securities lending income was approximately \$2 MM/year under latest parameters.

Challenges:

- Limitations on staff time. Diversification and implementation of the non-core fixed income portfolio among other goals are higher priorities for the remainder of 2017
- Restarting now would require a new search effort to ensure proper launch including:
 - ✓ RFI preparation, distribution and evaluation
 - ✓ Vendor selection
 - ✓ Program design
 - ✓ Program implementation, and
 - ✓ Monitoring, both initial and ongoing
- The evolving securities lending industry and regulatory environments continue to change and are creating ongoing challenges:
 - ✓ Indemnification requirements may impact providers' ability to offer comparable risk mitigation versus that currently being offered
 - ✓ Security settlement timelines are expected to change to T+2 for equity settlement and will increase operational risks to any security lending program.

Recommendation

TMRS Fixed Income Staff and RVK recommend that TMRS postpone the analysis of restarting the securities lending program until 2018 for the following reasons:

- Prioritizing competing initiatives
- Regulatory uncertainty
- Expected changes in security settlement cycles
- Securities lending industry changes

Fixed Income Staff will include a Securities Lending search process in the 2018 Systemwide Investment Pacing Plan for Q1 2018.

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