



<u>Committee and Date</u>
Pensions Committee
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10am

<u>Item</u>
15
Public

SECURITIES LENDING

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Summary

The report informs Members of a proposal to reactivate the Fund's securities lending programme. The Fund implemented a securities lending programme from April 2002 to October 2008 when the programme was suspended as a precautionary measure following the Lehman bankruptcy. Over this period the programme generated additional income of £658,000 for the Fund. The report highlights how a securities lending programme operates and recommends its reactivation on the basis that collateral is restricted to AAA OECD Sovereign Debt (the highest rated collateral available). Reactivating the programme in this risk controlled manner is expected to generate additional income of around £55,000 per annum.

Decisions Required

Members are asked to ;

- A) Agree that the Fund reactivates its securities lending programme on the basis that collateral is restricted to AAA OECD Sovereign Debt (the highest rated collateral available).

REPORT

Background

1. Member will be aware that the Fund uses a range of investment managers and that the vast majority of the Funds investments are held on a segregated basis. In other words, the stock is held in a separate account by the Fund's Global Custodian, Northern Trust. It is possible to generate additional income on these assets by implementing a securities lending programme.
2. Securities lending is an activity where the beneficial owner of an asset lends it to a borrower. In return, the lender receives a fee for lending the asset. Collateral

is received from the borrower, which is held as security against the lent asset. If the borrower were to default and not return the assets then the collateral would be sold and the proceeds used to buy the equivalent holding of the asset that was originally loaned.

3. The Fund implemented a securities lending programme up to the time when Lehman brothers went bankrupt in 2008. The Fund did not lose any money from its securities lending programme as a result of the Lehman Brothers bankruptcy. However, in the challenging financial environment of late 2008 it was felt that the securities lending programme should be suspended so as to eliminate any potential risk.
4. Up to October 2008 the securities lending programme implemented by the Fund accepted collateral in the form of OECD sovereign debt, DBV equities, certificates of deposit, and irrevocable letters of credit. Cash was not permitted as collateral.
5. Between April 2002 and October 2008 the securities lending programme earned the Fund £658,000. This was a significant source of additional revenue for the Fund over the period. The securities lending programme was managed by the Fund's Global Custodian, Northern Trust.

Securities Lending Proposal

6. Over the last period officers have met with representatives of Northern Trust to discuss the re-introduction of the securities lending programme. Officers highlighted that the Fund would only re-introduce the programme on a conservative basis with a view to minimising risk exposure.
7. Northern Trust have highlighted a number of restrictions that could be used to re-introduce the programme at minimised risk to the Fund. These include;-
 - Limiting collateral to AAA OECD rated sovereign debt (this is the highest rated collateral available)
 - Capping the total lending balance to \$150 million
 - Capping exposure to an individual lender at \$40 million
8. Whilst restricting collateral to AAA rated OECD rated sovereign debt will mean that the potential income earned from the programme is restricted it is considered the appropriate approach so as to minimise risk.
9. Northern Trust have robust risk management procedures which ensure that a loan is unlikely to become under-collateralised and furthermore Northern Trust indemnifies clients for any direct loss if they are unable to recover borrowed securities.
10. Officers have consulted with AON Hewitt on the Northern Trust securities lending proposal. AON Hewitt have completed a detailed paper on the proposal which is attached at Appendix A for information. AON Hewitt recommend that the Fund reactivates the securities lending programme on the basis that collateral is restricted to AAA rated OECD Sovereign Debt.

11. Over the next year the revenue generated and any issues arising from the lending programme will be reviewed on a quarterly basis.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)

N/A

Human Rights Act Appraisal

The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.

Environmental Appraisal

There are no direct implications for the environment arising from this report.

Risk Management Appraisal

Regular monitoring of securities lending will ensure regulatory compliance and give early warning of areas of difficulty and potential loss.

Community / Consultations Appraisal

N/A

Cabinet Member

N/A

Local Member

N/A

Appendices

A – AON Hewitt's Views on Securities Lending for Shropshire