

SECURITIES LENDING

Report by Chief Financial Officer

JOINT PENSION FUND COMMITTEE AND BOARD

12 September 2019

1 PURPOSE AND SUMMARY

- 1.1 The purpose of this report is to propose that the Pension Fund undertakes securities lending to enhance the future returns available from the Fund's equity investments.**
- 1.2 Securities lending is where securities are loaned on a temporary basis to a borrower for a return. Although there is an absolute transfer of title of the securities, the Fund remains the beneficial owner, with the "borrower" obligated to reimburse economic benefits during the period of the loan.
- 1.3 Northern Trust, the Fund's custodian, has run a securities lending programme since 1981 demonstrating long term experience in this area of activity. The programme operated by Northern Trust meets the requirements LGPS regulations.
- 1.4 Based on the current level of equity assets held by the Fund which would fall within the securities lending programme, it is estimated on a prudent basis that the Fund would gain £20k per annum additional income from participation.

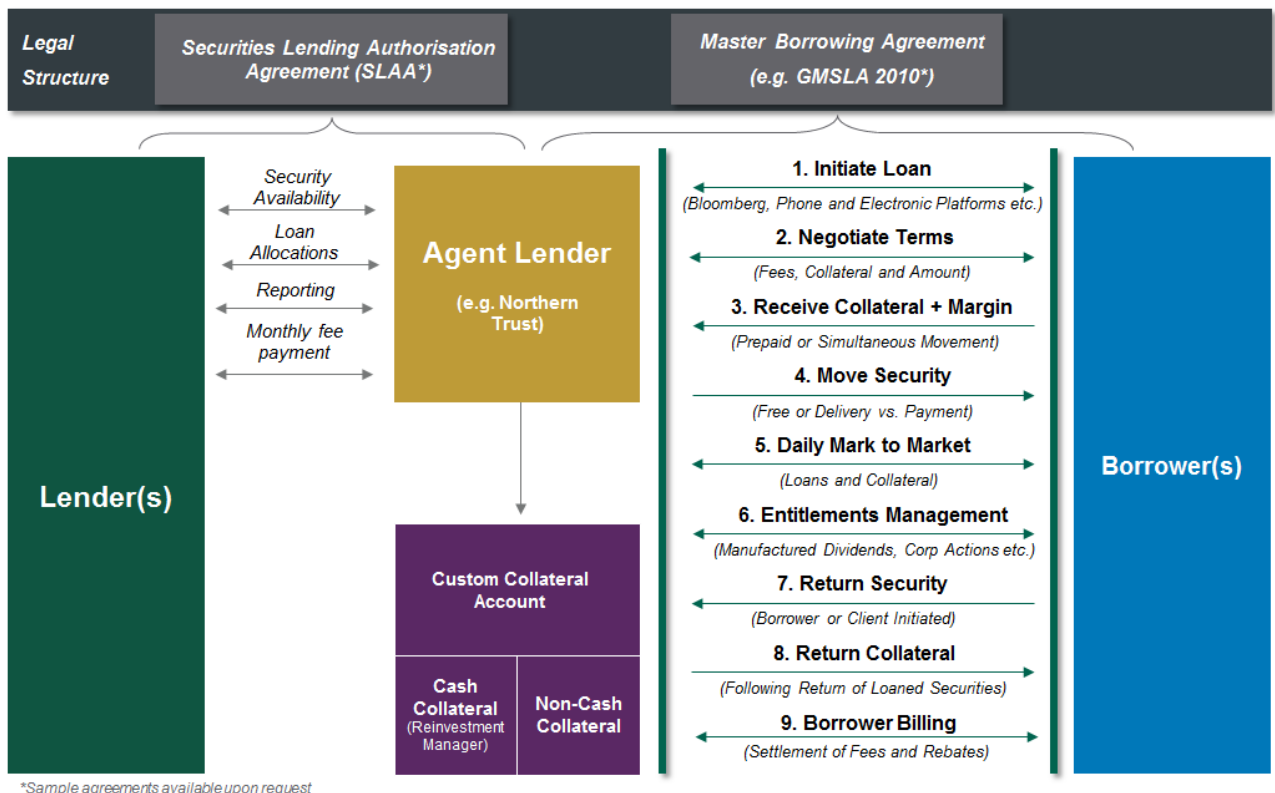
2 RECOMMENDATIONS

2.1 It is recommended that the Committee and Board:

- (a) Agree the implementation of a securities lending programme;**
- (b) Agree to delegate to the Chief Financial Officer the implementation of the programme with Northern Trust.**

3 SECURITIES LENDING

- 3.1 Securities lending is the temporary lending of securities, which are held against collateral. On payment, the "borrower" returns the security along with an agreed fee margin, and the "lender" returns the collateral held for the period of the loan. The securities that can be loaned exclude cash instruments, co'mingled funds, derivatives and securities in non-lending markets.
- 3.2 Although there is an absolute temporary transfer of title of both the securities and the title the "lender" remains the beneficial owner, with the "borrower" obligated to reimburse economic benefits during the period of the loan. The "Lender" does lose voting rights during the period when securities are out on loan. Securities can however be recalled at any time (within standard settlement) to enable voting should an investment manager expressly wish to exercise the right to vote.
- 3.3 Securities are borrowed by Investment Banks, Prime Brokers, Local Brokers, Investment funds, Prop traders and Market traders. Each borrower must be able to demonstrate their credit worthiness.
- 3.4 Assets must be held directly in the Funds name to qualify for securities lending. This therefore restricts the scope of securities lending to segregated funds managed by Baillie Gifford. These assets represent 24% of the total Fund assets.
- 3.5 Northern Trust provide a securities lending service to 43 other similar clients and have a well governed and secure process which is fully compliant with LGPS regulations. 9 out of 11 LGPS funds currently participate in a securities lending programme. The diagram below shows the loan process.



3.6 Northern Trust has provided a securities lending services since 1981 and a dedicated team who specialise in this area. They work within strict programme parameters to ensure income is maximized whilst ensuring that borrowers meet strict credit rating standards. The credit worthiness of borrowers is assessed continuously using four nationally recognised rating agencies, augmented by information from Northern Trusts own in house independent credit determination process. Appendix 1 provides further information on the Northern Trust securities lending programme.

4 IMPLICATIONS

4.1 Financial

- (a) Based on the current levels of lendable securities the Fund holds, and the current market conditions, it is estimated that the lending programme could earn £40k gross per annum of which £20k would be paid to the Fund. This estimate may fluctuate depending on the securities held and the prevailing market demand for these. All costs associated with the security lending process will be absorbed by Northern Trust from their share of the income earned.
- (b) There is no loss of economic benefit to the Fund in terms of investment returns, and any income earned from securities lending would be beneficial to overall performance.

4.2 Risk and Mitigations

- (a) As with any lending there is a risk of borrower default which may result in the loss of the asset. Northern Trust's proposal however includes a borrower default indemnification backed by Northern Trust's strong balance sheet. This would protect the Fund from loss in the event of borrower default.
- (b) Although lenders with enhanced indemnity are contractually protected for any shortfall, the following controls assist in ensuring that the following operating risks are adequately managed.

Risk	Impact	Mitigating Factors
Borrower default combined with insufficient collateral	Unable to compensate for securities and accrued entitlement	Rigorous credit committee review prior to approval
		Loans and collateral marked to market daily
		Risks measured and exposure calibrated by sophisticated risk analysis tools
		Default simulation exercises carried out bi-annually
Failure to return security in time to settle trade in event of sale	Trade settlement failure	Automated securities reallocations
		Contractual settlement protection
		Buffer management process

4.3 Equalities

There are no adverse impacts due to race, disability, gender, age, sexual orientation or religion/belief arising from the proposals in this report.

4.4 Acting Sustainably

There are no direct economic, social or environmental issues with this report which would affect the Council's sustainability policy.

4.5 Carbon Management

There are no direct carbon emissions impacts as a result of this report.

4.6 Rural Proofing

It is anticipated there will be no adverse impact on the rural area from the proposals contained in this report is report.

4.7 Changes to Scheme of Administration or Scheme of Delegation

There are no changes required to the Scheme of Administration or Scheme of Delegation arising as a result of this report.

5 CONSULTATION

- 5.1 The Monitoring Officer, the Chief Legal Officer, the Chief Officer Audit and Risk, the Service Director HR and the Clerk to the Council have been consulted and any comments received have been incorporated into the final report.

Approved by

David Robertson
Chief Financial Officer

Signature

Author(s)

Name	Designation and Contact Number
Kirsty Robb	Pension & Investment Manager, 01835 825249

Background Papers:

Previous Minute Reference:

Note – You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. The Pension & Investment Team can also give information on other language translations as well as providing additional copies.

Contact us at: Pension & Investment Team, Council Headquarters, Newtown St Boswells, Melrose, TD6 OSA Tel: 01835 825249 Fax 01835 825166. email: t&cteam@scotborders.gov.uk