# SECURITIES LENDING POLICY

**(rev. effective December 9, 2022)**

This Securities Lending Policy is adopted by the Board of Trustees of the Teacher Retirement System of Texas (the "Board") pursuant to section 825.303 of the Texas Government Code. The staff shall include the provisions of this Policy in any contract with securities lending agent(s) engaged to lend TRS securities under Tex. Gov't Code section 825.303.

## 1. Objectives

The securities lending program is designed to achieve the following objectives:

**1.1.** Earn a competitive market return on securities lending through conservative securities lending practices, consistently with the preservation of capital.

**1.2.** Manage risk to a reasonable and acceptable level with respect to both the broker and borrower and the collateral.

**1.3.** Operate the securities lending program so that it will not interfere with the management of the TRS portfolios.

**1.4.** Participate in an enhanced custody program that facilitates both TRS borrowing of securities and lending of securities to the lending agent(s) as a principal.

**1.5.** Provide an alternative source of Trust financing that would be used in accordance with Investment Policy Statement ("IPS").

## 2. Controls

**2.1.** The Executive Director will ensure that the responsibilities for the securities lending program are appropriately allocated and implemented as between the Chief Investment Officer and the Chief Financial Officer.

**2.2.** The Chief Investment Officer and his or her designated employees are responsible for implementing and monitoring the securities lending program to ensure compliance with TRS policy and guidelines and restrictions by the lending agent(s). Such monitoring will include at least an annual review of the creditworthiness of the lending agent(s), as lending agent(s) and as borrower. The Chief Financial Officer is responsible for monitoring the program and providing accurate and timely accounting for the securities lending program.

**2.3.** The Board will select the lending agent(s) that will perform the securities-lending function. The selection will be made in accordance with applicable statutory requirements and any other factors deemed appropriate pursuant to a competitive evaluation process and due diligence by the staff.

**2.4.** The Investment Management Division will negotiate a securities lending authorization agreement with the lending agent(s) selected by the Board consistent with this policy and applicable law. The executive director or designee must execute the agreement and any amendments to the agreement.

**2.5** The lending agent(s) selected by the Board must agree to conduct securities lending activities pursuant to the following minimum requirements. Only the Board may determine whether to waive any such requirement.

**2.5.1** The lending agent(s) may not take actions that would cause TRS to engage in a prohibited transaction under section 503 of the Internal Revenue Code ("Code").

**2.5.2** The lending agent(s) shall assist the Investment Management Division to monitor the creditworthiness of all borrowers and shall obtain the most recent audited statement of a borrower's financial condition (or the most recent unaudited statement, if more recent) as part of this process.

**2.5.3** The lending agent(s) shall perform its responsibilities in a manner consistent with that of professional securities lending agent(s) with the care, skill, prudence and diligence under the circumstances prevailing that a professional securities lending agent(s) acting in like capacity and familiar with such matters would use, all in accordance with applicable federal and state laws.

**2.5.4** The lending agent(s) may, pursuant to a separate written agreement signed by the executive director or designee, and subject to the TRS Code of Ethics for Contractors, be authorized to borrow TRS securities in a principal capacity for its own account (including for re-lending to other clients). To the extent that TRS and the lending agent(s), acting as a principal, have offsetting collateral delivery obligations in connection with TRS as a borrower of securities and the lending agent(s) as a principal borrower, such collateral delivery obligations may be netted to maximize efficiency in fees and the delivery of collateral.

## 3. Guidelines

The securities lending program will include the following types of loan collateral, short-term cash collateral investments, and loan terms with the exception of activities conducted in accordance with paragraph 1.5 which will be governed by IPS:

**3.1.** **Securities eligible for lending**. Domestic and international equity and fixed income securities held by a bank custodian may be loaned, except those securities which the Investment Management Division specifies from time to time are not available for lending. TRS securities held in custody by a prime broker are not eligible for securities lending.

**3.2.** **Compliance monitoring**. Except as specifically provided in these guidelines with respect to maintaining the required market value of collateral for loaned securities, compliance with these guidelines shall be determined as of the time of the investment of cash collateral.

**3.3.** **Collateral received**. Collateral received from borrowers must be delivered in the form of cash or government securities eligible for book entry in either the Federal Reserve System or the Participants Trust Company, or their respective successors.

**3.4.** **Cash collateral collective investments authorized.** Cash collateral may be invested in (a) any collective trust fund the assets of which are invested in compliance with these guidelines, is qualified for exemption from taxation under Internal Revenue Service Ruling 81-100, 1981-1C.B. 326, or any successor ruling, regulation or similar pronouncement (the "qualified trust fund exemption”), and of which the current bank custodian or securities lending agent(s) is the trustee; or (b) if approved by the Chief Investment Officer, (1) any open-ended money market mutual fund managed by a registered investment adviser or (2) any short-term money market investment collective trust fund that has the qualified trust fund exemption and of which the current bank custodian or securities lending agent(s) is the trustee. No more than 10% of cash collateral may be invested in funds authorized in clause (b)(2) of the preceding sentence.

**3.5. Cash collateral authorized portfolio investments**. All investments of cash collateral must be denominated in U.S. dollars. When the borrower of a TRS security delivers cash collateral to secure its obligations to redeliver the borrowed security to the lending agent, such cash collateral shall be invested only in the following types of instruments in accordance with these guidelines:

**3.5.1** U.S. Government securities and U.S. government-sponsored enterprise (GSE) or agency securities.

**3.5.2** Money market instruments including but not limited to commercial paper, master notes, time deposits, bank certificates of deposit and bankers’ acceptances.

**3.5.3** Repurchase agreements, either deliverable or triparty, that are fully collateralized by collateral determined by the lending agent(s) consistently with its established practices and in its reasonable discretion, which collateral may include, but is not limited to, any of the following: U.S. Treasuries, U.S. Treasury STRIPS, federal agency obligations, mortgage-backed securities, agency REMICS and CMOs, commercial paper, corporates, asset-backed securities, equities, whole loans, or any combination of these. The lending agent(s) shall notify the Investment Management Division when other types of collateral are used. The market value of collateral received under any repurchase agreement must exceed the market value of the cash distributed by a margin of not less than two percent.

**3.5.4** Fixed or floating rate debt obligations, including, but not limited to, corporate and medium term notes, automobile loans (including dealer inventory financing), credit card receivables, student loans, home equity, and residential and commercial mortgage issues. Any floating rate obligation must meet the following criteria:

**3.5.4.1** Interest must be based upon a coupon formula that resets at least quarterly.

**3.5.4.2** The coupon formula must be tied to one of the following: the Federal Funds Effective Rate, the U.S. prime lending rate, the three-month U.S. Treasury Bill rate, the Secured Overnight Financing Rate (SOFR), the Overnight Bank Funding Rate (OBFR), any similar successor rate indices, or a published composite index for interest rates on commercial paper or certificates of deposit.

**3.5.4.3** The coupon formula must be based upon a constant spread relationship between the security coupon rate and the reference rate. Step-up or -down floaters are permitted. Prohibited floaters include, but are not limited to, complex derivative structures such as inverse floating rate notes, and defined range floating rate notes. No investment may be made in any instrument for which a negative coupon interest rate is possible. Zero coupon securities such as commercial paper, short term discount notes, and original issue discount notes purchased at prevailing market yields are acceptable for purchase.

**3.5.5** Derivative instruments, including but not limited to, futures contracts and options on futures, interest rate swaps, credit default swaps, total return swaps, and options on securities and securities indices. No individual derivative instrument may exceed applicable guideline limits, and no derivative exposure, either individually or in the aggregate, may cause the collateral fund to exceed applicable guideline limits. All derivatives exposure must be measured on a net basis.

**3.6. Maturity limits for individual cash collateral investments.** At the time of purchase, the expected final maturity of any individual fixed-rate or floating- rate instrument (expected weighted-average life in the case of amortizing fixed or floating- rate investments (e.g., asset back securities)) may not exceed 37 months based on settlement date.

**3.7. Portfolio maturity limits for cash collateral investments.** The par value, dollar-weighted average maturity of the collective cash collateral investment portfolio may not exceed 120 days. For purposes of this calculation, the maturity of any floating rate obligation may be considered the remaining time to the instrument's next coupon reset. Additionally, for the purpose of this calculation, the weighted-average life of any amortizing, fixed-rate obligation may be substituted for the instrument's maturity.

**3.8. Minimum credit quality ratings for individual cash collateral investments.**

**3.8.1** Each instrument having a maturity at the time of purchase of less than 13 months must be rated in one of the two highest short-term ratings categories of the following Nationally Recognized Statistical Ratings Organizations (NRSROs): Moody's Investors Service, Inc. (P-2 or higher); S&P Global Ratings (A-2 or higher); Fitch Ratings, Inc. (F-2 or higher); or DBRS, Inc. (R-2 (high) or higher); or be determined by the Board to be of comparable quality based on a recommendation by the Chief Investment Officer or his designee.

**3.8.2** Each instrument having a maturity at the time of purchase greater than 13 months must be rated at the time of purchase within the highest major, long-term rating category of an NRSRO (e.g., Moody's A3 or S&P Global's A-), or, if unrated, be determined to be of comparable quality by the Board based on a recommendation by the Chief Investment Officer or his designee.

**3.9. Downgraded Securities.** If, subsequent to purchase, a security is downgraded by an NRSRO such that the security no longer meets the minimum credit rating requirements prescribed in Section 3.8 above, the securities lending agent(s) shall inform one or more of the Chief Investment Officer, or the Chief Risk Officer of the downgrade in writing by email through another type of electronic transmission within 72 hours of the downgrade action. Upon receipt of such a notice, the Chief Risk Officer, or his or her designee, will conduct a review of the downgraded security and submit a recommended action to the Chief Investment Officer, or his or her designee, within 72 hours of the receipt of written notice from the securities lending agent(s). Within 48 hours of the receipt of this recommendation, the Chief Investment Officer or his or her designee will instruct the securities lending agent(s) as to how to administer the downgraded security.

**3.10. Initial collateral; marking to market**. Loaned securities and initial collateral delivered by the borrower of TRS securities shall be marked to current market value in the applicable currency at the close of each business day, as "business day" may be defined in an applicable securities lending authorization agreement between TRS and the securities lending agent(s).

**3.10.1 Domestic securities**. For purposes of this policy, domestic securities are securities denominated in U.S. dollars and whose primary trading markets are in the United States. The initial collateral delivered to secure a loan of domestic securities must have a market value of at least 102% of the initial market value of the loaned securities. If, while an individual loan to a borrower is outstanding, the current market value of the collateral initially delivered by the borrower is less than 100% of the current market value of the loaned securities, or if the aggregated current market value of the collateral for all domestic securities loaned to a borrower is less than 102% of the current market value of all such securities loaned to a borrower, the securities lending agent(s) must require the borrower to deliver additional collateral to restore the value of the collateral to 102% of the then-current market value of the relevant loan or loans of such securities.

**3.10.2** **International equity securities**. For purposes of this policy, international securities are securities not denominated in U.S. dollars or whose primary trading markets are not in the United States. The initial collateral delivered to secure a loan of international equity securities must have a market value of at least 105% of the initial market value of the loaned securities. If, while an individual loan is outstanding, the current market value of the collateral initially delivered by the borrower is less than 103% of the current market value of the loaned international equity securities, or if the aggregated current market value of the collateral for all such securities loaned to a borrower is less than 105% of the aggregated current market value of all securities loaned to a borrower, the securities lending agent(s) must require the borrower to deliver additional collateral to restore the market value of the collateral to 105% of the then-current market value of the relevant loan or loans of such securities.

**3.10.3** **International sovereign debt and non-U.S. corporate debt securities**. In the case of loans of (i) sovereign debt issued by non-U.S. governments and (ii) non-U.S. corporate debt securities, the initial collateral delivered must have a market value of at least 102% of the initial market value of the loaned securities. If, while an individual loan is outstanding the current market value of the collateral is less than 100% of the current market value of the loaned international sovereign debt and non-U.S. corporate debt securities, or if the aggregated current market value of the collateral for all such securities loaned to a borrower is less than 102% of the aggregated current market value of all securities loaned to a borrower, the securities lending agent(s) must require the borrower to deliver additional collateral to restore the value of the collateral to 102% of the then-current market value of the relevant loan or loans of such securities.

**3.10.4** **Invested cash collateral.** When cash collateral is invested for the account of TRS, the borrower is not required to deliver additional collateral based on a drop in the market value of such cash collateral investments except as provided in the applicable securities loan agreement.

**3.11.** Loans must be callable by the Investment Management Division or the lending agent(s) for timely delivery on the applicable trade settlement date if the loaned security is sold by a TRS portfolio. Any term loans that are not callable must be approved in advance by the Chief Investment Officer or his or her designee.

## 4. Restrictions

**4.1.** A fundamental investment approach will be used to identify collateral investments appropriate for the relevant portfolio guidelines. A fundamental investment approach employs both internal and external quantitative and qualitative research to monitor credit quality within the active universe of investable credits. Several factors are analyzed including: capitalization levels, funding profiles, trends in earnings, credit rating trends, standard financial ratio analysis, changes in regulatory environments, and fluctuations in relevant macroeconomic conditions that could potentially impact an issuer's creditworthiness profile. Maturity restrictions, as identified below, are assigned to individual securities, and notional credit limits are determined for each issuer, in order to manage the portfolio exposure to each issuer's credit. All limits within this Section 4 are reviewed regularly to address issuer credit exposure concentration risks and are managed on a real-time basis.

**4.2.** The maximum market value of TRS securities on loan at any one time shall not exceed 50% of the market value of the eligible securities available for loan under Section 3.1 in the TRS investment portfolio.

**4.3.** No mortgage-backed securities may be loaned in "dollar roll" transactions in which the identical borrowed securities are not returned to TRS.

**4.4.** On at least an annual basis, the lending agent(s) will deliver to the Investment Management Division a list of proposed borrowers and corresponding dollar loan limits. The Chief Investment Officer or his/her designee has the discretion to remove any name from the borrower list and may require the lending agent(s) to deliver an updated list of proposed borrowers on request.

**4.5.** Securities lending agreements entered into with borrowers by the securities lending agent(s) must be evidenced by written contracts that comply with this policy and applicable law. The lending agent(s) may use a proprietary form for such written agreements.

**4.6.** Diversification requirements.

**4.6.1** No more than 10% of total cash collateral investments may be made in issues of any one non-governmental entity. There are no concentration limits for U.S. Treasury and agency securities. The single counterparty exposure on a repurchase agreement may not exceed 5% of the total cash collateral account unless those transactions are covered by an indemnification agreement that is sponsored by an organization that bears a long- term NRSRO rating of A- or better and is enhanced by acceptable collateral as specified by section 5.3 of the guidelines. For purposes of this requirement, counterparty includes the counterparty's subsidiaries.

**4.6.2** Exclusive of approved money market funds, no more than 40% of cash collateral investments may be made in asset-backed commercial paper.

**4.6.3** Exclusive of approved money market funds, no more than 50% of cash collateral investments may be made in foreign debt obligations.

**4.7.** Investments in structured notes are prohibited with the exception of those listed in Section 3.5 of the guidelines.

## 5. Reports

The Investment Management Division will review the progress of the securities lending program, including an overall evaluation of the performance of the lending agent(s) and the program, with the Investment Committee of the Board of Trustees at least annually. This review will include a written report on the lending volume with and without amounts used per Section 1.5, income generated, the lending agent(s')'s borrowing balance and its credit limit as a principal, and top borrower balances and their respective credit limits.