



**Police & Firemen's Retirement System of New Jersey  
Securities Lending Policy**

## Table of Contents

---

<b>Chapter I: Introduction</b> .....	3
A. Purpose .....	3
B. Investment Objective .....	3
<b>Chapter II: Governance and Responsibilities</b> .....	4
A. Management and Governance Structure .....	4
<b>Chapter III: The Program</b> .....	5
A. Permissible Loans .....	5
B. Risk Management .....	6
<b>Chapter IV: Remediation</b> .....	9

## Chapter I: Introduction

---

### A. Purpose

The purpose of the policy is to provide clear guidelines and governance for the Securities Lending Program instituted on behalf of the Board of Trustees for the Police and Firemen's Retirement System of New Jersey. It does not address securities lent from commingled investments, which will be held to the standard of the securities lending policy of that commingled fund.

Securities lending occurs when the System transfers a security to a borrower, such as a broker-dealer or bank, for collateral in the form of cash or non-cash collateral (i.e. securities) pursuant to an agreement to return the identical security in the future. Securities are borrowed for a variety of reasons including: settlement of short sales and to cover hedges, options, arbitrage positions, and settlement fails. Consequently, the borrower receives custody of the transferred security and has the right to resell it. The borrower, however, is obligated to return the exact same security at the end of the loan period and make the System whole for dividends, interest and other distributions as if the security remained in the System's portfolio. Further, securities on loan may be recalled at any time at the discretion of the System.

The purpose of this program is to prudently provide supplemental income on the assets of the System.

This Policy has been drafted by PFRSNJ Staff and reviewed and approved by the Investment Committee and approved by a majority of the Board.. Material deviation from this document is not permitted without explicit written permission, in advance, from the Board.

### B. Investment Objectives

To provide the System with incremental income by obtaining market level fees for non-cash loans and investing cash collateral in a risk controlled separate account with a yield exceeding the rebate rate paid to borrowers.

## Chapter II: Governance and Responsibilities

---

### A. Management and Governance Structure

Under the purview of the Chief Investment Officer and the Chief Financial Officer, securities lending is conducted pursuant to a written agreement with the System's agent lender(s). The agent lender(s) provides a list of borrowers, which is reviewed and approved at least annually by the Chief Investment Officer and/or the Investment Committee.

The agent lender(s) then negotiate the lending terms and collects all cash and non-cash collateral and loan premiums. Additionally, the agent lender(s) will invest the cash collateral pursuant to System approved investment guidelines and may act as custodian of the System's cash collateral short-term investment fund (STIF). When pledging cash collateral, a portion of the interest earned on the STIF may be paid to the borrower because of a negotiated rebate. When pledging non-cash collateral, the borrower pays the System a fee for borrowing the security.

The Chief Investment Officer and/or the Chief Financial Officer will provide updates at least annually to the Investment Committee and the Board on the health and effectiveness of the Securities Lending Program.

The program at all times must be in compliance with N.J.A.C. 17:4A-4.1 et seq., including the requirements of N.J.A.C. 17:4A-4.2 and 4.4.

## Chapter III: The Program

---

### A. Permissible Loans

Subject to approval by the Board of Trustees and upon the recommendation of the Investment Committee, the System is authorized to enter into Securities Lending Program via written security loan agreements for the purpose of prudently supplementing the income normally received from investments. Agreements to lend a security must be with a broker-dealer or with nationally chartered banks and must not exceed a period of one (1) year. Additionally, the System may lend only those securities that are freely traded on recognized exchanges or marketplaces, which may include U.S. and non-U.S. bonds, equities, ETF's, warrants, when issued's, etc. The following provisions also apply to all System security loan agreements:

- The System must retain the right to collect from the borrower all dividends, interest, premiums, rights and any other distributions to which the System otherwise would have been entitled.
- The System must retain the right to return the security upon not more than five (5) business days' notice.
- The borrower must provide collateral to the System in the form of cash, bonds or performance letters of credit drawn on a bank with capital in excess of \$100 million or other interest-bearing notes and obligations of the U.S. or federal instrumentalities eligible for investment by the System.
- The security loan agreement must provide for payment of additional collateral on a daily basis or at such time as the value of the loaned marketable securities increases to agreed-upon ratios.
- The market value of the loaned securities must be monitored daily. The value of the collateral posted must remain at or above the market value of the loaned securities.

The market value of securities loaned by the System shall not exceed thirty percent (30%) of the market value of the System's invested assets.

Not more than fifteen percent (15%) of the market value of the assets of the System will be loaned to any one borrower. This limit is an aggregated total, which is inclusive of subsidiaries or other related business entities.

The System may waive the right to vote proxies for the securities out for lending, for the duration of the term of the loan.

## B. Risk Management

There are three primary risks associated with any Securities Lending Program

- the risk of a the Borrower not being able to return the securities being borrowed
- the Market Risk of the underlying investments in the collateral pool utilized to support the Securities Lending Program
- Operational Risks

Each of these risks has to be managed in order to properly implement an effective Securities Lending Program for the System.

1. Borrower Counter-Party Credit Risk is controlled by the following measures:

- The agent lender shall only lend securities to borrowers that have been approved by both:
  - The agent lender's counter-party credit operations and risk management teams
  - The PFRSNJ Chief Investment Officer and/or the Investment Committee.
- The agent lender shall indemnify the System for any losses resulting from borrower default on return of securities as well as dividends, interest or other distributions resulting from a default by the borrower.
- The agent lender shall collect all cash and non-cash collateral from the borrower at the time of the loan.
- The agent lender shall provide safekeeping for any non-cash collateral received.

The collateral level must be greater than 100% of the market value of the loaned securities

- The agent lender shall return securities to the System in the event the System decides to recall a loan. Recalls occur within the normal settlement period for that security based upon the specific local market requirements – usually two to seven days.
- The agent lender shall collect all distributions to which the System would otherwise have been entitled to and remit the same distributions to the System as if no security loan had occurred.

2. Controlling Market Risk is addressed in two categories: the overall program and the collateral pool.

- The overall program:
  - The agent lender shall ensure initial cash collateral received is at least 102% of the market value of U.S. securities loaned or 105% of the market value of non-U.S. securities loaned, plus accrued interest. While the market value of non-cash collateral is at least 102% of the market value of domestic securities loaned or 105% of the market value of non-US securities loaned.
  - The agent lender shall mark-to-market the securities on loan each business day and adjust the collateral required from borrowers using the target of 102% for U.S. securities on loan and 105% for non-U.S. securities on loan.
- The collateral pool:
  - The agent lender shall invest any cash collateral in the collateral pool pursuant to investment guidelines approved by the PFRSNJ Board that contain, at a minimum, the following provisions:
    - The guidelines must contain specific credit quality standards, as follows:
      - 1) At the time of purchase, the issuer and/or instrument must meet the following minimum credit ratings issued by two of the

three nationally recognized statistical rating organizations: Standard Poor's (S&P), Moody's Investors Service (Moody's), and Fitch Investors Services, Inc. (Fitch): issuer must have a short-term debt rating not lower than A-1/P-1/F1 and/or the issuer must have a long-term debt rating not lower than A/A2/A

- 2) At the time of purchase, Asset Backed Securities shall have a minimum rating of AAA by S&P or Aaa by Moody's.
  - Maximum maturities must not exceed 18 months for individual securities, while the weighted average maturity of the pool shall not exceed 180 days.
  - STIF investments must be diversified by issuer.
    - No more than five percent (5%) of the collateral pools total assets can be invested in a single issue corporate obligation.
    - No more than five percent (5%) of the collateral pools total assets can be in a single issuer of Bank Obligations
    - No more than ten percent (10%) of the collateral pools total assets can be invested in a single issuer of Foreign Sovereign Obligations
    - No more than twenty five percent (25%) of the collateral pools total assets can be invested in a single counter parties Repurchase Agreements.
    - No more than five percent (5%) of the collateral pools total assets can be invested in a single Money Market Mutual Fund and cannot own more than five percent (5%) of the outstanding shares of any single Money Market Mutual Fund.
  - The Agent Lender(s) must supply a list of eligible investments as a part of the collateral pool guidelines. This list must be approved by the Chief Investment Officer or Investment Committee.
  - The collateral must be held in a separate account for the benefit for PFRSNJ and/or the eligible fund.
  - The Agent Lender(s) must maintain records to account for the securities lending transactions and the income derived therefrom.
  - The Agent Lender(s) must maintain securities lending agreements between the borrower and eligible fund.
3. Operational Risk:
- A written contract, reviewed by the Chief Investment Officer, Chief Financial Officer and Legal Departments shall govern the relationship between the System and the agent lender(s), as well as any necessary operating agreements between the System, custodian and agent lender(s).
  - The agent lender(s) shall utilize written contracts (i.e., security lending agreements) to govern relationships with the borrowers on behalf of the System.
  - In order to effectively monitor the operations and health of the Securities Lending Program, the agent lender(s) will supply:
    - Daily exposure reports showing loan level characteristics, the level of collateral held for each borrower.

- Collateral pool investment reports showing portfolio composition and pertinent ratios such as overnight liquidity, maturity, issuer exposure, credit quality and other information as required.
- Quarterly performance packages containing detailed earnings attribution, key portfolio metrics and trader/portfolio manager commentary.
- Program accounting performance including monthly earnings reports, attribution of income showing how the lending program generated the monthly earnings in detail.



## Chapter IV: Remediation

---

If the securities lending regulations or policy is violated, the Board shall be notified at the next regularly scheduled meeting of the Board. The Chief Investment Officer or the Investment Committee may authorize a six-month grace period to bring the transactions into compliance, except that the grace period may be extended for additional four-month periods with the approval of the Board, provided the extension is in the financial best interest of the fund.