Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 17

MEETING DATE: **February 21, 2024**

SUBJECT: **Dedicated Cash Allocation—Implementation Strategy**

SUBMITTED FOR: __ **Consent** __X__ **Deliberation and Action** ___ **Receive and File**

RECOMMENDATION

Reallocate dedicated cash allocation from State Street Demand Deposit Account (DDA) to State Street Government Short Term Investment Fund (GSTIF).

PURPOSE

This item supports the Strategic Management Plan by contributing to the effective management and oversight of investment activities.

BACKGROUND

At the December 2023 meeting, the Board and Staff discussed the implementation approach to SCERS' various cash allocations at SCERS' custodian State Street Bank and Trust Company (SSBT).

SCERS manages two cash allocations. The first is a dedicated cash allocation that has a 2% target within SCERS' strategic asset allocation. The dedicated cash allocation is intended to close the gap between benefit payments and total contributions in an environment where investment earnings fall short of the targeted assumed rate of return, and it also serves as an extra layer of liquidity to meet SCERS' cash needs. The current value of SCERS' dedicated cash allocation is $255 million as of January 31, 2024 (1.98% of SCERS' total portfolio).

SCERS also holds other/non-dedicated cash separately at SSBT that is not part of SCERS' strategic asset allocation. This revenue source holds the County's annual employer contribution, which is received in full in July of each calendar year, and is then drawn down monthly over the course of SCERS' fiscal year to make monthly benefit payments. The 'other' cash allocation is also used to fund drawdowns (capital calls) within the private market segments of the portfolio, and other implementation and rebalancing activity within SCERS' portfolio. SCERS' Overlay Program rebalances the portfolio by eliminating cash drag by investing the non-dedicated cash allocation into positions that replicate SCERS' target portfolio. The current value of SCERS' non-dedicated cash allocation is $241 million as of January 31, 2024 (1.87% of SCERS' total portfolio).

NON-DEDICATED CASH ALLOCATION IMPLEMENTATION

SCERS' non-dedicated cash allocation has historically been invested in the State Street Short Term Investment Fund (STIF), which seeks to provide safety of principal, a high level of liquidity, and a competitive yield. STIF is a type of cash management fund and invests in a number of high quality, short-term securities, and other instruments, which include but are not limited to:

- U.S. Treasury bills, notes, and bonds
- Other U.S. government securities (i.e., government agency bonds)
- Corporate debt obligations (i.e., commercial paper)
- Certificates of deposits
- Mortgage-backed and asset-backed securities
- Repurchase agreements
- Money market mutual funds

STIF offers a slightly higher yield than pure short-term government securities given its allocations to some credit risk (i.e. commercial paper and asset-backed securities). The cash yield on STIF as of December 31, 2023 was 5.7%. This compares to the yield on a purely short-term government securities short-term fund of approximately 5.4%. SSBT charges an asset management fee of 12 bps for STIF.

DEDICATED CASH ALLOCATION IMPLEMENTATION

When SCERS added the dedicated cash allocation with a 1% target in 2019 (increased to 2% in 2023), Staff and Verus focused on utilizing short duration government bonds and short-term investment funds such as STIF. At that time, a short-term investment fund such as STIF had the potential to generate marginally higher yields than short duration government bonds (in 2019, the yield difference was 2.8% versus 2.4%), but the added yield came with some exposure to market risks including duration, interest rate, and credit risk. SCERS opted for a more prudent approach to invest the dedicated cash allocation in short duration government bonds (i.e., 90-day Treasury Bills, which are generally considered risk-free), or an interest rate tied to overnight LIBOR rates.

LIBOR represents the average interest rate that banks charge one another to lend funds, and its rate tends to be highly correlated to 90-day Treasury Bills. LIBOR transitioned to SOFR (secured overnight financing rate) in 2022-23. SSBT offers a demand deposit account (DDA) that pegs itself to overnight LIBOR/SOFR rates. SOFR currently yields approximately 5.3%, which is in line with 90-day Treasury Bills (currently 5.2%). Staff and Verus believed that managing the dedicated cash allocation through SCERS' custodial relationship with State Street created greater efficiencies than managing a dedicated 90-day Treasury Bill allocation by one of SCERS' fixed income managers. Therefore, Staff and Verus recommended to the Board in

2019 that the cash allocation be implemented through State Streets' DDA. State Street does not charge a management fee for DDA exposure. However, SSBT's DDA does expose SCERS to single entity counterparty risk with State Street, while a short-term investment fund like STIF exposes SCERS' to multiple counterparties.

SCERS' Diversifying asset category investment policy statement (IPS) designates a range of eligible investment vehicles for the dedicated cash allocation, including short duration government bonds (90-day Treasury Bills), a DDA, and cash management funds such as STIF.

During the December 2023 Asset Protection presentation, Staff discussed SCERS' current duel exposure to STIF and a DDA. The Board directed Staff to evaluate other options for SCERS' dedicated cash allocation outside of the DDA to minimize single entity counterparty risk to SSBT.

DEDICATED CASH IMPLEMENTATION OPTIONS

SSBT offers a version of STIF that only invests in government securities, without the credit risk associated with STIF. The fund is called the State Street Government Short Term Investment Fund (GSTIF). GSTIF seeks to provide safety of principal, a high level of liquidity, and a competitive yield. The fund invests substantially all of its assets in obligations issued or guaranteed by the U.S. government or its agencies. GSTIF is a type of cash management fund and invests in a number of high quality, short-term securities, and other instruments, which include but are not limited to:

- U.S. Treasury bills, notes and bonds
- Other U.S. government securities (i.e., government agency bonds)
- Repurchase agreements – collateralized by U.S. government securities
- Money market mutual funds

GSTIF offers a similar yield (though slightly higher) to that of the DDA option that pegs itself to SOFR. The yield on GSTIF as of December 31, 2023 was 5.4%. This compares to the yield on the DDA of 5.3% and the yield on STIF of 5.7%. GSTIF is also short duration with a weighted average maturity of less than 60 days, though approximately 11% of the portfolio has a maturity of over 90 days. Similar to STIF, SSBT charges an asset management fee of 12 bps for GSTIF.

RECOMMENDATION

Staff recommends converting the dedicated cash allocation from the DDA account to GSTIF. GSTIF offers a slightly higher yield to the DDA and diversifies the single entity counterparty risk away from SSBT. A negative for GSTIF is that the fund charges an annual management fee of 12 bps, while the DDA account does not charge a management fee.

Given the potential risk associated with single entity counterparty risk, Staff believes the tradeoff of the higher management fee associated with GSTIF is a better option than no management fee and single entity counterparty risk associated with the DDA investment.

A third option is to put SCERS' dedicated cash allocation into STIF rather than GSTIF, similar to the non-dedicated cash allocation. While STIF offers a modestly higher yield than GSTIF (5.7% vs. 5.4%), it also introduces market risks including duration, interest rate, and credit risk. Staff believes the optimum approach is to place SCERS' cash allocations in different vehicles with varying risk factors and diversified counterparties.

The follow table provides a summary of the options available:

	DDA	**GSTIF**	**STIF**
Fee	None	12 bps	12 bps
Return (12/31/22)	5.3%	5.4%	5.7%
Counterparty Risk	Higher	Lower	Lower
Market Risk	Lower	Lower	Higher

State Street communicated that many of its clients use multiple cash vehicles, across a DDA, STIF, and GSTIF. Asset levels within the various vehicles at SSBT include:

- GSTIF: $7.3 billion
- DDA: $220 billion
- STIF: $61.3 billion

The implementation of GSTIF from a DDA is straightforward and requires a letter of direction from SCERS after which the transition from the DDA to GSTIF will take a couple of days.

<u>ATTACHMENT</u>

- Board Order
- Dedicated Cash Allocation – Implementation Strategy presentation

Prepared by:

/s/

Steve Davis
Chief Investment Officer

Reviewed by:

/s/

Eric Stern
Chief Executive Officer

Retirement Board Order

Sacramento County Employees' Retirement System

Before the Board of Retirement
February 21, 2024

AGENDA ITEM:

Dedicated Cash Allocation—Implementation Strategy

THE BOARD OF RETIREMENT hereby approves Staff's recommendation to reallocate dedicated cash allocation from State Street Demand Deposit Account to State Street Government Short Term Investment Fund.

I HEREBY CERTIFY that the above order was passed and adopted on February 21, 2024 by the following vote of the Board of Retirement, to wit:

AYES:

NOES:

ABSENT:

ABSTAIN:

ALTERNATES:
(Present but not voting)

James Diepenbrock
Board President

Eric Stern
Chief Executive Officer and
Board Secretary

Dedicated Cash Allocation – Implementation Strategy

February 21, 2024

SCERS Cash Allocations

Dedicated Cash

2% target allocation

Added in 2019; increased in 2023 – extra layer of liquidity

Implemented via State Street Demand Deposit Account (DDA)

‘Other’ Cash

No target allocation

Invested in STIF (short-term investment fund)

Overlay Program invests ‘Other’ cash

Dedicated Cash Implementation Options

DDA

- Pegged to SOFR (similar yield to 90-day T-Bills)
- 5.3% cash yield (as of 12/31/23)
- No management fee
- Counterparty – State Street Bank and Trust
- SSBT deposits/assets: $221 billion

GSTIF

- U.S. government and agency securities
- 5.4% cash yield (as of 12/31/23)
- Annual management fee of 12 bps
- Counterparty – U.S. government and its agencies
- SSBT assets: $7 billion

STIF

- U.S. government and agency securities, corporate debt, asset-backed securities
- 5.7% cash yield (as of 12/31/23)
- Annual management fee of 12 bps
- Counterparty – U.S. government/agencies; corporate and banking credits
- SSBT assets: $61 billion

Recommendation

- Reallocate dedicated cash allocation from DDA to GSTIF
  - Reduces single entity counterparty risk to State Street
  - Adds 12 bps management fee charged by GSTIF

- Implementation requires letter of direction to State Street and a 2-day turnaround