



# TRANSACTION COST ANALYSIS POLICY

## PURPOSE

The purpose of this policy is to provide guidelines and procedures for the monitoring of Sacramento County Employees' Retirement System public investment manager transaction costs, including directed brokerage transactions, to minimize overall transaction costs while maintaining the manager's primary and foremost requirement to obtain best execution.

## POLICY

SCERS' investment managers have a fiduciary duty to obtain best execution when implementing trades on behalf of SCERS. Best execution is defined as taking reasonable care to obtain the most advantageous terms when executing trades on behalf of clients. The goal of SCERS' investment managers should be to minimize total transaction costs while seeking best execution for all transactions and maximizing the value of services received.

Commission recapture programs help to minimize SCERS' overall transaction costs. SCERS' investment managers should direct trades through the designated commission recapture program when "all things being equal" the manager can direct a trade and still achieve best execution as required by the manager's investment management agreement with SCERS. The commission recapture program is administered by an approved third-party provider. When able to maintain best execution, an investment manager should direct through the commission recapture program as follows:

- A. **U.S. stock exchange listed securities:** Obtain a commission of three cents or less per share or direct the trade to a SCERS designated commission recapture broker. Any trade directed to a commission recapture broker shall be identified as a trade for the benefit of the plan. SCERS anticipates that a manager will be able to direct 25% of U.S. exchange transaction commissions to a commission recapture broker.
- B. **Non-U.S. stock exchange listed securities:** Obtain a commission that is 25% or more below the prevailing local market rate or direct the trade to a SCERS designated commission recapture broker. Any trade directed to a commission recapture broker shall be identified as a trade for the benefit of the plan. SCERS anticipates that a manager will be able to direct 25% of non-U.S. exchange transaction commissions to a commission recapture broker.

With the progression of quantitative/systematic investment strategies, many investment managers have developed advanced internal trading capabilities. These managers may have the ability to achieve best execution and minimize overall transaction costs by trading securities internally, and therefore be less likely to direct 25% of transactions to a commission recapture broker.

Staff shall provide each of SCERS' public market investment managers a copy of this policy and SCERS' list of approved designated commission recapture brokers, as that list may be amended from time to time without revision to this policy.

## **MONITORING AND REPORTING**

SCERS will utilize a third-party service provider to monitor transaction costs for its public market investment managers. SCERS' Staff will review and recommend a service provider to the Board for approval.

The transaction cost analysis will be performed across public equity and fixed income asset classes, and will include any trades executed through SCERS' commission recapture program, in addition to all other trades executed by SCERS' public market investment managers. TCA will be performed on a quarterly basis and will review costs for each manager and asset class to peer universe and relevant asset class benchmarks, as determined by the service provider and SCERS' investment staff.

While transaction costs can vary from quarter-to-quarter, over extended time periods it is expected that SCERS' investment managers will rank in the top half of relevant industry benchmarks or below expected costs as determined by the TCA provider. When an investment manager ranks below the top half of their benchmark or above expected costs for multiple quarters, Staff will perform additional analysis, which includes following up directly with the manager and TCA service provider, to identify causes and potential action necessary to reduce costs. The TCA will be included in the overall evaluation of the investment manager, which includes both quantitative and qualitative analysis.

Staff will provide an annual report to the Board summarizing the transaction cost analysis. The summary report will emphasize overall transaction costs by asset class, but will also include instances when transaction costs were above industry benchmarks and/or if follow up action was necessary by Staff. The annual report will also include an update on SCERS' commission recapture program and the net benefit provided to SCERS.

## **BACKGROUND**

A significant portion of SCERS' multi-billion dollar investment portfolio is invested in publicly traded equity securities, across domestic and international markets. Transaction costs are incurred whenever a security is bought or sold. Transaction costs are made up of the direct fee or commission (explicit costs) and the market impact of executing a trade (implicit costs). Transaction cost analysis has become a recognized industry standard for evaluating transaction costs. While transaction cost analysis initially focused on public equity assets, improved market data and transparency has allowed for the analysis to expand into fixed income markets. Transaction cost analysis helps to ensure investment managers are meeting their fiduciary obligations to achieve best execution.

Another common way for an institutional investor to control commission costs is through commission recapture. Commission recapture programs help reduce overall commission costs by providing a rebate of commission costs back to the asset owner. This policy provides direction to SCERS' investment managers in the conduct of investment trades to control commission costs, but not interfere with the manager's first and foremost obligation to achieve best execution.

## RESPONSIBILITIES

Executive Owner: Chief Investment Officer

## POLICY HISTORY

Date	Description
06-21-2023	Board approved revised Transaction Cost Analysis Policy
05-19-2021	Board approved revised policy, retitled as Transaction Cost Analysis Policy, replacing the Directed Brokerage Transactions and Commissions Recapture Policy
02-21-2018	Board affirmed policy in revised policy format
08-22-2002	Board amended Inv. Policy No. 2001-01 by Resolution 2002-02
01-18-2001	Board approved Investment Policy No. 2001-01 that replaced the previous policy
October 1996	Board adopted policy