

# Developing an Effective Investment Policy



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# Why a Policy?

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- To establish guidelines for safety
- To state and fulfill *your* investment objectives
- To establish provide flexibility to adjust to changes
- To set controls

# Foundation Points

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- **Cash Flow Analysis**
  - Identifies known liability dates which will be funded
  - establishes controls
    - ✦ WAM (weighted average maturity)
    - ✦ maximum maturity
- **Risk Tolerance Levels**
  - sets the tone for your active/passive strategy and actions
- **Internal Resources**
  - identifies how much can be done with your resources on hand

# Texas PFIA Statutory Requirements

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- Primary emphasis on safety and liquidity
- PFIA does not ignore *yield*
  
- Statute also requires addressing
  - Diversification to spread risk
  - Yield to use assets most effectively
  - Maximum maturity to prevent overextension
  - Capability of investment management i.e. training
    - ✦ To understand what could and should be used
    - ✦ To introduce you to markets which can be safely used

# Introductory Statement of Policy

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- It is the Policy of the County to invest its funds in a manner which will provide maximum safety with a reasonable market yield while meeting all the cash flow demands.
- All investments will be made in accordance with this Policy and state and federal laws.
- Emphasis on
  - Safety of assets
  - Matching unique cash flow needs
  - Accord with policy and law

# Scope of Policy

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- Define the funds covered by the Policy
  - By name or in entirety
- This policy applies to *all financial assets* of the County as accounted for in the Comprehensive Annual Financial Report.
- Or, This policy applies to all financial assets of the County and includes:
  - Fund -----
  - Fund -----

# Legal Authorization

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- Statutory references through a link
  - Public Funds Investment Act - TX Gov't Code 2256, as amended
  - Public Funds Collateral Act - TX Gov't Code 2257, as amended
  - Depositories, Local Government Code Title 4, Chapter 113
- Use a link not a copy
  - [www.statutes.legis.state.tx.us/Docs/GV/htm/GV.2256.htm](http://www.statutes.legis.state.tx.us/Docs/GV/htm/GV.2256.htm)
  - [www.statutes.legis.state.tx.us/Docs/GV/htm/GV.2257.htm](http://www.statutes.legis.state.tx.us/Docs/GV/htm/GV.2257.htm)

# Standard of Care

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- Prudent Person Rule
- Sets the standard for the investment program and the actions of those investing for the County
- Investments shall be made with judgment and care under circumstances then prevailing that persons of prudence, discretion and intelligence exercise in the management of their own affairs not for speculation but for investment considering probable safety as well as probable income.



# Officer Ethics and Disclosure

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- **Standards and Disclosure for Investment Officers**
- Investment officers and employees involved in investments shall refrain from personal business activity that could conflict with the investments or impair their judgment.
- Officers shall disclose material financial interests to the Court
- Personal or business relationships as defined by 2256.005(i) shall be reported to the Court and the Texas Ethics Commission.
  - This disclosure to Texas Ethics Commission is only made under specific conditions

# Policy and Investment Program Objectives

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- Objectives are defined uniquely by:
  - cash flow,
  - risk tolerance levels
  - internal resources.
- Best practice defines objectives as:
  - Safety,
  - Liquidity,
  - Diversification
  - Yield

# Objectives

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- **Safety**

- The primary objective is the preservation of capital. Each investment transaction shall be conducted in a manner to avoid capital losses, whether from security defaults safekeeping, or erosion of market value.

- **Liquidity**

- The investment portfolio shall be structured to meet all expected obligations in a timely manner. This shall be achieved by matching investment maturities with forecasted cash flow liabilities and maintaining a liquidity buffer for unexpected liabilities.

- **Diversification**

- The County shall diversify its portfolio to spread risk and eliminate the risk of loss resulting from over-concentration of assets in a specific maturity, a specific issuer or a specific class of investments.

- **Yield (*not 'rate of return'*)**

- The portfolio shall be designed to attain a reasonable market yield, taking into account the investment risk constraints and cash flow needs of the County. Reasonable yield shall be obtained through competitive bidding on all transactions and a comparative analysis of all market alternatives authorized by this Policy.

# Strategies by Fund

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- A written strategy is required by portfolio (“*pooled fund group*”)
  - A strategy can include commingling for investment purposes
    - ✦ Give yourself that option
  - Strategies can be directed to certain types of funds
  - Different type funds often require different strategies
- The strategy sets the maximum weighted average maturity (WAM)
- A strategy should describe:
  - Objective
  - Suitability
  - Safety of Principal
  - Liquidity
  - Marketability
  - Diversification
  - Yield

# Sample Strategy

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- The County may maintains one commingled portfolio for investment purposes which incorporates the specific uses and the unique characteristics of the funds in the portfolio.
- The investment strategy has as its primary objective the assurance that anticipated liabilities are matched and adequate investment liquidity provided.
- The County shall pursue a pro-active, conservative portfolio management strategy using a laddered maturity structure with some extension for yield enhancement.
- The maximum dollar weighted average maturity of one year or less will be calculated using the stated final maturity date of each security. *The one-year Treasury Bill, for the comparable period, will be used as the risk benchmark for the portfolio.*

# Delegation of Authority

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- Designation of Investment Officer
  - By title in policy but by resolution with specific names
- Ethics Requirements and Limits
- Liability Issues
- Responsibilities
- Training Requirements
  
- The County Treasurer and \_\_\_\_\_ are designated as the Investment Officers and are responsible for all investment management decisions.

# Delegation of Responsibility

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- The Officer will obtain ten (10) hours of training within twelve (12) months of assuming the position and every two (2) years thereafter beginning measured on the fiscal year.
- All participants in the process shall seek to act responsibly as custodians of the public trust.
- The Officer will develop written administrative procedures for the operation of the program.
- The Officer will be relieved of personal liability when acting in accordance with this Policy, procedures and the prudent person Rule.

# Delegation of Responsibility

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- **County Commissioners**
- The County Commissioners hold ultimate fiduciary responsibility for the portfolio.
- The Court will designate investment officer(s) by resolution
- The Court will receive and review quarterly reports
- The Court will approve and provide for officer training
- The Court will annually approve broker/dealers
- The Court will review and adopt the Investment Policy and Strategy at least annually



# Authorized Investments

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- Only the following securities are authorized for investment
  - Assets of the County may be invested only in the following instruments as further defined by the Act. If changes are made to the Act they will not be authorized until this Policy is modified and adopted by the Court. All investment transactions will be made on a competitive basis and require delivery versus payment settlement.
  
- Diversification tables to set maximum percentages help control:

○ US Obligations	80 %
○ Depository CDs	50 %
○ Commercial paper	30 %
✦ By issuer	10 %
○ Local Government Pool	100 %

# Authorized Investments

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- Each authorized investment should be defined
  - Credit requirements and stated maximum maturity
  - Obligations of the US Government, its agencies and instrumentalities, excluding mortgage-backed securities, with a maximum stated maturity of 3 years.
  - Fully FDIC insured or collateralized depository certificates of deposit with banks in Texas with a maximum stated maturity of 2 years.
  - Fully FDIC insured brokered certificate of deposit securities from a state in the US, delivered versus payment to the County depository.
  - A1/P1 rated commercial paper with a state maturity of 180 days.
  - Local government pools striving to maintain a \$1 NAV.
  - Interest bearing accounts in any bank in Texas.

# Safekeeping

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- Safekeeping of County Owned Securities
  - All purchased securities are to be cleared to the County's depository on a **delivery versus payment (DVP)** basis.
  - All safekeeping arrangements shall be approved by the Treasurer and an agreement of the terms executed in writing.
  - The depository shall be required to issue safekeeping receipts to the County describing each specific security pledged
  - The custodian will provide monthly reports of collateral held
  - The Treasurer will maintain documentation and safekeeping receipts for every County security.

# Specific Internal Controls are Needed

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- **Delivery versus Payment - DVP**
  - All security transaction will be settled on a delivery versus payment basis to assure the safety of County assets.
  
- **Cash Flow Analysis**
  - The Treasurer will analyze and maintain a cash flow plan to monitor and forecast cash positions for investment purposes.
  
- **Monitoring FDIC status** *(if using brokered CDs)*
  - The Investment Officer shall monitor, on no less than a weekly basis, the status and ownership of all banks issuing brokered CDs owned by the County based upon information from the FDIC ([fdic.gov](http://fdic.gov)). If any bank has been acquired or merged with another bank in which brokered CDs are owned by the County, the Treasurer shall immediately liquidate any brokered CD which places the County above the FDIC insurance level.

# Internal Controls

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- **Competitive Bidding**
  - All security transactions will be made on a competitive basis to assure the County is receiving fair market rates. “New Issue” agency securities will be compared to other securities available in the secondary market.
  
- **Monitoring credit ratings**
  - The Treasurer shall monitor, on no less than a monthly basis, the credit rating on all authorized investments in the portfolio which require credit ratings based upon independent information from a nationally recognized rating agency. *If any security falls below the minimum rating required by Policy, the Treasurer shall notify the Judge of the loss of rating and liquidate the investment within two days.*
  
  - *Or: If any security falls below the minimum rating required by Policy, the Treasurer shall notify the Judge of the loss of rating and the conditions affecting the downgrade to schedule liquidate the investment.*

# Financial Broker/Dealers and Intermediaries

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- **Depositories**

- At least every four years, a banking services depository shall be selected through a competitive request for proposal. A written collateral agreement will provide for collateral if balances exceed FDIC insurance.
- Other banking institutions from which the City may purchase certificates of deposit will also be designated as a depository for depository/collateral purposes. All depositories will execute a depository agreement

- **Security Broker/Dealers**

- All pools, financial institutions, and broker/dealers who desire to transact business with the County must supply the following documents:
  - ✦ Completion of a County broker questionnaire
  - ✦ (if brokers) Financial Industry Regulatory Authority (FINRA) certification and CRD #
  - ✦ (if brokers) proof of Texas State Securities registration
  - ✦ [send them the policy – only pools need to certify to reviewing the policy]

# Financial Broker/Dealers and Intermediaries

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- **Policy Certification**

- Any pool used by the County must be provided a copy of the County's current Investment Policy and certify to a review of the Policy stating that the pool has put controls in place to assure only Policy approved investments will be sold to the County.
- Certification must be received before any transactions take place.
- This is no guarantee – all decisions come back to the County

- **Annual Broker/Dealer Approval**

- A list of County qualified broker/dealers will be adopted at least annually by the Court.
- In order to perfect the DVP process the banking services depository, or its brokerage subsidiary, will not be used as a broker.
- Information regarding all financial counter-parties will be maintained by the investment officer.

# Collateral

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- The PFCA assumes you have a collateral policy
  - Create the policy inside your investment policy
- Time and Demand Deposit Collateral
  - All bank time and demand deposits shall be collateralized above the FDIC coverage by pledged collateral.
  - In order to anticipate market changes and provide a level of security for all funds, collateral will be maintained and monitored by the pledging depository at 102% of market value of principal and accrued interest on the deposits daily.
  - Collateral pledged to secure deposits shall be held by an independent financial institution outside the holding company of the depository. The collateral agreement with the depository shall be approved by resolution of the Bank Board or Bank Loan Committee in accordance with FIRREA.
  - The Custodian shall provide a monthly report of collateral directly to the County.



# Investment Reporting

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- Only quarterly reporting is required
  - Best practice requires monthly reporting
- Quarterly Reporting of Risk
  - The Treasurer shall submit a signed quarterly investment report to the Court in accordance with the Act giving detail information on each portfolio and bank position and summary information to permit an informed outside reader to evaluate the performance of the investment program.
- Market prices for the calculation of market value will be obtained from independent sources.

# Investment Reporting

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- The report must include the following at a minimum:
  - A full description of each individual security or bank/pool position held at the end of the reporting period
    - ✦ including the *amortized book* and *market value* at the beginning and end of the period,
  - *Unrealized* gains or losses (book value minus market value),
  - Weighted average yield of the portfolio and its applicable benchmarks,
  - Earnings for the period,
  - Allocation analysis of the total portfolio by market sector and maturity, and
  - Statement of compliance of the investment portfolio with the Act and the Investment Policy signed by the Investment Officer(s).

# Investment Policy Adoption

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- To reconsider all changing circumstances and adapt to them the Policy shall be reviewed and adopted every year.
- This Policy shall be reviewed and adopted by resolution of the Court no less than annually.
- A written resolution approving that review and *noting any changes* to the Policy will be recorded by the Court.
- Adopting resolution should state it is adoption of policy and strategy

# Possible Addendum and Exhibits

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- **Broker/dealer approved list**
  - Adopt at same time
  - Reflect on adopting resolution that broker list is adopted also

Thank you and good luck!

