County Investment Policies What and Why…

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COUNTY JUDGES AND COMMISSIONERS
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The Court's Legal Responsibilities

- Court must adopt the County's investment policy annually
- Court must adopt the County's macro strategy annually
- Court must designate County investment officers
- Court must receive quarterly investment reports
- Court must approve the officer training sources and fund the training
- Court must adopt a list of authorized broker/dealers *(if applicable)*

- Court retains the *ultimate fiduciary responsibility*

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Governing Statutes

For Investments

- Government Code, Title 10, Chapter 2256
  - **The Public Funds Investment Act**
  - Requires a written policy
  - Does not supersede other laws

For Collateral

- Government Code, Title 10, Chapter 2257
  - **Public Funds Collateral Act**
  - Assumes you have a written policy
  - Supersedes all other collateral law

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PFIA's Guiding Principle

The Prudent Person Rule

- Guidance and Flexibility

"The County shall seek to ensure that all investments be made with the utmost judgment and care, *under circumstances then prevailing*, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of the capital as well as the probable income to be derived."

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Why Adopt an Investment Policy?

- It's your primary investment control for **safety**
- It's the law but flexible enough to **tailor to your needs**
- It **prioritizes** investment goals
- It establishes **risk tolerance**
- It sets your investment **limits and controls**

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Annual Policy Reviews

Required to be *adopted* annually by the Court

You are looking for key areas that might require a change

- Authorized individuals
- Authorized investments
- Maximum maturities
- WAM changes
- Changes in procedures or controls
- Legislative change requirements

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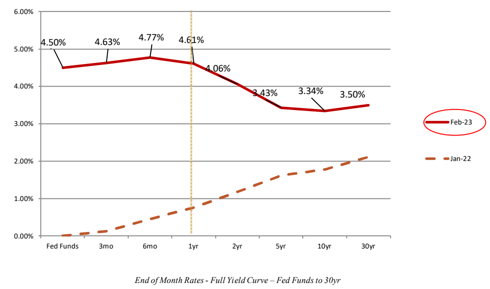
Why Annually?
Changes are Internal and External



End of Month Rates - Full Yield Curve ~ Fed Funds to 30yr

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Policy Goals

- **Safety, Liquidity, Diversification and Yield**
  - All are important
- An effective policy is tailored to your County
- An effective policy provides the foundation for all decisions
- An effective policy establishes critical controls
- An effective policy defines alternatives for flexibility

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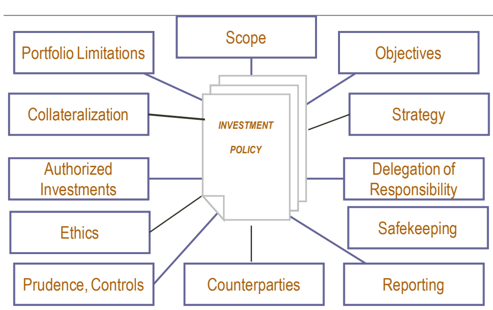
Key Policy Elements Support Each Other



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The Scope: brings it all together

- Basically identifying applicable funds/sub-portfolios or 'pooled fund group'
- Refers to all County funds
  - Refers to *every* dollar (attorney, sheriff, assessor, hospitals, etc)
  - Reporting will then include *all* funds under Court purview
- PFIA does not apply to pension funds
- It applies to security investments and pools and bank accounts
- The goal is to oversee your entire portfolio

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Objectives

Clearly set the tone of the policy
- These are the County's objectives and should be defined briefly

Investment of Funds shall be governed by the following priorities:
- ✓ Safety of principal
- ✓ Liquidity
- ✓ Diversification
- ✓ Yield

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SAFETY- The objective is to mitigate credit and interest rate risk.

1. Limit investments to the highest credit quality securities
2. Pre-qualify and monitor the financial institutions
3. Diversify the investment portfolio.
4. Structure the portfolio to meet cash requirements.
5. Assure settlement of all securities on a delivery versus payment basis.
6. Adopt a pro-active but conservative buy-and-hold strategy.

LIQUIDITY-
County shall maintain a cash flow schedule addressing liquidity needs to ensure adequate and timely availability of funds.

DIVERSIFICATION-
The portfolio shall be diversified to spread market risk.

YIELD-
Investment for reasonable market yield within the policy guidelines.

All four are critically important.

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Delegation of Responsibility

- County must designate one or more positions as investment officer(s) to be responsible for investment of its funds. If there is a Treasurer they must be an investment officer.
  - Officers make all the daily decisions based on policy
- The Officer may deposit, withdraw, transfer or manage funds and establish investment accounts in accordance with policy.
- Designation through a resolution to name the officer

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The Question of Ethics

- Four conditions require disclosure to the Texas Ethics Commission
  - These are extremely high and rarely if ever met
  - The conditions focus on equity and income
- The real control is **competition**!
  - Requiring competition on all transactions resolves ethical questions
  - Levels the playing field
  - Investment Officers work for the County not the banks

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The Primary Controls

The primary goals are based on your cash flow and your risk tolerance

- Both are set in your policy

Maximum maturity for any investment

- Allowing for extensions when needed/necessary

Maximum weighted average maturity

- Providing the control against overextension

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Controls Based on Cash Flows

- Maximum maturity
  - County needs flexibility to extend
    - With funds that will be there: bond funds, reserves, etc.
    - Most need a maximum maturity of three years (perhaps five in large counties)

- Maximum weighted average maturity (WAM)
  - County always needs to take care of anticipated operating needs
    - Operating funds normally used in one fiscal year
    - Longer funds can be allowed longer WAMs
    - WAMs are set by fund type in the policy

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Authorized Investments

- Policy defines County choices – always
  - Sometimes refined definitions trump legalese
  - Clarity and limits expressed for any citizen readers

- Favored Investment Options – all of the highest credit quality by law
  - Pools and money market funds
  - Bank liquidity alternatives
  - US Government treasuries and agencies, excluding mortgage-backed securities
  - Certificates of deposit
  - Municipal Obligations (state and local bonds)
  - Commercial paper

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Investment Definitions Matter

Obligations of the United States, its agencies and instrumentalities, excluding mortgage backed securities, with a final stated maturity not to exceed three (3) years.

Obligations of any state of the United States or their respective agencies rated A or better, not to exceed three (3) years to final stated maturity.

Fully insured or collateralized certificates of deposit from banks doing business in Texas, collateralized in accordance with this Policy, not to exceed two (2) years to maturity under a depository agreement executed under the terms of FIRREA.

Clear definitions

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Security Policy Controls

- Maximum stated maturities for each market sector
- Possible diversification requirements by market sector
- Possible minimum % only for liquidity purposes? (15%)
- Diversification Tables for total portfolio – *inflexibility caution*
- Specific issuer limitations for control
  - CP issuers 5%
  - Agencies issuers 25%
  - Ownership of a pool or fund

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Collateral

- The PFCA *assumes* you have a collateral policy
- Collateral is *pledged to* County in case of bank failures/non-performance
- Rights must be protected to FDIC standards

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County Collateral Policy

- Amount:
  - County requires 102% market value on all time and demand deposits
- Selection:
  - County authorizes specific investments
- Reporting:
  - County requires a monthly report of pledged collateral
- Responsibility:
  - Bank is responsible for monitoring and maintaining margins

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Collateral and FIRREA

- Collateral control (and ultimate payout) depends on FIRREA
  - Bank accounts and CDs
- Financial Institutions Resource, Recovery & Enforcement Act
- Applies to any deposit over the FDIC insurance limit
  - agreement must be in writing
  - agreement must be approved by Bank Board or Bank Loan Committee
  - agreement must be in official books of the bank

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Key Controls

The investment officer is responsible for establishing and maintaining written controls to ensure that financial assets are protected.

Key controls:
- Competitive bidding
- Cash flow analysis (maturity and average maturity)
- DVP (delivery versus payment)
- Brokered CD merges and acquisitions
- Separation of responsibilities
- Documentation on all transactions
- Credit ratings verification

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Controls

Competitive Bidding Requirement
All securities, including certificates of deposit, require a minimum of three (3) offers/bids to assure receipt of fair market value/price for the investment.

Delivery versus Payment
All security transactions shall be executed delivery versus payment (DVP) basis. No payment is made before receiving the security.

Rating Declines or Loss of Rating
Any security which loses its required credit rating must be liquidated prudently. Investment Officers determine the best liquidation alternative.

Loss of Authorization
Securities which become unauthorized through either State or Court action need not be liquidated.

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Policy Certification

- Only pools need to certify to the County policy.

- Best practice is to send the policy to any counter-party.
  - Broker/dealers
  - Banks
  - Advisers

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Safekeeping and Custody

- Safekeeping Agent – holds your securities
- Custodian – holds securities with fiduciary responsibility
- Both must be independent of the trade transaction
- Both clear every transaction DVP (delivery versus payment)
- Both need to report holdings

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Quarterly Reporting as a Control

- Compliance statement
- Summary Information
- Detail accounting information

- The Court needs to look at:
  - Adherence to objectives
  - Adherence to limits set by policy
  - Red flags

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Two Types of Strategies

Legal Macro Strategies
- The Public Funds Investment Act requirements

Market Strategies
- Counties are conservative buy-and-hold entities

Both strategies must be Dynamic
- Your internal changes can change
- Market relative value and rate movements control
- Markets move constantly and circumstances then prevailing change

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Required Written Strategies

PFIA requires a strategy for each *pooled fund group* addressing
- Suitability = is the investment suitable for the fund type
- Safety = will it preserve principal and keep it safe
- Liquidity = does it meet the funds needs for liquidity
- Marketability = can it be sold if needed
- Diversification = does it put eggs in different baskets
- Yield = will this also best use my assets

- PFIA requires WAM set for each 'fund group' (portfolio)

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Thank you!

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