

PUBLIC OFFICIALS' RESPONSIBILITIES WHEN INVESTING PUBLIC FUNDS

California Debt and Investment
Advisory Committee

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Legal, Ethical and Fiduciary Obligations

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Statutory Basis for Investing

- “Local Agency” means county, city, city and county, school district, community college district, public district, county board of education, county superintendent of schools, or any public or municipal corporation. (Gov’t. Code §53600)
- **Governing Body is responsible, but** may designate authority for a one-year period to a fiduciary (Gov’t. Code §27000.1 and §53607).

Delegation of Investment Responsibility

- Delegation shifts fiduciary responsibility to the County Treasurer (Gov't. Code §27000.3)
- Once delegated, a county board of supervisors may not set conditions with respect to contracts for investment management services executed by the treasurer (Attorney General Opinion #04-1203, May 11, 2005)

Statutory Investment Objectives

(Gov't. Code §27000.5 and §53600.5)

- The primary objective of a trustee shall be to **SAFEGUARD THE PRINCIPAL** of the funds.
- The second objective shall be to **MEET THE LIQUIDITY** needs of the depositor.
- The third objective shall be to **ACHIEVE A RETURN**.

Standards for Governing Bodies or Persons Authorized to Make Investment Decisions for Local Entities (Gov't Code §27000.3 and §53600.3)

- "...all governing bodies of local agencies or persons authorized to make investment decisions on behalf of those local agencies investing public funds pursuant to this chapter are trustees and therefore fiduciaries subject to the prudent investor standard."

The "Prudent Investor Standard"

- Gov't. Code §27000.3 and §53600.3:
 - *" a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims..."*

What does it mean to be “prudent”?

- Exercise care, skill and caution
 - Care is reasonable effort and diligence in making and monitoring investments
 - Fiduciary must have at least the skill of a person of ordinary intelligence
 - Caution means balancing risk and return

What does it mean to be “prudent”?

- Duties of loyalty, impartiality and personal performance (non-delegation)
 - Loyalty means acting solely in the interest of the beneficiaries
 - Impartiality means giving equal respect to needs of all beneficiaries
 - Fiduciary must take care in delegating duties to an agent

Liability for breach of fiduciary duty

- Liability is based on *imprudent conduct*, not poor investment performance
 - Measure of liability: Put the beneficiaries in the position they would have been in had the breach not occurred
- “Good faith” may provide a complete or partial defense

Ethical Considerations

- Need for Transparency
- Selecting Broker/Dealers
 - Level of professional ethics
 - Amount of experience with local agencies
 - Capitalization and transaction volume
 - Gifts and gratuities
- “Social Investing” criteria
 - Examples: South Africa, tobacco
 - Appropriate only when risk and other characteristics are essentially equivalent

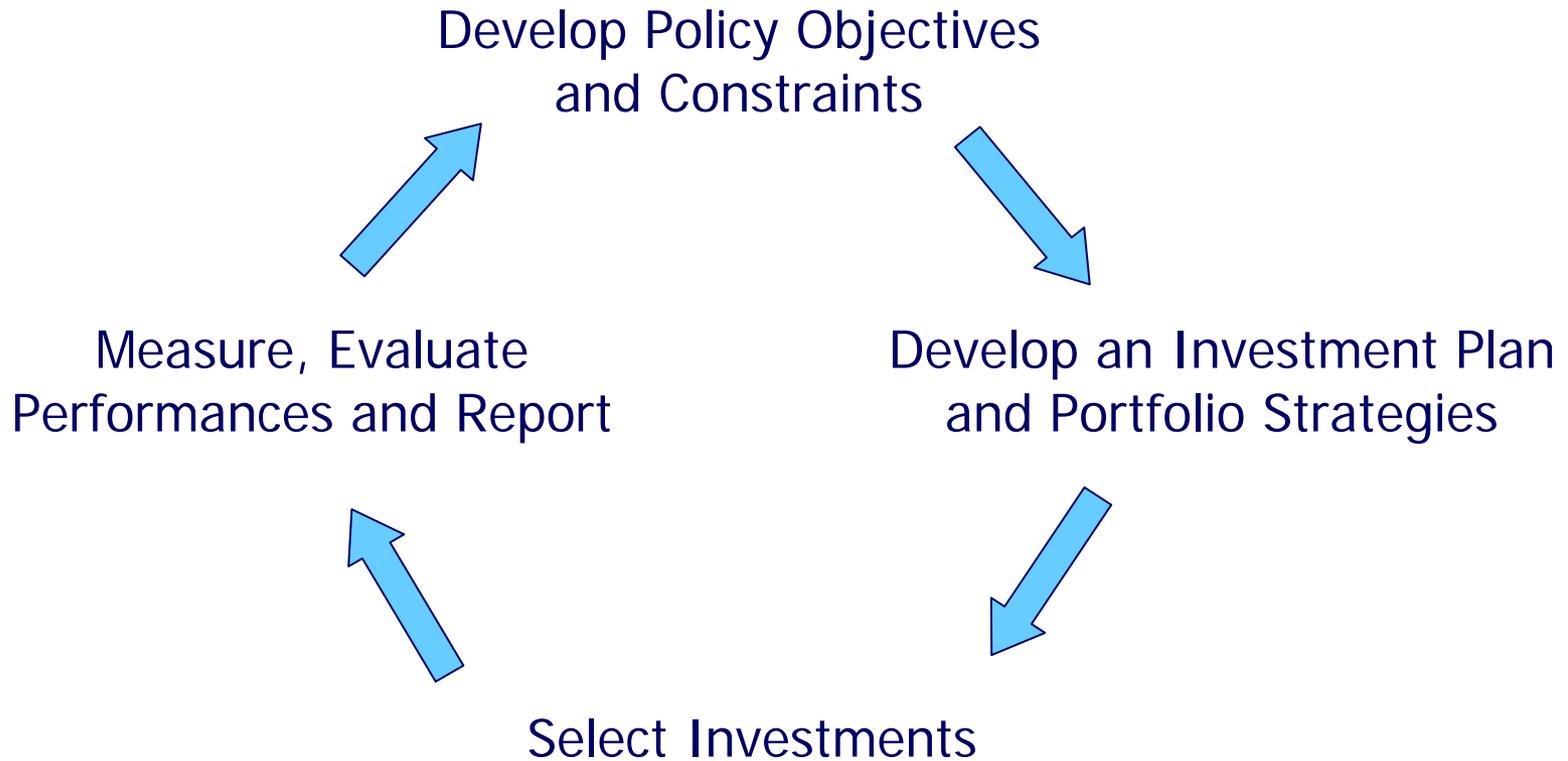
Political Issues

- Resist pressure to use “friends” for investments
 - Stick to investment policy
 - Have an approved list of broker/dealers
 - Have an investment plan in place
 - Use objective criteria to evaluate any purchase

Public Funds Investment Management

Vic Erganian, City Treasurer
City of Pasadena

The Investment Management Cycle



Purpose of an Investment Policy

- To establish procedures and guidelines that will ensure the prudent management of public agency funds
- To incorporate all of the regulations specified by California Code sections into the agency's investment program
- To specify the risk tolerance and investment philosophy of the agency

Sec 53646 (a) (1)

- In the case of a local agency, the Treasurer or Chief Fiscal Officer of the local agency may annually render the legislative body a statement of investment policy...

Develop an Investment Policy (Components)

- Statement of Objectives
- Prudence
- Delegation of Authority
- Identification of Fund Types and Investment Horizons
- Safekeeping and Custody of Securities
- Diversifications/Limits
- Risks
- Ethics and Conflict of Interest
- Authorized Investments
- Collateralization
- Performance Standards
- Reporting Requirements
- Policy Adoption

Prepare Cash Forecasts

- Perform Cash Flow Analysis
 - 6 Month
 - 1 Year
 - 1.5 Years
- Determine adequate level of short-term investments for liquidity purposes
- Maintain an extra layer for safety purposes
- Total Portfolio
 - Liquidity Portfolio
 - Reserve Portfolio

Liquidity Portfolio

- Structured to meet liquidity needs
- Investments in short-term securities
- MMF, Government Investment Pools, Repos, T-bills, Agency Discount Notes, CDs, BAs, CPs
- Must have a short average maturity

Reserve Portfolio

- Funds not required for short-term liquidity needs
- Determine the highest suitable duration
- Target long-term securities
- Invest in liquid and easily marketable securities
- US T-bonds and Notes, Government Agency Bonds and Notes, Corporate Bonds
- Risk Tolerance

Portfolio Management Strategies

- Passive Management Techniques
 - Managed Assets
 - Laddered Maturities
 - Rolling T-bills
 - Government Pools
 - Indexing
 - Immunization
 - Cash Flow Matching

Portfolio Management Strategies

- Active Portfolio Management
 - Yield Curve Analysis
 - Enhanced Indexing
 - Market Timing Strategies
 - Relative Return Analysis
 - Sector/Securities Strategies

Portfolio Management Strategies

- Hybrid Active/Passive
 - Duration Management
 - Sector Weighting
 - Individual Security Selection

Risk

- Credit Risk/Default Risk
- Liquidity Risk
- Market Risk
- Reinvestment Risk
- Event Risk
- Political Risk

Measure and Evaluate Performance

- Select the appropriate benchmark
 - 90-Day Treasury Bill Rate
 - LAIF
 - Index – ML (1 – 3)
 - Custom Index
- Benchmark should reflect the appropriate risk in your portfolio

Sec 53646 (a)(b)

In the case of any other local agency, the Treasurer or Chief Fiscal Officer of the local agency may render a quarterly report to the CEO, the internal auditor, and the legislative body of the local agency within 30 days following the end of the quarter covered by the report.

The Quarterly Report shall state:

- Type of investments
- Issuer
- Date of maturity, par and dollar amount
- Investments or moneys held by the local agency
- Investments under management of contracted officer
- Description of the compliance with the statement of investment policy

The Quarterly Report shall state:

- Statement denoting local agency's ability to meet expenditures for the next six months
- Additional information as required by agency's governing body
- Funds deposited in LAIF, County Pools, FDIC, or NCUA insured accounts may use recent statements in lieu of above requirements

The Quarterly Report should include discussions about:

- Economic Outlook
- Interest Rates
- Portfolio Performance and Benchmarks
- Historic Performance Statistics
- Portfolio Strategy and Changes in Strategy

Oversight Committee

- Treasury Oversight Committee for Counties
 - 3 to 11 members
 - Monitor and review the County investment policy
 - Conduct or cause an annual audit and discuss findings
 - Give local agencies or private sector a say in the policies governing the investment pool
 - No interference in the day-to-day operations of the Treasury

Oversight Committee

- For other local agencies:
 - Committee appointed by the local governing body
 - Any combination of staff and outside professionals appointed by the governing body