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# CA Government Code for Legal Investments and Events that Changed Public Funds Investing

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**CDIAC-CMTA Fundamentals**  
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# CA Government Code and Resources

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# Figure 1 Allowable Investment Instruments Per State Government Code

**FIGURE 1**

ALLOWABLE INVESTMENT INSTRUMENTS PER STATE GOVERNMENT CODE  
(AS OF JANUARY 1, 2019)<sup>A</sup> APPLICABLE TO ALL LOCAL AGENCIES<sup>B</sup>

See "Table of Notes for Figure 1" on the next page for footnotes related to this figure.

INVESTMENT TYPE	MAXIMUM REMAINING MATURITY <sup>C</sup>	MAXIMUM SPECIFIED % OF PORTFOLIO <sup>D</sup>	MINIMUM QUALITY REQUIREMENTS	GOVERNMENT CODE SECTIONS
Local Agency Bonds	5 years	None	None	53601(a)
U.S. Treasury Obligations	5 years	None	None	53601(b)
State Obligations: CA and Others	5 years	None	None	53601(d)
CA Local Agency Obligations	5 years	None	None	53601(e)
U.S. Agency Obligations	5 years	None	None	53601(f)
Bankers' Acceptances	180 days	40% <sup>E</sup>	None	53601(g)
Commercial Paper: Non-pooled Funds <sup>F</sup>	270 days or less	25% of the agency's money <sup>G</sup>	Highest letter and number rating by an NRSRO <sup>H</sup>	53601(h)(2)(C)
Commercial Paper: Pooled Funds <sup>I</sup>	270 days or less	40% of the agency's money <sup>G</sup>	Highest letter and number rating by an NRSRO <sup>H</sup>	53635(a)(1)
Negotiable Certificates of Deposit	5 years	30% <sup>J</sup>	None	53601(i)
Non-negotiable Certificates of Deposit	5 years	None	None	53630 et seq.
Placement Service Deposits	5 years	30% <sup>K</sup>	None	53601.8 and 53635.8
Placement Service Certificates of Deposit	5 years	30% <sup>K</sup>	None	53601.8 and 53635.8
Repurchase Agreements	1 year	None	None	53601(j)
Reverse Repurchase Agreements and Securities Lending Agreements	92 days <sup>L</sup>	20% of the base value of the portfolio	None <sup>M</sup>	53601(j)

# Figure 1 Allowable Investment Instruments Per State Government Code (continued)

**FIGURE 1**

ALLOWABLE INVESTMENT INSTRUMENTS PER STATE GOVERNMENT CODE  
(AS OF JANUARY 1, 2019)<sup>A</sup> APPLICABLE TO ALL LOCAL AGENCIES<sup>B</sup>

See "Table of Notes for Figure 1" on the next page for footnotes related to this figure.

INVESTMENT TYPE	MAXIMUM REMAINING MATURITY <sup>C</sup>	MAXIMUM SPECIFIED % OF PORTFOLIO <sup>D</sup>	MINIMUM QUALITY REQUIREMENTS	GOVERNMENT CODE SECTIONS
Medium-term Notes <sup>N</sup>	5 years or less	30%	"A" rating category or its equivalent or better	53601(k)
Mutual Funds and Money Market Mutual Funds	N/A	20% <sup>O</sup>	Multiple <sup>P,Q</sup>	53601(l) and 53601.6(b)
Collateralized Bank Deposits <sup>R</sup>	5 years	None	None	53630 et seq. and 53601(n)
Mortgage Pass-through and Asset Backed Securities	5 years or less	20%	"AA" rating category or its equivalent or better	53601(o)
County Pooled Investment Funds	N/A	None	None	27133
Joint Powers Authority Pool	N/A	None	Multiple <sup>S</sup>	53601(p)
Local Agency Investment Fund (LAIF)	N/A	None	None	16429.1
Voluntary Investment Program Fund <sup>T</sup>	N/A	None	None	16340
Supranational Obligations <sup>U</sup>	5 years or less	30%	"AA" rating category or its equivalent or better	53601(q)

# Table of Notes For Figure 1

TABLE OF NOTES FOR FIGURE 1			
A	<p><i>Sources: Sections 16340,16429.1,27133,53601,53601.6, 53601.8, 53630 et seq.,53635, and 53635.8.</i></p>	<p><i>spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity dates of the same security.</i></p>	
B	<p><i>Municipal Utilities Districts have the authority under the Public Utilities Code Section 12871 to invest in certain securities not addressed here.</i></p>	M	<p><i>Reverse repurchase agreements must be made with primary dealers of the Federal Reserve Bank of New York or with a nationally or state chartered bank that has a significant relationship with the local agency. The local agency must have held the securities used for the agreements for at least 30 days.</i></p>
C	<p><i>Section 53601 provides that the maximum term of any investment authorized under this section, unless otherwise stated, is five years. However, the legislative body may grant express authority to make investments either specifically or as a part of an investment program approved by the legislative body that exceeds this five year remaining maturity limit. Such approval must be issued no less than three months prior to the purchase of any security exceeding the five-year maturity limit.</i></p>	N	<p><i>"Medium-term notes" are defined in Section 53601 as "all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States."</i></p>
D	<p><i>Percentages apply to all portfolio investments regardless of source of funds. For instance, cash from a reverse repurchase agreement would be subject to the restrictions.</i></p>	O	<p><i>No more than 10 percent invested in any one mutual fund. This limitation does not apply to money market mutual funds.</i></p>
E	<p><i>No more than 30 percent of the agency's money may be in bankers' acceptances of any one commercial bank.</i></p>	P	<p><i>A mutual fund must receive the highest ranking by not less than two nationally recognized rating agencies or the fund must retain an investment advisor who is registered with the SEC (or exempt from registration), has assets under management in excess of \$500 million, and has at least five years' experience investing in instruments authorized by Sections 53601 and 53635.</i></p>
F	<p><i>Includes agencies defined as a city, a district, or other local agency that do not pool money in deposits or investment with other local agencies, other than local agencies that have the same governing body.</i></p>	Q	<p><i>A money market mutual fund must receive the highest ranking by not less than two nationally recognized statistical rating organizations or retain an investment advisor registered with the SEC or exempt from registration and who has not less than five years' experience investing in money market instruments with assets under management in excess of \$500 million.</i></p>
G	<p><i>Local agencies, other than counties or a city and county, may purchase no more than 10 percent of the outstanding commercial paper of any single issuer.</i></p>	R	<p><i>Investments in notes, bonds, or other obligations under Section 53601(n) require that collateral be placed into the custody of a trust company or the trust department of a bank that is not affiliated with the issuer of the secured obligation, among other specific collateral requirements.</i></p>
H	<p><i>Issuing corporation must be organized and operating within the U.S., have assets in excess of \$500 million, and debt other than commercial paper must be in a rating category of "A" or its equivalent or higher by a nationally recognized statistical rating organization, or the issuing corporation must be organized within the U.S. as a special purpose corporation, trust, or LLC, have program wide credit enhancements, and have commercial paper that is rated "A-1" or higher, or the equivalent, by a nationally recognized statistical rating agency.</i></p>	S	<p><i>A joint powers authority pool must retain an investment advisor who is registered with the SEC (or exempt from registration), has assets under management in excess of \$500 million, and has at least five years' experience investing in instruments authorized by Section 53601, subdivisions (a) to (o).</i></p>
I	<p><i>Includes agencies defined as a county, a city and county, or other local agency that pools money in deposits or investments with other local agencies, including local agencies that have the same governing body. Local agencies that pool exclusively with other local agencies that have the same governing body must adhere to the limits set forth in Section 53601(h)(2)(C).</i></p>	T	<p><i>Local entities can deposit between \$200 million and \$10 billion into the Voluntary Investment Program Fund, upon approval by their governing bodies. Deposits in the fund will be invested in the Pooled Money Investment Account.</i></p>
J	<p><i>No more than 30 percent of the agency's money may be in negotiable certificates of deposit that are authorized under Section 53601(i).</i></p>	U	<p><i>Only those obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development (IBRD), International Finance Corporation (IFC), and Inter-American Development Bank (IADB), with a maximum remaining maturity of five years or less.</i></p>
K	<p><i>No more than 30 percent of the agency's money may be invested in deposits, including certificates of deposit, through a placement service (excludes negotiable certificates of deposit authorized under Section 53601(i)).</i></p>	L	<p><i>Reverse repurchase agreements or securities lending agreements may exceed the 92-day term if the agreement includes a written codical guaranteeing a minimum earning or</i></p>

# Allowable Investments

- US Treasury Securities
- US Government Agency Securities, aka Government Sponsored Enterprises (GSEs)
- Medium Term Notes
- Municipal Notes/Bonds
  - Local Agency
  - State Obligations-CA & Others
  - CA Local Agency
- Supranational Securities
- Certificates of Deposit
- Bank Deposits
- Commercial Paper
- Bankers' Acceptances
- Investment Pools
- Other (mortgage-backed security [MBS], collateralized mortgage obligation [CMO], asset-backed security [ABS], repurchase /reverse-repurchase agreements, securities lending agreements, investment agreements, and mutual funds)

# US Treasury Securities

- ❑ 53601 (b) **United States Treasury notes, bonds, bills, or certificates of indebtedness**, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.
  
- ❑ Issues by auction:
  - ❑ Bills: 3 mo, 6 mo and 1 year
  - ❑ Fixed rate notes: 2, 3, 5, 7 & 10 year
  - ❑ Floating Rate Notes (FRNs) for a 2y term, introduced in 2014
  - ❑ Bonds: 30 years
  - ❑ TIPSs (Treasury Inflation Protected Securities); the principal is adjusted for inflation by use of the Consumer Price Index (CPI)
  
- ❑ 5y maximum maturity; no % limits; no minimum quality requirements
  
- ❑ CDIAC Webinar 1; [Investing In Treasuries](#)

# US Government Agency Securities

- ❑ 53601(f) ) **Federal agency or United States government-sponsored enterprise (GSEs) obligations, participations, or other instruments**, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises.
- ❑ Allowable GSEs (most recognizable): Federal Farm Credit Bank (FFCB); Federal Home Loan Bank, (FHLB), Federal Home Loan Mortgage Corp (FHLMC); Federal National Mortgage Assoc. (FNMA), Farmer Mac (FAMCA), and Tennessee Valley Authority (TVA)
- ❑ 5y max maturity; no % limits; no minimum quality requirements
- ❑ CDIAC Webinar 2; [\*Demystifying the World of U.S. Federal Agencies and Supranationals\*](#)



# Medium Term Notes

- ❑ 53601(k) Medium-term notes, defined as all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States. Notes eligible for investment under this subdivision shall be rated in a rating category of “A” or its equivalent or better by an NRSRO. Purchases of medium-term notes shall not include other instruments authorized by this section and may not exceed 30 percent of the agency’s moneys that may be invested pursuant to this section.
- ❑ 5y maximum maturity; 30% maximum of the agency’s money; rated in a rating category of “A” or its equivalent or better by an NRSRO (consider limitation per issuer for this category, combining CP issuance)
- ❑ CDIAC Webinar 5; [\*\*\*Making Sense of Corporate Notes and Bonds\*\*\*](#)

# Municipal Notes or Bonds

- 53601(a) **Bonds issued by *the local agency*** including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency or by a department, board, agency, or authority of the local agency...consider conflict of interest
- 53601(c) **Registered state warrants or treasury notes or bonds of *this state***, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency, or authority of the state.
- 53601(d) **Registered treasury notes or bonds of *any of the other 49 United States*** in addition to California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the other 49 United States, in addition to California.
- 53601 (e) **Bonds, notes, warrants, or other evidences of indebtedness of *any local agency within this state***, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority of the local agency.
- 5y maximum maturity; no % limits; no minimum quality requirements (consider limitation per issuer for this category)
- CDIAC Webinar 3; [\*When It Makes Sense to Buy Municipals\*](#)

# Supranational Securities

- ❑ 53601(q) **United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank**, with a maximum remaining maturity of five years or less, and eligible for purchase and sale within the United States. Investments under this subdivision shall be rated "AA" or better by an NRSRO and shall not exceed 30 percent of the agency's moneys that may be invested pursuant to this.
- ❑ The World Bank, officially called the International Bank for Reconstruction & Development (IBRD); International Finance Corporations (IFC) and the Inter-American Development Bank (IABD)
- ❑ 5y maximum maturity; 30% portfolio limit; "AA" minimum rating category
- ❑ CDIAC Webinar 2; [\*Demystifying the World of U.S. Federal Agencies and Supranationals\*](#)

# Certificates of Deposit

- ❑ CDs types: traditional, negotiable and Placement Service CDs (CDARS)
- ❑ Issued by nationally or state chartered banks, savings association or a federal association, state or federal credit union, or by a federally licensed or state licensed branch of a foreign bank
- ❑ Guaranteed by FDIC for banks up to \$250,000 and NCUA for credit unions up to \$250,000
- ❑ Negotiable CDs 53601(i) are limited to 30% of the portfolio
- ❑ Private Placement Service 53601.8 & 3635.8 are limited to 30% of the portfolio (combined with deposits)
- ❑ CDIAAC Webinar 4 Part 2; [\*\*Money Markets Certificates of Deposit, Deposit Placements Services & Collateralized Bank Deposits\*\*](#)

# Bank Deposits

- ❑ Monies in checking account or other means of deposit
- ❑ If more than the FDIC limit, must be collateralized
- ❑ 30% maximum of the agency's money may be invested in deposits, including CDs through a placement service
- ❑ CDIAC Webinar 4 Part 2; [\*Money Markets Certificates of Deposit, Deposit Placements Services & Collateralized Bank Deposits\*](#)

# Commercial Paper (CP)

- ❑ 53601(h) **Commercial paper of “prime” quality of the highest ranking or of the highest letter and number rating** as provided for by a nationally recognized statistical rating organization (NRSRO)
- ❑ **CP is a short-term unsecured promissory note from the issuer to pay; 1<sup>st</sup> line of defense is the issuer’s stand-alone credit strength**
- ❑ Maximum maturity is 270 days
- ❑ The issuing entity must be organized and operating in the US as a general corporation, trust, or limited liability company with total assets in excess of \$500 million
- ❑ Has debt other than CP, if any, that is rated A or higher by an NRSRO
- ❑ Has program wide credit enhancements including but not limited to over-collateralization, letters of credit or surety bond
- ❑ Has CP that is rated A-1 or higher or the equivalent by an NRSRO
- ❑ For local agencies other than a county or city/county, no more than 10% of the outstanding CP of any single issuer
- ❑ For local agencies other than a county or city/county, this category is limited to 25% of the portfolio
- ❑ CDIAC Webinar 4 Part 1; [Understanding Banker’s Acceptances and Commercial Paper](#)

# Bankers' Acceptances (BA)

- ❑ 53601(g) **Bankers acceptances otherwise known as bills of exchange or time drafts** that are drawn on and accepted by a commercial bank. Purchases of bankers acceptances may not exceed 180 days' maturity or 40 percent of the agency's money that may be invested pursuant to this section. However, no more than 30 percent of the agency's money may be invested in the bankers acceptances of any one commercial bank pursuant to this section.
- ❑ **BAs are a common way to finance international trade. It is issued by a non-financial firm and guaranteed by a bank to make payment.**
- ❑ 180 days maximum maturity; 40% maximum limit; 30% maximum in any one commercial bank
- ❑ CDIAC Webinar 4 Part 1; [Understanding Banker's Acceptances and Commercial Paper](#)

# Investment Pools

- Organized and operated by a treasurer, investment officer or external investment advisory firm
- Local Agency Investment Fund (LAIF), limited to \$65 million
- County Investment Pools
- External investment advisory firm options
- No limit on the percentage that can be invested in this category
- CDIAC Webinar 7 [\*Differentiating Mutual Funds from Money Market Mutual Funds and Understanding Investment Pools\*](#)



# Remaining Allowable Investments

- ❑ 53601(o) A mortgage passthrough security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable passthrough certificate, or consumer receivable-backed bond. Securities eligible for investment under this subdivision shall be rated in a rating category of “AA” or its equivalent or better by an NRSRO and have a maximum remaining maturity of five years or less. Purchase of securities authorized by this subdivision shall not exceed 20 percent of the agency’s surplus moneys that may be invested pursuant to this section.
- ❑ Effective January 1, 2019, AB 1770 cleaned up 53601(o), changing the 5 year maturity limit to all investment types in the sub-section above. The legislation removed the requirement for the issuer to be rated “A” or its equivalent or better...
- ❑ CDIAAC Webinar 6; [Understanding Structured Pooled Securities](#)
- ❑ Other allowable investments available are: Repo/Reverse Repo/Securities Lending [56301(j)], investment agreements, and mutual funds and money market funds [53601(i)] etc.
- ❑ CDIAAC Webinar 4 Part 3; [Utilizing Repurchase Agreements, Reverse Repos, and Securities Lending Agreements](#)
- ❑ CDIAAC Webinar 7; [Differentiating Mutual Funds from Money Market Mutual Funds and Understanding Investment Pools](#)
- ❑ ***Many of the above are more complicated investment vehicles and require more due diligence and understanding.***

# Investment Tales from The Crypt

- ❑ “The stories you are about to hear are true. Only the names have been changed to protect the innocent.” Dragnet TV Series 1951

# 1984 San Jose

- ❑ Treasurer bet on the direction of interest rates
- ❑ Invested heavily in the “long-end” of the curve
- ❑ “Reversed” and the portfolio to raise cash to purchase more long-term investments, reverses were not matched
- ❑ As rates began to rise, positions went quickly underwater, no cash for margin calls or daily operations
- ❑ \$60MM loss booked to unwind positions

# Resulting Changes to 53600

- ❑ Reverse repurchase limits were introduced

# 1987 Camarillo

- ❑ Bet on lower interest rates
- ❑ Bought “when issued” securities with expectation that securities would be sold before settlement day
- ❑ Rates rose going against the trade
- ❑ Comingled funds from the City, the Sanitation District and 3 Employee pension funds
- ❑ Bought real estate private placements
- ❑ \$20MM loss on a \$24MM portfolio
- ❑ Discovered when a \$16M check bounced

# 1988 Lawndale, Palmdale, San Marino

- ❑ Invested in “forward contracts” strategy
- ❑ Brokers engaged in excessive and unsuitable trading
- ❑ Losses were not recognized or disclosed when they occurred

## 1988 5-year final maturity

- ❑ In 1988, the 5-year final maturity was implemented with the special approval requirement to extend beyond 5 year final was added to 53601

# 1991 Wymer Investment Fraud

- ❑ 1991 Multiple California public agencies affected \$105MM in losses
- ❑ Steve Wymer was unknown but hired retired treasurers to open doors
- ❑ Touted sophisticated investment strategy using US treasuries
  - ❑ Promised high returns with little/no risk; Ponzi Scheme
  - ❑ Reportedly used options strategy to achieve returns
  - ❑ Account funds were co-mingled; assets held by a Wymer account, Institutional Treasury Management (ITM) at Refco Securities
- ❑ Client accounts at Refco Securities were transferred days before the SEC obtained a court order freezing the assets
- ❑ Pled guilty in September 1992; 14-year, 7 months prison sentence
- ❑ In six years, Wymer spent \$29 million in clients' money on himself



# 1994 Orange County Bankruptcy

- ❑ County Treasurer vowed to provide 11% of budget from portfolio returns; secretive; no reporting requirements
- ❑ Treasurer invested heavily in “inverse floaters”
- ❑ Reversed and leveraged portfolio to raise cash to invest in more inverse floaters
- ❑ Reverses were not matched; portfolio not hedged
- ❑ Fed began to tighten; County could not make its margin calls; losses of \$1.64 billion

# 1995 Changes in Oversight and Limits

- ❑ Legislation was introduced and passed that addressed professional qualifications, oversight committees and regular reporting

# 1995 Vista

- ❑ Experienced Finance Director invested the portfolio
- ❑ Began taking gratuities from broker
- ❑ Invested in interest-only strips, equity mutual funds and limited partnerships
- ❑ Finance Director pleads guilty to fraud after millions in losses

# 1999 Oceanside Prime Bank Notes

- ❑ Mayor approached Treasurer with investment that was “risk free” and chance for 130% monthly return:
  - ❑ International Monetary Fund
  - ❑ Required Power of Attorney on \$100MM and secrecy
  - ❑ Mayor signed a “Letter of Intent”
- ❑ Elected Treasurer refused to sign documentation
- ❑ Matter brought to the attention of Council and press
- ❑ Deal was dropped; Mayor was not re-elected

# 1999 “Futures” changes through securities lending limitations

- ❑ In 1999, the “futures” changes were introduced in the text of Section 53601 through the addition of language in the reverse repo sections identifying “securities lending agreements” as subject to similar limitations. The statute was AB 530.

# 2016 Beaumont

- ❑ FBI raids City Hall in April 2015, after a year-long investigation
- ❑ May 2017, 7 charged with embezzlement and misappropriation of public funds in a \$43MM corruption case
- ❑ Jailed: former City Manager, former Police Chief, former Public Works Director, former City Attorney, former Economic Development Director, former Finance Director and former City Planner
- ❑ Heavily outsourced to Urban Logic Consultants for planning, economic development and public works; diverted funds from the joint power agency's Transportation Uniform Mitigation Fee
- ❑ 6 pled guilty to a felony; 1 to a misdemeanor (City Attorney, 12/18)

## 2016 Placentia

- ❑ Finance-Services Manager embezzled \$5.16MM bypassing accounting safeguards when transferring money to personal accounts; bank statements and ledgers manipulated with software
- ❑ As of July 2017 \$4.66MM of the stolen funds have been returned to the city
- ❑ March 10, 2017, former finance-services manager sentenced to 25 years in prison

# 2016 Compton

- ❑ Deputy City Treasurer was arrested in December 2016 for embezzling City funds; handling cash for 22-years
- ❑ City Treasurer noticed discrepancies in ledgers
- ❑ Colleague spotted a discrepancy triggering an investigation; when confronted by a supervisor, admitted to stealing money for years (starting in May 2010)
- ❑ November 3, 2017, ex-deputy treasurer and his wife plead guilty to embezzling over \$3.7mm
- ❑ Ex-deputy sentenced to 6.5 years; wife sentenced to 3 years probation, 12 months home detention and 800 hours community service



# 2017 Unknown District

- ❑ District used 53601.1 that allows financial futures or financial options as a hedge to justify shorting the 10-year treasury
- ❑ Shorting is NOT a legal investment strategy
- ❑ Shorting is when you sell a security at a price expecting the price to drop; then buying it back at a lower price
- ❑ It is a naked short if you don't own the security; you are "naked" because you are exposed to unlimited risk if the market moves up
- ❑ District incurred substantial losses; settled out-of-court with the dealer

# Internal Control Procedures

- ❑ Separation of Duties
- ❑ Access Controls
- ❑ Physical Audits
- ❑ Documentation
- ❑ Trial Balances
- ❑ Reconciliations
- ❑ Approval Authority

# Disclosure and Resources

- ❑ *INTENDED FOR INSTITUTIONAL INVESTORS ONLY. The information provided herein is for informational purposes only and should not be construed as a recommendation of any security, strategy or investment product, nor as an offer or solicitation for the purchase or sale of any financial instrument. Any information or data used in presentation was obtained from sources we believe to be reliable, but we do not guarantee its accuracy. This presentation contains the current opinions of the author, which are subject to change without notice. Any statements concerning financial market trends or future forecasts are based on current market conditions, which will fluctuate. Past performance is not Indicative of future results. Member FINRA/SIPC.*
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