

CDIAC

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION



# CDIAC-CMTA Fundamentals of Public Fund Investing

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HIGGINS CAPITAL  
MANAGEMENT, INC.  
*We Quarterback Money®*

John Johnson, Chief Deputy Treasurer



# SESSION FIVE: INVESTMENT POLICY AND OBJECTIVES

# SESSION OBJECTIVES

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- ❑ Investment Policy Importance
- ❑ Changes to Code; where to look, when and why
- ❑ Best Practices, meeting minimum code requirements
- ❑ CMTA Certification Process
- ❑ Treasury Oversight and how to create one
- ❑ Examples of IP use and structure

# INVESTMENT POLICY IMPORTANCE

- ❑ Defines whether your IPS is more restrictive than CA Code or matches the minimum standards set forth by code requirements
- ❑ Identifies investment objectives, risk tolerance and constraints on the investment portfolio
- ❑ Facilitates decision making with the emphasis on safety, liquidity, and yield
- ❑ Demonstrates a commitment to the fiduciary care of public funds
- ❑ Your Investment Policy is important to:
  - ❑ Your Constituents
  - ❑ Auditors
  - ❑ Capital Markets (issuing, buying/selling)
  - ❑ Rating Agencies

# LEGISLATIVE CHANGES TO CODE

- ❑ New Index of Statutory Changes from 1996 to Present will be included in the 2019 LAIG.
- ❑ Upcoming Legislative changes are featured on CDIAC's website in the October Debt Line publication.
- ❑ **AB 1770 (Steinorth) Effective January 1, 2019.** Made substantive changes to California Government Code Sub-Section 53601(o) relating to the application of ratings standards and maturity limits for mortgage pass-through and asset-backed securities. The change clarified that the five year maturity limit applies to all investment types enumerated in the sub-section and the minimum ratings requirement is applied at the security level only.

# CMTA BEST PRACTICES-POLICY CERTIFICATION

- ❑ Scope
- ❑ Prudence
- ❑ Objective
- ❑ Delegation of Authority
- ❑ Ethics and Conflicts of Interest
- ❑ Authorized Financial Dealers and Institutions
- ❑ Authorized and Suitable Investments
- ❑ Review of Investment Portfolio
- ❑ Investment Pools/Mutual Funds
- ❑ Collateralization
- ❑ Safekeeping and Custody
- ❑ Diversification
- ❑ Maximum Maturities
- ❑ Internal Control
- ❑ Performance Standards
- ❑ Reporting
- ❑ Investment Policy Adoption
- ❑ Glossary

# INVESTMENT POLICY VS. CODE

- ❑ You must follow the minimum code requirements.
- ❑ You may make your investment policy *more restrictive* than the code, *but not less*.
- ❑ The code is very specific, if it is not listed, *then it is not permissible*.
- ❑ The following are specifically restricted by the code; 1) range notes; 2) inverse floaters; 3) mortgage-derived interest only strips; 4) any security that could result in zero interest accrual if held to maturity.
- ❑ Note: If you plan to report amortized cost vs. fair value on your CAFR as per the requirements of GASB Statement #79, your IPS should be consistent with the GASB 79 requirements.

# CMTA CERTIFICATION PROCESS


- ❑ CMTA's Investment Policy Certification will provide you with a run-down of the process. CMTA's Investment Policy Certification Program and Application Process was developed by CMTA with support from CDIAC.
- ❑ The CMTA Certification Program and Application takes you step by step through the application process
- ❑ The Sample Investment Policy is your “open book” to best practices, presentation and minimum points the committee is looking for to certify your investment policy
- ❑ Independent certification reinforces to your council/board, auditors, constituents, capital markets and rating agencies that you've taken steps towards a sound, quality investment policy
- ❑ Reviewed by Committee members that have extensive public finance experience
- ❑ Certification fee is nominal and turn-around time is 6 weeks or sooner



# SCORECARD IS PROVIDED, REVIEW SECTIONS

## CMTA Investment Policy Scorecard

*Internal use only*

NAME OF ENTITY:	
EVALUATOR:	
SECTION 2 – SCOPE – MAX 5 POINTS	SECTION 11 – COLLATERALIZATION – MAX 5 POINTS
SECTION 3 – PRUDENCE – MAX 5 POINTS	SECTION 12 – SAFEKEEPING AND CUSTODY – MAX 5 POINTS
SECTION 4 – OBJECTIVE – MAX 5 POINTS	SECTION 13 – DIVERSIFICATION – MAX 5 POINTS
SECTION 5 – DELEGATION OF AUTHORITY – MAX 5 POINTS	SECTION 14 – MAXIMUM MATURITIES – MAX 5 POINTS
SECTION 6 – ETHICS AND CONFLICTS OF INTEREST – MAX 5 POINTS	SECTION 15 – INTERNAL CONTROLS – MAX 5 POINTS
SECTION 7 – AUTHORIZED DEALERS & INSTITUTIONS – MAX 5 POINTS	SECTION 16 – PERFORMING STANDARDS – MAX 5 POINTS
SECTION 8 – AUTHORIZED & SUITABLE INVESTMENTS – MAX 10 POINTS	SECTION 17 – REPORTING – MAX 10 POINTS
SECTION 9 – REVIEW OF INVESTMENT PORTFOLIO – MAX 5 POINTS	SECTION 18 – INVESTMENT POLICY ADOPTION – MAX 5 POINTS
SECTION 10 – INVESTMENT POOLS/MUTUAL FUNDS – MAX 5 POINTS	SECTION 19 – GLOSSARY – MAX 5 POINTS
<b>TOTAL</b>	<b>TOTAL</b>
<b>GRAND TOTAL</b>	
CERTIFIED (85 POINTS OR ABOVE):	CERTIFICATION DATES
YES NO 	_____, 20____ THRU _____, 20____
EVALUATOR COMMENTS:	



# SAMPLE (CUT AND PASTE)

- ❑ 53601(i) Negotiable certificates of deposit issued by a nationally or state-chartered bank, a savings association or a federal association (as defined by Section 5102 of the Financial Code), a **state or federal credit union**, or by a federally licensed or state-licensed branch of a foreign bank...
- ❑ ...Must be FDIC-insured (\$250,000 maximum)
- ❑ Allows for banks and state or federal credit union, then states it must be FDIC-insured which applies to banks only. State or federal credit unions are insured by the NCUA through the National Credit Union Insurance Fund (NCUSIF)

# SAMPLE (MISUNDERSTANDING)

- ❑ Section 53607 The authority of the legislative body to invest or to reinvest funds of a local agency, or to sell or exchange securities so purchased, **may be delegated for a one-year period by the legislative body to the treasurer of the local agency**, who shall thereafter assume full responsibility for those transactions until the delegation of authority is revoked or expires, and **shall make a monthly report of those transactions to the legislative body**. Subject to review, the legislative body may renew the delegation of authority pursuant to this section each year
- ❑ If the authority to invest has been delegated by the legislative body to a treasurer, finance director, etc. which is almost 100% the case, then a monthly transaction report must be submitted

# TREASURY OVERSIGHT COMMITTEE

- GC Sections 27131 and 27132 through 27132.4 consider the formation, composition, and role of a county treasury oversight committee. These code sections provide that the function of the treasury oversight committee **is to *monitor and review the county investment policy*** by conducting or causing an annual audit and discussing its findings at a public meeting. The rationale behind the creation of an oversight committee is to give local agencies and private sector citizens a say in the policies governing the investment pool. (See LAIG Chapter IV)

# IPS AND RATING AGENCIES

- ❑ If your treasury pool is rated, it is advisable to ask your rating agency to review any proposed IPS changes. Good communication is very important.
- ✦ Rating Agencies will not officially “approve” your IPS.
- ✦ Rating Agencies will “review” your IPS and opine as to whether your limits are consistent with specific ratings criteria.
- ✦ Rating Agencies do consider your IPS when rating your treasury pool/fund.

# IPS POLICY TABLE

COUNTY OF SAN BERNARDINO INVESTMENT POLICY				
OFFICE OF THE AUDITOR-CONTROLLER/TREASURER/TAX COLLECTOR (SCHEDULE I)				
AUTHORIZED INVESTMENTS	DIVERSIFICATION	PURCHASE RESTRICTIONS	MATURITY (not to exceed)	MINIMUM ALLOWABLE CREDIT QUALITY (S&P/MOODY'S/FITCH)
United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the full faith and credit of the U. S. are pledged for the payment of principal and interest	100%	None	5 years	Not Applicable
Notes, participations or obligations issued or fully guaranteed as to principal and interest by an agency of the Federal Government or U.S. government-sponsored enterprises (excluding mortgage-backed securities)	100%	Senior debt only	5 years	Not Applicable
Notes, participations or obligations issued or fully guaranteed as to principal and interest by the International Bank for Reconstruction and Development, the International Finance Corporation, and/or the Inter-American Development Bank	30%	US Dollar denominated Senior Unsecured debt only	5 years	AA by at least one rating agency
Bonds, notes, warrants or certificates of indebtedness issued by agencies of and/or within the County of San Bernardino	10%	With approval of Treasurer	5 years	AAA by at least 2 of the 3 rating agencies*
Commercial paper of U.S. Corps with total assets in excess of \$500 MM	40% total for all Commercial Paper	Max 5% of portfolio by any one issuer, subject to 5% overall corporate issuer limit	270 Days	Rated by at least 2 of the 3 rating agencies, minimum A-1, P-1, and/or F1 (if rated)*
Asset-backed Commercial Paper	40% total for all Commercial Paper	Issuer must have program-wide credit enhancements	270 Days	Rated by at least 2 of the 3 rating agencies, minimum A-1, P-1, and/or F1 (if rated)*
Negotiable CDs issued by approved banks	30%	Max 5% of portfolio by any one issuer, subject to 5% overall corporate issuer limit	3 years from settlement date	Rated by at least 2 of the 3 rating agencies, minimum A-1, P-1, and/or F1 short-term rating or long-term letter rating of A- and/or A3, or higher (if rated)*
Collateralized Certificates of Deposit	10%	As stipulated in Article 2, Section 53630 et al. of the Calif. Govt. Code	1 year from settlement date	See Section 53630 et al. of the California Government Code

Repurchase Agreements with 102% collateral	40%	Repurchase Agreements (contracts) must be on file	180 days	Restricted to Primary Dealers on Eligible Broker/Dealer List
Reverse Repurchase Agreements	10%	See Schedule II	92 days (See Schedule II)	Restricted to Primary Dealers on Eligible Broker/Dealer List
Medium Term Notes of U.S. Corporations & Depository Institutions and/or Corporate or Bank notes	20% (shall not exceed 10% over 13 months)	Max \$200MM par value of any one issuer, subject to 5% overall corporate issuer limit.	3 years and 2 months (38 months) from settlement date	Rated long-term A- and/or A3, or higher by at least 2 of the 3 rating agencies*
Asset-Backed Securities	10%	Max \$200MM par value of any one issuer, subject to 5% overall special purpose entity** limit	2.75 Weighted Average Life and 5 years	As per Section 53601(o) of the California Government Code
FDIC Insured Deposit Accounts Authorized under California Government Code Sections 53601.8 & 53635.8	5%	Max \$50MM per selected depository institution, Max \$100MM per placement service	Term Deposits not permitted	Not Applicable
JPA Investment Pools authorized under California Government Code Section 53601(p)	5%	Max \$200MM per JPA Pool Maintain Constant Net Asset Value (NAV)	Immediate Liquidity	AAA by at least one rating agency
Money Market mutual funds that meet requirements of California Government Code	15%	Registered with SEC. No NAV adjustments. No loads. Max 10% per fund.	Immediate Liquidity	AAA by at least 2 of the 3 rating agencies*
* Standard & Poor's Ratings Services, Moody's Investors Service Inc., and Fitch Ratings Ltd.				
** See Glossary Terms				



# IPS POLICY TABLE

<b>COUNTY OF SAN BERNARDINO INVESTMENT POLICY</b>				
<b>OFFICE OF THE AUDITOR-CONTROLLER/TREASURER/TAX COLLECTOR</b>				
<b>(SCHEDULE I)</b>				
<b>AUTHORIZED INVESTMENTS</b>	<b>DIVERSIFICATION</b>	<b>PURCHASE RESTRICTIONS</b>	<b>MATURITY (not to exceed)</b>	<b>MINIMUM ALLOWABLE CREDIT QUALITY (S&amp;P/MOODY'S/FITCH)</b>
United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the full faith and credit of the U. S. are pledged for the payment of principal and interest	100%	None	5 years	Not Applicable
Notes, participations or obligations issued or fully guaranteed as to principal and interest by an agency of the Federal Government or U.S. government-sponsored enterprises (excluding mortgage-backed securities)	100%	Senior debt only	5 years	Not Applicable
Notes, participations or obligations issued or fully guaranteed as to principal and interest by the International Bank for Reconstruction and Development, the International Finance Corporation, and/or the Inter-American Development Bank	30%	US Dollar denominated Senior Unsecured debt only	5 years	AA by at least one rating agency

# BIG MISTAKES TO AVOID

- ❑ Having language in your IPS that *forces* you to take a realized loss
- ✘ Being too restrictive/inflexible to respond to market conditions and changes
- ✘ Failing to review every code reference in your IPS and update with new legislative changes on an annual basis (sunset provisions, code nomenclature changes, new code sections, etc.)



# LANGUAGE ON LOSSES

- ❑ **AUTHORIZED INVESTMENTS:** Investments shall be restricted to those authorized in the California Government Code and as further restricted by this policy statement, with the exception of certain bond funds in which the Board of Supervisors has specifically authorized other allowable investments. All investments shall be further governed by the restrictions shown in Schedule I, which defines the type of investments authorized, maturity limitations, portfolio diversification (maximum percent of portfolio), credit quality standards, and purchase restrictions that apply. Whenever a maximum allowable percentage of the portfolio is stated for any type of security as detailed above, the maximum allowable limit is determined by the portfolio size at the market close of the regular business day prior to the security purchase date. Maximum limits are applicable ***at the time of security purchase only unless otherwise noted or defined in Schedule I.***

# LANGUAGE ON LOSSES

- **MITIGATING MARKET & CREDIT RISKS:** Safety of principal is the primary objective of the portfolio. Each investment transaction shall seek to minimize the County's exposure to market and credit risks by giving careful and ongoing attention to the credit ratings issued by Standard & Poor's, Moody's and/or Fitch rating services on the credit worthiness of each issuer of securities, by limiting the duration of investments to the time frames noted in Schedule I, and by maintaining the diversification and liquidity standards expressed within this policy. ***In the event of a downgrade of a security held in the portfolio, the Investment Officer shall report the downgrade to the Treasurer promptly. In the event of a downgrade below the minimum credit ratings authorized by this policy, the security shall be evaluated to determine whether the security shall be sold or held.*** It is preferred to sell such a security if there is no book loss. ***In the event of a potential loss upon sale, the Treasurer will evaluate whether to hold or sell the security based on the amount of loss, remaining maturity and any other relevant factors.***

# LANGUAGE ON LOSSES

- ❑ **TRADING & EARLY SALE OF SECURITIES:** Securities should be purchased with the intent of holding them until maturity. However, in an effort to minimize market risks, credit risks, and increase the total return of the portfolio, ***securities may be sold prior to maturity, either at a profit or loss, when market conditions or a deterioration in credit worthiness of the issuer warrant a sale of the securities to either enhance overall portfolio yield or to minimize loss of investment principal.*** In measuring a profit or loss, the sale proceeds shall be compared to the original cost as per the County's books of the security plus accrued interest earned and/or any accretion or amortization of principal on the security from the date of purchase or the last coupon date to the date of sale. ***However, the sale of a security at a loss can only be made with the approval of the County Treasurer or his designee.***

# SPECIAL ATTACHMENTS TO IPS (EXAMPLE)

## **POLICY STATEMENT ON REVERSE REPURCHASE AGREEMENTS AND SECURITIES LENDING AGREEMENTS**

The Treasurer hereby institutes the following policies as further safeguards governing investments in Reverse Repurchase Agreements and Securities Lending Agreements:

1. The total of Reverse Repurchase Agreement and Securities Lending Agreement transactions shall not exceed 10 percent of the base value of the portfolio.
2. The term of such agreements shall not exceed 92 calendar days, unless the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using such an agreement and the final maturity date of the same security.
3. All loaned securities subject to Reverse Repurchase Agreements or Securities Lending Agreements shall be properly flagged and immediately accounted for in the Treasurer's financial system.
4. Investments purchased from the loaned proceeds of the Reverse Repurchase Agreement shall have maturities not exceeding the due date for repayment of the Reverse Repurchase Agreement transaction.
5. Only U.S. Treasury Notes and Federal Agency securities owned, fully paid for, and held in the Treasurer's portfolio for a minimum of 30 days can be subject to Reverse Repurchase Agreement and Securities Lending Agreement transactions.
6. Reverse Repurchase Agreements and Securities Lending Agreements shall only be placed on portfolio securities that are intended to be held to maturity, have been fully paid for, and have been held in the portfolio for a minimum of 30 days.
7. Reverse Repurchase Agreements and Securities Lending Agreements shall only be made with primary dealers of the Federal Reserve Bank of New York.
8. A contractual agreement must be in place prior to entering into a Reverse Repurchase Agreement or Securities Lending Agreement with any authorized primary dealer.
9. Reverse Repurchase Agreement and Securities Lending Agreement transactions shall have the approval of the County Treasurer.



# DISCLOSURES 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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