California State Treasurer's Office

Investment Policy
Pooled Money Investment Account

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Introduction and Overview

Through the Pooled Money Investment Account (PMIA), the State Treasurer invests taxpayers' money to manage the State's cash flow and strengthen the financial security of local governmental entities. PMIA policy sets as primary investment objectives safety, liquidity and yield.

The State Treasurer's Investment Division manages the PMIA under statutory authority granted by Government Code sections 16430 and 16480.4. The Pooled Money Investment Board (PMIB) governs the PMIA. The State Treasurer chairs the PMIB, which also includes the State Controller and the Director of Finance.

The PMIA has three primary sources of funds: the State General Fund; special funds held by State agencies; and moneys deposited by cities, counties, and other local agencies into the Local Agency Investment Fund (LAIF).

Investment Division Mission Statement

The Investment Division prudently invests the State's and local governments' idle cash through the Pooled Money Investment Account (PMIA), consistent with the objectives of safety, liquidity, and yield, while also providing low-cost investment opportunities for local governments and supporting increased lending in communities.

Investment Division Vision Statement

To provide the highest and most consistent level of service, leadership and accountability through innovation, collaboration, and teamwork, while maintaining investor confidence and trust.

Portfolio Management Goals, Objectives, and Policies

All state money held by the State Treasurer in treasury trust accounts and all money in the State Treasury is appropriated for the purpose of investment and deposit as provided in Government Code section 16480 et. seq.

Goal 1. Portfolio Safety/Diversification

The PMIA will be managed to ensure the safety of the portfolio by investing in high quality securities and maintaining a mix of securities that provide reasonable assurance that no single investment, or class of investments, will have a disproportionate impact on the total portfolio.

<u>OBJECTIVE</u>: In addition to the safety provided by investing in high quality securities, the safety of the portfolio is enhanced by maintaining a diverse, prudent mix of investments, and includes:

1) Spreading investments over different investment types to minimize the impact any one industry/investment class can have on the portfolio

2) Spreading investments over multiple credits/issuers within an investment type to minimize the credit exposure of the portfolio to any single firm/institution

3) Spreading investments over various maturities to minimize the risk of portfolio depreciation due to a rise in interest rates.

<u>POLICY</u>: The portfolio shall contain a sufficient number and diversity of marketable securities so that a reasonable portion of the portfolio can be readily converted to cash without causing a material change in the value of the portfolio. Limitation and eligibility as to specific investments are to be determined by the PMIB in the case of Commercial Paper, the State Treasurer's Investment Committee in the case of new broker-dealer authorizations, and the State Treasurer's Investment Division in all other matters.

Goal 2. Liquidity

The PMIA will be managed to ensure that normal cash needs as well as scheduled extraordinary cash needs can be met. Further, adequate liquidity shall be maintained to ensure unforeseen cash needs are also met, whether ordinary or extraordinary.

<u>OBJECTIVE</u>: The PMIA will maintain a "cash flow generated" portfolio balance sufficient to cover specifically the one-month cash forecast, as well as generally the six-month cash forecast. Further, sufficient marketable treasuries will be maintained to cover unforeseen withdrawals or delayed deposits.

<u>POLICY</u>: The first priority is to maintain specific calendar liquidity, as dictated by the most recent cash forecast. The second priority is to maintain adequate Treasury Bill positions to meet unscheduled needs. Final consideration would be given to other investments deemed appropriate to portfolio maintenance, enhancement, or restructuring.

Goal 3. Rate of Return

The PMIA investments and deposits shall be made in such a way as to realize the maximum return consistent with safe and prudent treasury management.

OBJECTIVE: The rate of return will be maintained on a consistent level representative of current market yield direction.

POLICY: Sales gains/losses will not be incurred to the point of radically altering the final quarterly apportionment rate. Significant sales gains will be offset for restructuring purposes to maintain consistent current return, as well as maximizing future portfolio performance. Significant sales losses shall be incurred only by the consent of the State Treasurer, or when sufficient profits negate the alteration of the apportionment rate. Range bonds and inverse yielding securities are examples of the types of investments that are precluded by the above-stated objective.

Conformance

All of the foregoing goals, objectives, and policies shall be observed by the Director of Investments or the Director of Investments' designee and monitored and reviewed continually by the State Treasurer or the State Treasurer's designee.

Portfolio Management Guidelines

The State Treasurer's Investment Division has set forth a general declaration of portfolio goals, objectives, and policies. The following are various guidelines necessary to the good faith observance of these policies.

Guidelines for Maintaining Safety/Diversification

There are few statutory limitations placed on individual categories of authorized investments. However, this does not entitle the investment staff to “carte blanche” participation in these security types. In the absence of direct statutory limitations, the “prudent person rule” shall govern all investment decisions. As market conditions change (e.g. altering credit risk, marketability, yield spreads, securities availability, etc.), it shall be discussed as soon as time permits with the Director of Investments. At the Director of Investments determination, the situation may be discussed with the State Treasurer or the State Treasurer’s designee.

Guidelines for Maintaining Liquidity

The priority will be cash flow needs as reported on both the monthly and six-month cash forecasts. These forecasts will be updated daily using the current investment input, as well as adjustment information provided by the Centralized Treasury and Securities Management Division.

Sufficient Treasury securities will be maintained for unscheduled cash needs. It has been determined that U.S. Treasury Securities will be used for this purpose.

Due to the make-up of the portfolio participants, an average maturity of 120 days to 18 months will be maintained.

Guidelines for Maintaining Rate of Return

It is important to focus on providing a consistent rate of return. It is often the case that investments made with long-term deposits create the base rate to the portfolio. Since sales gains/losses impact the portfolio on a quarterly basis, large gains/losses should be avoided. Failure to offset gains or losses proportionately could result in an uneven or erratic earnings apportionment rate history. Extreme positions or styles of trading are prohibited.

Current investment strategies and economic releases are regularly discussed amongst the investment staff. Decisions of value and direction are made to accommodate the occurrence of all those events that might be considered reasonable and probable.

Although securities trading is allowed for purposes of enhancing portfolio return, specific limitations have been established to protect the portfolio rate of return:

1) Prior to taking a position, apparent value and size shall be discussed between the Director of Investments, or the Director of Investments' designee, and the trader involved.

2) During a “when issued” (W.I.) period, long positions shall never exceed the amount intended to be purchased.

3) Short positions shall not be taken at any time.

4) Trading positions shall be reported daily to the Director of Investments.

Authorized Investments

The following are various considerations/limitations as they pertain to specific investment types:

Investment Type	Maximum Maturity	Maximum % of Portfolio	Maximum Per Name	Maximum Per Maturity
Agencies (Federal and Supranational)	5 years	None	None	None
Bankers Acceptances (Domestic and Foreign)	180 days	None	None	None
Certificates of Deposits	5 years	None	None	None
Collateralized Time Deposits	1 year	None	(1)	None
Commercial Paper	270 days	30%	10%	None
Corporate Bonds/Notes	5 years	None	None	None
Foreign Government Bonds/Notes	5 years	1%	None	None
Money Market Mutual Funds	Open ended	10%	10%	None
Negotiable Order of Withdrawal (NOW) Accounts	Open ended	5%	(3)	None
Repurchases (RP) and Reverse Repurchases (RRP)	1 year	(2)	None	None
U.S. Treasury Securities	5 years	None	None	None

(1) Shall not exceed the net worth of the institution or an amount considered prudent; whichever is less.
(2) RRP is limited to 10% of the current portfolio.
(3) Shall not exceed the net worth of the institution.

Credit Considerations

Agencies (Federal and Supranational) – Despite there being no statutory limitations concerning this category, prudent investment practice necessitates a constant credit analysis of certain issuing entities. Although there exists an implicit or explicit government guarantee of the various issues, market perception may limit the liquidity of these securities.

Banker's Acceptances (Domestic and Foreign) - A banker's acceptance is a money market instrument, and, like most money markets, it is safe and liquid, particularly when the paying bank has a high credit rating.

Certificates of Deposits – Institutions must be rated average or better by a nationally recognized statistical rating organization utilized by the State Treasurer's Investment Division and must pass a credit evaluation by the investment staff. This evaluation may include a review of such criteria as geographic location, market perception, management factors, and overall fiscal soundness. The approved investments will be regularly posted to the STO website.

Collateralized Time Deposits – Institutions must be headquartered in the State of California and rated average or better by a nationally recognized statistical rating organization utilized by the State Treasurer's Investment Division and must pass a credit evaluation by the investment staff. This evaluation may include a review of such criteria as geographic location, market perception, loan diversity, management factors, overall fiscal soundness, and the Community Reinvestment Act Rating. If, while holding a deposit, an institution is downgraded below acceptable levels by the State Treasurer or the State Treasurer's designee, the following steps shall be taken: Notify the Centralized Treasury and Securities Management Division, Collateral Management Section, to monitor collateral closely; review financials and update credit report; determine the appropriate plan of action, which may include early termination of the time deposit; or allow the time deposit to mature. Collateral must comply with Government Code section 16500 et seq. (bank deposits) and Section 16600 et. seq. (savings and loans association and credit union deposits).

Commercial Paper – Commercial paper must be rated "Prime" quality as defined by a nationally recognized statistical rating organization utilized by the State Treasurer's Investment Division and must be issued by a federally or state-chartered bank or a state-licensed branch of a foreign bank, corporation, trust, special purpose corporation, or limited liability company approved by the PMIB. Furthermore, these entities must be either (1) organized and operating within the United States and have total assets in excess of five hundred million dollars ($500,000,000) or (2) must be organized within the United States and have program wide credit enhancements, including, but not limited to, overcollateralization, letters of credit, or surety bonds. The approved investments will be regularly posted to the STO website.

Corporate Bonds/Notes – Securities must be issued by corporations (including banks) organized and operating within the United States and shall be within the top three ratings of a nationally recognized statistical rating organization utilized by the State Treasurer's Investment Division. The approved investments will be regularly posted to the STO website.

Foreign Government Bonds/Notes – Must be direct obligations of the government of a foreign country that the International Monetary Fund lists as an advanced economy and for which the full faith and credit of that country has been pledged for the payment of principal and interest. In addition, the securities must be rated investment grade or its equivalent, or better, by a nationally recognized statistical rating organization.

Money Market Mutual Funds – The money market mutual funds must invest in U.S. Treasury Securities, Agencies, Repurchases, or Reverse Repurchases as described by this Policy. The financial institutions issuing the shares must have at least five years of investment experience in these funds and have at least $10 billion in assets under management. In addition, money market mutual funds must have attained the highest ranking, or the highest letter and numerical rating provided by not less than two nationally recognized statistical rating organizations utilized by the State Treasurer's Investment Division.

Negotiable Order of Withdrawal (NOW) Accounts – The NOW will act as an intra-day cushion to accommodate unexpected cash flow irregularities. In lieu of late sales to cover unexpected increases in disbursements, or in lieu of late investment limitations to cover unexpected increases in revenues, the NOW will provide pre-market and postmarket liquidity and investment flexibility. Institutions must be rated average or better by a nationally recognized statistical rating organization utilized by the State Treasurer's Investment Division and must pass a credit evaluation by the investment staff. All other conditions, regulations, or requirements associated with demand and time deposits will also apply.

Repurchases (RP) and Reverse Repurchases (RRP) – Repurchases and reverse repurchases are only done with an established and well-capitalized broker-dealer. A signed Security Loan Agreement and/or General Repurchase Agreement must be on file. A Repurchase Agreement may be either the STO General Agreement or Bond Market Association Standard Agreement.

U.S. Treasury Securities – U.S. Treasury Securities are backed by the full faith and credit of the Federal Government. Treasury Bills are maintained for liquidity, trading, and yield enhancement as the underlying security in a Reverse Repurchase transaction. Treasury strips and full coupon securities are purchased for average maturity preservation, liquidity, and trading.

Reporting

In accordance with Government Code section 16480.7, the State Treasurer is required to prepare and submit a monthly report of investment activity.

In accordance with Government Code section 16481.2(b), the State Treasurer is required to prepare and submit a quarterly report of investment holdings and market valuation to the PMIB.

Authorized Broker-Dealer

The State Treasurer shall transact business with a broker-dealer that meet the qualification criteria established by the State Treasurer. Investment staff will annually review each broker-dealer to ensure they are qualified. Investment staff is permitted to deal directly with the issuers of any securities that are authorized for purchase and meet all the qualifications of this policy.

Glossary

Agencies – Securities issued or guaranteed by U.S. federal government agencies and by government-sponsored enterprises (GSEs)—corporations created by Congress to foster a public purpose, such as affordable housing. Bonds issued or guaranteed by federal agencies are backed by the full faith and credit of the U.S. government.

Banker's Acceptance –Short-term credit investments created by a non-financial firm and guaranteed by a bank to make payment. Acceptances are traded at discounts from face value in the secondary market. Banker's acceptances are considered very safe instruments and are used extensively in foreign trade.

Bank Notes – Senior, unsecured promissory notes issued in the United States on either an underwritten or continuously-offered basis by domestic commercial banks. Bank Notes are very similar to CDs, represent senior debt of the bank that are on equal footing with all other senior obligations of the bank, except deposit liabilities or obligations that are secured or subject to any priorities or preferences.

Certificates Of Deposit (CD) – Issued by commercial banks and thrift institutions against funds deposited for specified periods of seven days or longer and earn specific rates of interest. Major banks and thrifts also issue variable rate CDs with maturities of up to five years. Variable rates are adjusted every 30, 90, or 180 days, and usually include a fixed spread to the benchmark rate for major bank CDs, as compiled and published by the Federal Reserve Bank of New York. Yankee CDs, also authorized by statute, are U.S. dollar-denominated CDs issued by foreign banks domiciled in the United States. Australian, Canadian, French, German, Japanese, Nordic, Swiss, and UK banks are active issuers of Yankee CDs.

Commercial Paper – Short-term discounted obligations with maturities ranging from one to 270 days issued by banks, corporations and limited liability companies. Commercial Paper can be issued directly or through a broker. Commercial paper is the only authorized investment with restrictions pertaining to the amount eligible for investments.

Corporate Bonds – Debt securities issued by a company instead of a government. Corporate bonds are a major way companies raise funds for their operations or for a specific project. The risk of a corporate bond for a bondholder depends on the creditworthiness of the issuing company.

Foreign Government Bonds/Notes – A bond issued in a domestic market by a foreign government in the domestic market's currency as a means of raising capital and to pay for services or other obligations.

Money Market Mutual Funds – A mutual fund that invests in highly liquid, near-term instruments and are considered low-risk investments that can be suitable for short-term investment goals.

Negotiable Order of Withdrawal (NOW Account) – A deposit account that pays interest on which checks may be written and are offered by commercial banks, mutual savings banks, and savings and loan associations.

Real estate mortgage investment conduits (REMICs) – A special purpose vehicle used to pool mortgage loans and issue mortgage-backed securities (MBS). Real estate mortgage investment conduits hold commercial and residential mortgages in trust and issue interests in these mortgages to investors. REMICs piece together mortgages into pools based on risk and issue bonds or other securities to investors.

Repurchase Agreements (Repo) – Consists of two simultaneous transactions. One is the purchase of securities by an investor from a bank or dealer. The other is the commitment by the bank or dealer to repurchase the securities at the same price at some mutually agreed upon future date. Most transactions are for maturities from one to three days.

Reverse Repurchases (Reverse Repo) –Matched sales-purchase agreements that are the opposite of a Repurchase Agreement. In this instance, the investor is the owner of the collateral, and the bank or dealer is the lender of money.

Supranationals – US dollar denominated debt obligations issued by entities formed by two or more central governments to promote economic opportunity for the member countries.

Time Deposits – Interest-bearing deposits with specific maturities negotiated with California banks, savings and loans and credit unions. These deposits are secured by collateral pledged by the financial institution and in compliance with the Government Code. Required collateralization levels are monitored on a regular basis. In addition, financial institutions are evaluated for credit criteria.

U.S. Treasury Bills – A short-term (maturities up to a year), discounted government security (secured by the full-faith and credit of the U.S. government) sold through competitive bidding at weekly and monthly auctions. One-, three-, and six-month bills are auctioned weekly, and one-year bills monthly. Treasury bills are the most widely used of all government debt securities and are the primary instrument of Federal Reserve monetary policy.

U.S. Treasury Notes – Debt obligations of the U.S. government, issued at various schedules (monthly in most cases) and are intermediate securities with maturities from one to 10 years.

U.S. Treasury Strips – Originally issued by the U.S. Treasury in complete form as principal and interest obligations. Strips, or Zero Coupons as they are often referred, are the result of separating the interest obligation from the principal and trading the body of the bond and the individual coupon obligations as separate securities.