

Local Investment Policy

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GTOT Checklist



**Government Treasurers'
Organization of Texas**

- Objectives
 - Understand the difference between required elements of an investment policy under PFIA and “best practice”
 - Understand the 2017 legislative changes to PFIA and how to incorporate them into the policy
 - Understand other regulatory influences on investment policy maintenance
- **Government Treasurers' Organization of Texas**
- <https://gtot.unt.edu/>
- **GTOT Investment Policy Certification Program**
- <https://gtot.unt.edu/content/investment-policy-certification-program>

GTOT Checklist

- Policy Statement
 - “invest in a manner which will provide the highest rate of return with the maximum security”
 - “invest in a manner that will provide security and optimize interest earnings to the maximum extent possible”

Policy Statement

Policy statement emphasizing the guiding principles of the investment program and conformance to all statutes, rules and regulations governing the investment of public funds.

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- Scope
 - Should all funds be included in the investment policy?
 - Non-profit corporations
 - Deferred compensation and retirement funds
 - Endowment/donated funds (If separately managed under specified terms of use.)
 - Funds governed by additional authority (bond funds)
 - Pooled or separately invested?
 - “All funds are managed as a pooled fund group, referenced in this Policy as the City’s investment pool, with the exception of the following, which are managed as separately invested assets.”

Scope

List of funds covered by the policy. Funds can either be defined specifically as they are listed in the CAFR, or more generally (i.e. short-term operating funds). This section should also specify which funds, if any, are combined for investing purposes as a “pooled fund group”, and which funds are managed as “separately invested assets”, as defined in PFIA 2256.002(9).

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- General Objectives

- Watch for inconsistent objectives/guidelines!
 - Example: A maximum maturity of five years for individual investments and a maximum weighted average maturity of five years
- Include procedures to monitor rating changes and liquidation procedures for investments that have a minimum PFIA rating.
 - “Ratings shall be monitored using nationally recognized financial information sources, including actions published on rating agency websites. All prudent measures consistent with PFIA shall be taken to liquidate an investment that no longer has the minimum rating required by PFIA.”

General Objectives

Investment policy must primarily emphasize safety of principal, liquidity [PFIA 2256.005 (b)(2)], and yield [PFIA 2256.005 (b)(3)]. Policy includes procedures to monitor rating changes and liquidation of such investments consistent with [PFIA 2256.005 (b)(4)(F)].

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- Prudent Person Rule

- Include PFIA language protecting investment officers in addition to prudent person standard
- “...the governing body of the investing entity retains ultimate responsibility as fiduciaries of the assets of the entity”
- Determination of prudence based on the investment of all funds and consistency with the written investment policy

Prudent Person Rule

“Prudent Person” statement relating to the standard of care that must be exercised when investing public funds. PFIA 2256.006 (a-b)

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- Capability of Investment Management

- Suggested language: *The City shall provide periodic training in investments for the investment personnel through courses and seminars offered by professional organizations and associations in order to insure the quality and capability of the City's investment personnel making investment decisions in compliance with the PFIA.*

Capability of Investment Management

Investment policy must address quality and capability of investment management. PFIA 2256.005 (b)(3)

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- Ethics Disclosure and Conflicts of Interest

- PFIA requirements apply to investment officers
- "Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions."

Ethics Disclosure and Conflicts of Interest

Investment Policy must require the investment officer(s) to file a disclosure statement with the Texas Ethics Commission and the governing body if:

- a. the officer has a personal business relationship with a business organization offering to engage in an investment transaction with the City (as defined in 2256.005 (i)(1-3)); or
- b. the officer is related within the second degree by affinity or consanguinity, as determined under Chapter 573 of the Texas Government Code, to an individual seeking to transact investment business with the entity. PFIA 2256.005 (i)

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- Delegation of Investment Authority
 - If not included in the investment policy, request a copy of resolution

Delegation of Investment Authority

Investment Policy must designate one or more officers of the entity as the investment officer(s) responsible for the investment of its funds (does not apply to a state agency, local government, or investment pool for which an officer of the entity is assigned by law the function of investing funds).
PFIA 2256.005 (f)

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- Investment Training
 - Know the difference between state agency and local government requirements
 - Two-year training period consistent with local government's fiscal year
 - Does the policy include the correct number of training hours?
 - 10 hours of ongoing training reduced to 8 hours every two years for city and school district investment officers
 - Are the independent sources of investment training included in the investment policy?
 - If not, request a copy of the resolution

Investment Training

Training requirements can be viewed at <https://cpm.hps.unt.edu/training-requirements>. PFIA 2256.008

GTOT Checklist

- Investment Policy Certification

- HB 1701 (2017) limited presentation of investment policies to local government investment pools only
- Correct outdated provisions
 - Example: “preclude imprudent activities” instead of the more narrow “preclude transactions that are not authorized by the policy”
 - Example: “registered principal” as the required signatory of the certification instead of “qualified representative”

Signed Investment Policy Certification form

HB 1701 changes “person” to “business organization” and narrowly defines business organization as either an investment pool or an investment management firm under contract to manage the entity’s portfolio with discretionary authority. Very few investment management contracts for public funds grant such discretion, meaning investment pools will generally be the only organizations still required to sign this certification. This bill has all but killed the legal requirement for the policy certification. Public entities may wish to revise their investment policy as it seems likely that brokers, absolved of this legal requirement, may no longer be willing to sign those certifications.

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- Investment Policy Certification

Signed Investment Policy Certification form

Public entities should still provide their investment policy to their brokers, who in fact should be asking for it. Among other things, FINRA’s “Know Your Customer” rules, largely established by the suitability requirements of FINRA Rule 2111, require that brokers, “have a reasonable basis to believe that a recommendation is suitable for a particular customer based on that customer’s investment profile.” Providing the broker with your investment policy should very clearly describe your investment profile, particularly with regard to the primary objective of safety of principal.

Compliant certification includes acknowledging that the business organization has:

- a. received and reviewed the entity’s Investment Policy; and
- b. implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the entity and the organization that are not authorized by the entity’s Investment Policy, except to the extent that this authorization is dependent on an analysis of the makeup of the entity’s entire portfolio or requires an interpretation of subjective investment standards. PFIA 2256.005 (k-l)

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- Qualified Bidders List

- Most common errors

- Applying to all business organizations, including banks and investment pools
 - Not acknowledging in the policy that either the governing body or a designated investment committee approves the list followed by an annual review
 - Assigning responsibility for approving the list either to the CEO or the CFO

Establishment and annual review of qualified bidders list

Investment Policy must require either the entity's governing body, or its Investment Committee to, at least annually, review, revise, and adopt a list of qualified brokers that are authorized to engage in investment transactions with the entity. PFIA 2256.025

GTOT Checklist

- Independent Third-Party Safekeeping

- Most common errors

- Not addressing this "best practice"
 - Not applying to both securities owned by the investing entity and to collateral pledged to the investing entity
 - Not requiring a written agreement among the parties

Independent Third-Party Safekeeping

Securities and collateral will be held by a third party custodian designated by the entity, and held in the entity's name as evidenced by safekeeping receipts of the institution with which the securities are deposited.

GTOT Checklist

- Delivery vs. Payment
 - Must be included in investment policies

Delivery vs. Payment

Investment Policy must require “delivery vs. payment” (DVP) settlement of all transactions, except local government investment pool and mutual fund transactions. PFIA 2256.005 (b)(4)(E)

GTOT Checklist

- Competitive Bidding
 - Most common errors
 - Not addressing this “best practice”
 - Should be addressed if the investing entity includes securities on the list of authorized investments
 - Should be addressed if there is a need to establish that a market price was received in the investment of bond proceeds
 - Establish exceptions for certain types of transactions
 - Certificate of deposit included in the depository contract

Competitive Bidding

Investment Policy should require at least three competitive offers or bids for all individual security purchases and sales (excluding transactions with money market mutual funds, local government investment pools and when issued securities, which are deemed to be made at prevailing market rates).

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- Suitable and Authorized Investments
 - Most common errors
 - Outdated requirements such as restricting banks eligible to provide certificates of deposit to those “domiciled in Texas”
 - Not including the required ratings for investment types
 - Requiring a rating without considering appropriate exceptions
 - Not including all investment types in the list of authorized investments, including those used for sweep accounts and bond proceeds
 - Not including interest-bearing bank deposits that are insured by FDIC or NCUS Insurance Fund as authorized in 2017 by HB 1003 and HB 2647
 - Not including all investment types in the list of authorized investments in the application for GTOT investment policy certification

GTOT Checklist

- Suitable and Authorized Investments

Suitable and Authorized Investments

List the types of authorized investments in which the investing entity’s funds may be invested. Investments authorized by PFIA are listed in Sections 2256.009 – 2256.016 and Section 2256.019 – 2256.0201. It is recommended that investment descriptions be either directly quoted from PFIA and/or referenced to PFIA. Be sure to include minimum required ratings and maximum allowable stated maturities, where applicable. If Repurchase Agreements are an authorized investment, the policy should require execution of a “Master Repurchase Agreement”. Your policy may be more restrictive than PFIA and need not include every investment authorized by PFIA.
PFIA 2256.005 (b)(4)(A-B)

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- Suitable and Authorized Investments

Prohibited Investments

An entity may choose to prohibit certain investments that are authorized by PFIA. The Policy should either:

- a. list prohibited investments, including those specifically prohibited in PFIA 2256.009 (b)(1-4); or
- b. state only those investments listed in this section are authorized.

Effect of Loss of Required Rating

All prudent measures will be taken to liquidate an investment that is downgraded to less than the required minimum rating. PFIA 2256.021 (do we need to state this twice, it was added to General Objectives)

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- Collateral Policy – Most Common Errors

- Not addressing this requirement of the Public Funds Collateral Act, Chapter 2257, Government Code
- Not addressing all aspects of collateral management, i.e., margin, frequency of valuation, substitution procedure, eligible securities
- Limiting eligible collateral to authorized investments in the Policy

Collateral Policy

The governing body must approve a written policy relating to collateralization. It should be included in the Investment Policy and require collateralization for all uninsured collected balances, plus accrued interest, if any. In addition, the policy should address acceptance, substitution, release, and valuation of collateral. Collateral for Public Funds, Chapter 2257, Texas Government Code

GTOT Checklist

- **Diversification and Maximum Maturities**

- Is it enough to declare that diversification is a goal, or must we practice what we preach?
- Is action required if limits are exceeded?

Diversification and Maximum Maturities

Investment policy must address investment diversification, yield, and maturity. (Yield is normally addressed under General Objectives following primary objectives of safety of principal and liquidity.)
PFIA 2256.005 (b)(3)

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- **Investment Strategies**

- Weakest part of investment policies
- Check for inconsistency with the policy
 - Example: "Investment maturities shall be staggered throughout the budget cycle" but almost 100% is invested in pools
 - Strategy statement includes an investment not on the authorized list (ex.: flexible repurchase agreement)

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- Investment Strategies

Investment Strategies

The Investment Policy must require adoption by the governing body of a separate investment strategy for each of the funds, or group of funds, under its control. Each investment strategy must describe the investment objectives for the particular fund using the following priorities in order of importance:

- (1) understanding of the suitability of the investment to the financial requirements of the entity;
- (2) preservation and safety of principal;
- (3) liquidity;
- (4) marketability of the investment if the need arises to liquidate the investment before maturity;
- (5) diversification of the investment portfolio; and
- (6) yield (assign performance benchmarks as appropriate) PFIA 2256.005 (d)

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- Weighted Average Maturity for Pooled Fund Groups

- Does the policy include a statement that funds are/are not pooled?
- WAM is required if funds are pooled

Weighted Average Maturity for Pooled Fund Groups

If your entity combines funds as a “pooled fund group” for investing purposes, then the maximum dollar-weighted average maturity of the portfolio, based on the stated maturity date, must be included in your Investment Policy. PFIA 2256.005 (b)(4)(C)

GTOT Checklist

- Quarterly Investment Reporting
 - Refer to PFIA requirements instead of listing in the Policy

Quarterly Reporting

Investment Policy must require quarterly investment reports, prepared by the investment officer(s) and submitted to the governing body. Specific PFIA reporting requirements should be either included in your policy or referenced to PFIA. PFIA 2256.023

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- Review by Independent Auditor

Review by Independent Auditor

Quarterly reports must be formally reviewed at least annually by an independent auditor and reported to the governing body. (An entity is exempt from this review if it only invests in money market mutual funds, investment pools or accounts offered by its depository bank in the form of CDs or money market accounts.) PFIA 2256.023 (d)

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- Marking to Market
 - Methods to monitor the market price of investments
 - Watch for statements such as “market value shall be obtained from one of the approved brokers”

Marking to Market

The market value of the portfolio must be determined at least quarterly and included in the quarterly investment reports. The Investment Policy must include methods to monitor the market price of investments acquired with public funds (e.g. IDC, Bloomberg, etc.) PFIA 2256.005 b)(4)(D)

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- Internal Controls
 - PFIA compliance audit requirement
 - Establishment of internal controls
 - Assign responsibility for creating, implementing and maintaining an internal control system

Internal Controls

Investment Policy must require, in conjunction with its annual financial audit, a compliance audit of management controls on investments and adherence to the entity’s established investment policies (see 2256.005(n) for the requirement for state agencies). PFIA 2256.005 (m)

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- Exemption for Existing Investments

Exemption for Existing Investments

An entity is not required to liquidate investments that were authorized investments at the time of purchase. PFIA 2256.017

- Annual Review and Adoption of Investment Policy and Strategies

Annual Review and Adoption of Investment Policy and Strategies

Investment Policy must require the governing body to, not less than annually, adopt a written instrument stating that it has reviewed the Investment Policy and investment strategies and that the written instrument so adopted shall record any changes made to either the policy or strategies. PFIA 2256.005 (e)

Accounting and Audit Considerations

- Accounting:

- In general, governments are required to report their investments (assets held primarily to generate income or profit) at fair value (the amount the seller would be paid currently in a transaction between a willing buyer and willing seller):
 - interest-earning investment contracts
 - positions in external investment pools
 - positions in mutual funds
 - debt securities
 - equity securities, option contracts, stock warrants, and stock rights (if value is readily determinable)
- Auditors will look for documentation of credible 3rd party information supporting fair values
- Cost or amortized cost is appropriate for investments with current maturities real estate, venture capital limited partnerships, loans receivable, accounts receivable and restricted stock.

Accounting and Audit Considerations (continued)

- Required disclosures:
 - Participation in external investment pools
 - Information concerning realized gains and losses
 - Legal and contractual provisions governing investments
 - Investment policies
 - Exposure to custodial credit risk as of the date of the Statement of Position
 - Defaults and recovery of prior-period losses
 - Other credit risk exposure
- Be careful to ensure disclosures are appropriately tailored to consider changes from the previous year

Accounting and Audit Considerations (continued)

- Public Funds Investment Act compliance:
 - Annual approval of Investment Policy by Governing Board
 - Investment strategy included with investment policy
 - Quarterly reporting of investment cost and fair value information
 - Compliance with Investment Policy regarding authorized and unauthorized investments (considering diversification requirements)
 - Designated investment officers meeting continuing professional education requirements (many training budgets have been trimmed)
 - Use of approved brokers, including review of investment policy certification

Municipal Advisor Rule

- Effective July 1, 2014
- A municipal advisor includes any person (other than an employee of the municipality) providing advice to a municipality on the issuance of municipal securities.
- Persons who provide advice to a municipality on the investment of municipal bond proceeds are also considered municipal advisors.
 - Professionals who provide such advice generally but are not registered as municipal advisors may request written confirmation that the sources of the municipality's investments do not include proceeds of bonds or other municipal securities

SEC Money Market Mutual Fund Reform

- SEC-approved reforms became effective October 2016
 - Created a division between institutional prime and tax-exempt funds and the rest of the MMMF's by allowing a floating NAV and a combination of fees-gates
 - MMMF's that did not seek to maintain a \$1.00 NAV were no longer authorized investments under PFIA
 - HB 1003 (2017) incorporated SEC reforms into PFIA by removing \$1.00 NAV as a required stated objective of the fund
 - Substitutes compliance with SEC Rule 2a-7

Liquidity Coverage Ratio

- The Federal Reserve Board and the FDIC finalized a rule in September 2014 to strengthen the liquidity positions of large financial institutions, called the Liquidity Coverage Ratio or LCR
 - Hold high quality, liquid assets (HQLA) that can be converted easily and quickly into cash in an amount equal to or greater than its projected cash outflows minus its projected cash inflows during a 30-day stress period
 - HQLA does not include municipal securities

Additional Resources

- **Government Treasurers' Organization of Texas**
 - <https://gtot.unt.edu/>
- **GTOT Investment Policy Certification Program**
 - <https://gtot.unt.edu/content/investment-policy-certification-program>
- **Government Finance Officer's Association**
 - <https://www.gfoa.org/materials/investment-policy>
- **Association of Public Treasurers (US and Canada)**
 - <https://www.aptusc.org/investment-policy-certification>