

**Investment Program,
Investment Policy,
Investment Procedures Manual**



ILLINOIS MUNICIPAL
TREASURERS ASSOCIATION

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Topics

- Investment program
- Investment policy
- Investment procedures manual

GFOA Best Practice - Investment program

- Management and monitoring of investment activity
- Allows structure to set policy, make decisions, and safeguard the government's financial assets
- Fiduciary responsibility, regardless of size or type of government entity
- Components:
 - ✓ Develop investment leadership team
 - ✓ Identify funds used for investments and their characteristics
 - ✓ Review all Federal, State and Local laws and regulations
 - ✓ Establish a risk profile
 - ✓ Determine Portfolio Management Team (internal/external)
 - ✓ Create and use an investment policy

Why an investment program ?

*"Governments have a **fiduciary responsibility in managing their funds**, including the ongoing management and monitoring of investment activity. Developing a public funds investment program is essential to **effective financial management**, and it sets the **foundation** for creating protocols and internal controls, constructing and managing the portfolio, navigating changing economic conditions, and communicating information to stakeholders. While different types and sizes of governments require differing levels of complexity in their investment programs, all governments need to recognize their fiduciary responsibility. **Having an established public funds investment program provides structure to effectively set policy, make decisions, and safeguard a government's financial assets"***

GFOA Best Practice – Investment Program for Public Funds

Fiduciary duty requires investment program

"...fiduciaries subject to the prudent person standard...a fiduciary will act with care, skill, prudence, and diligence under the circumstances then prevailing...that a prudent person acting in a similar capacity and familiarity with those matters would use..."

Fiduciary duty

- Test of compliance is one of conduct, not performance
- Measures for evaluating compliance
 - ✓ Establish formalized investment policy
 - ✓ Compliance with policy
 - ✓ Prudent investment decisions
 - ✓ Best price trade executions
 - ✓ Diversification of risk
 - ✓ Strict avoidance of conflicts of interest

Fiduciary duty quiz

Case 1

❑ Treasurer of a city where staff has been halved. HR and IT have recently come under her purview. She is placing maturing CDs in the local government investment pool because she does not have the time to research the market. There are other higher-yielding investments.

?

Fiduciary duty quiz

Case 2

A socially active citizenry has influenced the City's investment policy so that it prohibits investing in U.S. Treasuries because they disagree with federal policy, even though U.S. treasury securities are considered risk-free and they provide great liquidity.

?

Fiduciary duty quiz

Case 3

An experienced investment officer for a fast-growing county has managed the portfolio in full compliance with the policy and executed all transactions on a competitive basis, but has underperformed the county's benchmark for two consecutive quarters.

?

Another quiz

What is one of the most important components of a public sector investment program?

- ✓ Relationship with your broker/dealer
- ✓ Investments you buy
- ✓ Luck
- ✓ Investment policy

Why an investment policy ?

*“An investment policy enhances the **quality of decision making** and demonstrates a **commitment to the fiduciary care of public funds**, making it the most important element in a public funds program.”*

GFOA Best Practice – Investment Policy

Investment policy

Why an investment policy?

- ✓ Drives the investment program
 - Legal & permitted activities
 - Who is in charge
 - What are you allowed to invest in
 - Who can you do business with
 - Relationship to counterparties
- ✓ Protection
 - Statutes
 - Authority, delegation
 - Oversight
- ✓ Dynamic process

GFOA Best Practice – Investment policy

Investment Policy

INTRODUCTION

An investment policy describes the parameters for investing government funds and identifies the investment objectives, guidelines, constraints for risk, investment, and operational matters, and how the investment program will be managed and reviewed. The document should only be a non-binding policy for the fund manager. The policy should specify the investment objectives, constraints, and other standards on investment guidelines and portfolio. An investment policy provides the basis of decision making and should serve as a framework to monitor and manage funds, making the investment manager a public funds investment program.

RECOMMENDATIONS

GFOA recommends that all governments establish a comprehensive written investment policy which should be adopted by the governing body. The investment policy should be reviewed and updated annually and should include statements on the following:

- Investment objectives:** State the investment objectives, including the risk, return, and asset allocation objectives. The policy should specify the public assets to be invested (e.g., direct investments, bond proceeds, government securities).
- Risk management:** Identify the risks of all assets included in the investment portfolio. This includes identifying the types of investments, the types of risks, and the types of assets. It should include the types of investments, the types of risks, and the types of assets. It should include the types of investments, the types of risks, and the types of assets.
- Asset allocation:** Identify the asset allocation objectives, including the types of investments, the types of risks, and the types of assets. It should include the types of investments, the types of risks, and the types of assets.
- Investment manager selection:** Identify the criteria for selecting an investment manager, including the types of investments, the types of risks, and the types of assets. It should include the types of investments, the types of risks, and the types of assets.
- Monitoring and reporting:** Identify the criteria for monitoring and reporting on the investment program, including the types of investments, the types of risks, and the types of assets. It should include the types of investments, the types of risks, and the types of assets.
- Reporting and disclosure:** Identify the criteria for reporting to the governing body and the public on the investment program, including the types of investments, the types of risks, and the types of assets. It should include the types of investments, the types of risks, and the types of assets.

Investment policy – APTUSC policy certification

Investment Policy Certification

APTUSC's Investment Policy Program provides publicly traded securities and real estate investment services to municipal governments across the United States. The program is designed to help municipalities improve their investment performance and reduce risk. The program is designed to help municipalities improve their investment performance and reduce risk. The program is designed to help municipalities improve their investment performance and reduce risk.

Certification Questions

- 1. How long does the certification process take?
- 2. What documents are required for certification?
- 3. How often does the certification need to be renewed?
- 4. What are the consequences of failing to renew the certification?
- 5. Can I certify multiple investment programs at once?
- 6. How do I contact APTUSC for more information?

Investment policy steps

How to create a policy

1. Examine state statutes
2. Examine collateral statutes
3. Sample/comparable entity investment policies
4. Draft investment policy
5. Have right parties review
6. Adopt by formal action of governing body
 - Resolution, ordinance
7. Review annually
8. Establish written investment procedures

Investment policy

- Must comply with state statutes
 - ✓ [\(30 ILCS 235\) Public Funds Investment Act](#),
 - ✓ [\(30 ILCS 225\) Public Funds Deposit Act](#),
 - ✓ [\(30 ILCS/350/\) Illinois Local Government Debt Reform Act](#)
- May be more conservative, but never less
- Typically, adopted by elected officials, updated annually

Starting with a sample



- Learn from your investing peers
- Remember your situation is unique
 - ✓ Cash-flows, risk tolerances and conditions vary
- Never adopt a boilerplate policy

Investment policy components

Components

<ul style="list-style-type: none">• Scope• Prudence• Objectives• Delegation of authority• Ethics / conflicts of interest• Financial partners• Investments• Pools, mutual funds• Collateralization	<ul style="list-style-type: none">• Safekeeping, custody• Diversification• Parameters - max maturities• Internal control• Performance standards• Reporting• Policy adoption
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Policy component - objectives


- ❑ Safety 
 - ✓ Preserving the principal is more critical than the return it might generate
- ❑ Liquidity 
 - ✓ Degree to which an asset can be bought/sold without affecting its price

Policy component - objectives

- ❑ Return – yield 

Policy component - objectives

- ❑ Public investors have a fiduciary duty to optimize return in the context of safety and liquidity



Be careful - do not be too vague or contradictory

Policy component - financial relationships

Relationships with financial institutions – banks, depositories, broker-dealers, custodians, investment advisers – are amongst the most important for the public treasurer:

- ✓ Access to information and advice/expertise
- ✓ Facilitate banking, investing, custody

The selection, engagement and on-going maintenance of all financial relationships is key.

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Policy component - financial relationships

Competitive procurement

- ✓ timely manner
 - may be mandated by statute, policy
 - procurement 3-5 years – best practice
- ✓ defined process
- ❑ Competition promotes “fairness”
 - ✓ vendors more likely to participate, support government
 - ✓ citizens and interested parties appreciate government’s care of their monies
- ❑ Competition enhances government knowledge
 - ✓ technical
 - ✓ pricing

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Financial relationships

Competitive procurement process

- ✓ Inventory current usage and consider needs
- ✓ Create RFP/RFQ/RFI
- ✓ Develop scoring matrix
- ✓ Identify potential respondents and distribute RFP
- ✓ Field questions
- ✓ Review proposals
 - technical
 - pricing
- ✓ Interview candidates
- ✓ Governing body approval process
- ✓ Ensure contract exemplifies GFOA best practice

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Banks

- Governments use wide variety of banking services for deposits, disbursement, investing, safekeeping
- Continual technology changes, treasury management practices, and banking industry structure, evolving statutes give public funds managers reasons to reevaluate banking services/costs

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Broker-dealers

- Suitability responsibility
- Fees – what, how are you paying
- Have at least three – generate some transparency

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Portfolio management is risk management

- Greater an investor's exposure to properly diversified risk, higher expected return over time

BUT

- Greater an investor's exposure to risk, higher volatility from period to period

Think about your risk – what you can "handle"

Understand and manage risk

Know your risks

- Interest rate risk – the value of your securities falls when rates rise
- Credit risk – loss of all or some of your P&I due to inability or perception of inability to pay back
- Liquidity risk – you do not have adequate liquidity in the portfolio and have to sell
OR
not able to turn your securities to cash
- Reputational risk – YOU ARE DONE!

Manage or mitigate risk

- Establish risk profile
- Use profile to determine limits –
- Diversification can be achieved by investing in variety of securities with dissimilar risk characteristics
 - ✓ Maturity distribution
 - ✓ Sector allocation
 - ✓ Issuer allocation
 - ✓ Structures

Diversification as a risk mitigant



Diversification as a risk mitigant



Investment procedures manual



Investment procedures

- Selecting financial institutions
- Collateralization
- Diversification requirements
- Safekeeping procedures
- Reports (who, what, when)
- Investment flowchart – decision-making, duties
- Security selection process

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Investment procedures – Internal Controls

- Segregation of duties (ie transactions and bookkeeping)
- Compensating controls
- DVP in safekeeping
- Delegation of subordinates
- Written transaction records and confirmations
- Dual authorization on wires
- Continuing Education
- Maintenance and monitoring of procedures

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Investment procedures

- Documents
 - ✓ Governing statutes
 - ✓ Code of Ethics
 - ✓ Agreements
 - Safekeeping
 - Bank
 - ✓ Broker questionnaires
 - ✓ Due diligence checklists
 - ✓ Sample reports

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Documents

- Enabling legislation links
- Bank agreement
- Collateralization agreement
- Safekeeping agreement
- Investment adviser agreement

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Authorized investment support

- Monitoring Credit Rating
 - ✓ Credit ratings should be monitored at least monthly
 - ✓ What action will be taken
 - Disclosure
 - Immediately liquidate or consider conditions
- Monitoring FDIC Status
 - ✓ Check on FDIC status for your CDs in a bank's merger/acquisition
 - ✓ Officer should monitor at least each Friday
 - ✓ What action will be taken
 - Immediate liquidation

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Banks

- Do full treasury management inventory/review prior to RFP
- Weigh costs
- Direct fees, compensating balances, blend
- Undertake cost/benefit analysis
- Identify primary relationship manager
- Use contract


Collateralization

- ❑ A key safeguard for public funds
 - ✓ through pledging
 - appropriate securities
 - other instruments
 - ✓ surety bonds
 - ✓ letters of credit
- ❑ State statute
- ❑ Federal rules
 - ✓ is in writing
 - ✓ was approved by BOD or loan committee
 - ✓ an official record

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Collateralization

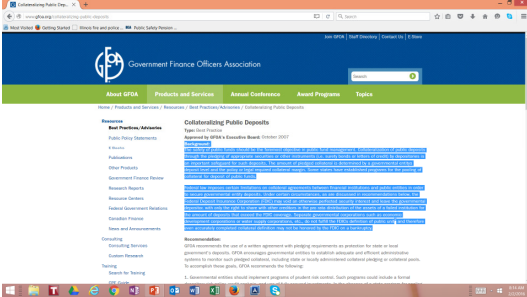
- ❑ FDIC
 - ✓ Federal deposit insurance is NOT determined on a per-account basis.
 - ✓ All "time and savings deposits" and all "demand deposits" owned by a public entity in an insured in-state bank are added up together and insured up to \$250,000.
 - ✓ \$250,000 applies to the face amount + accrued interest.



FEDERAL DEPOSIT INSURANCE CORPORATION

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Collateralization



The screenshot shows the Government Finance Officers Association (GFOA) website. The main content area is titled "Collateralizing Public Deposits" and includes a "Type Your Query" section with a search bar. Below this, there are several links and a detailed paragraph explaining the GFOA's recommendations for public entities regarding collateralization. The paragraph states that GFOA recommends the use of a written agreement with pledging requirements as protection for state or local government's deposits. It also mentions that GFOA encourages governmental entities to establish separate and distinct administrative systems to monitor such pledged collateral, including state or locally administered collateral pledging or collateral pools. A note at the bottom of the page indicates that Government entities should implement programs of prudent risk control, and such programs could include a formal collateral management process.

Collateralization

- ❑ Pledged collateral
 - ✓ held at 3rd party
 - ✓ evidenced by written agreement
 - ✓ marked-to-market at least monthly
 - ✓ substitutions should meet
 - requirements of agreement
 - be approved in writing prior to release
 - not released until replacement collateral received
 - ✓ reporting directly from custodian

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Collateralization issues

- ❑ More things to think about
 - ✓ what is acceptable collateral?
 - define acceptable and authorized securities
 - include in policy, RFPs, and contracts
 - ✓ is there enough of it?
 - margin of 102%*
 - monthly market value reports
 - has it been called?
 - downgrade?
 - ✓ is the collateral mine?
 - safekeeping receipts and reports
 - calls? Substitutions?

Collateralization procedures

- ✓ Reports

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What is a broker/dealer?

- ❑ Two separate functions
 - ✓ Brokers
 - Bring buyers and sellers together
 - Don't take positions
 - ✓ Dealers
 - Take positions
 - Inventory

Some firms perform both functions – others specialize

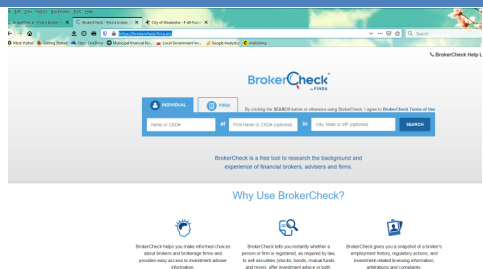
Broker/dealer selection

- ❑ What are policy requirements?
 - ✓ Investment objectives determine needs
 - ✓ Local vs. non-local
 - ✓ Primary vs. second tier vs. brokers
 - ✓ Banks? Your lead bank? Your safekeeping bank?
 - ✓ How many brokers?

Broker/dealer selection

- ❑ Due diligence
 - ✓ Broker-dealer Request for Information (RFI)/questionnaire
 - ✓ Certification
 - ✓ References
 - ✓ Capital adequacy – NY Fed for Primaries
 - ✓ [FINRA BrokerCheck](#)
 - ✓ [SIPC \(Securities Investor Protection Corporation\)](#)
 - ✓ State licensing
 - ✓ Certified audited financials

Selecting broker/dealers

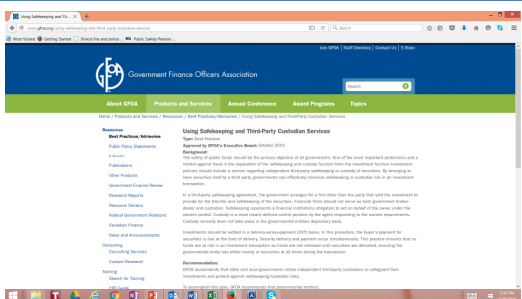


Safekeeping and third-party custody

- ❑ A firm other than the party that sells the investment provides transfer and safekeeping of the security.
- ❑ Financial firms should not serve as both broker-dealer and custodian.
- ❑ Investments should be settled in a delivery-versus-payment (DVP) basis.

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Policy component – safekeeping



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Safekeeping and third-party custody

- Select safekeeping agents/custodians by competitive procurement (RFP) periodically
- Evidence safekeeping/custodial relationship with signed, written security agreement
 - ✓ reviewed by counsel
 - ✓ establishes firm as agent
- Designate specific DDA (demand deposit account) clearing account

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Safekeeping services

- Settlement of security transactions
- Depository for physical & book-entry securities
- Receive payments
 - ✓ Interest income
 - ✓ Sold, matured and called securities
- Provide advice (safekeeping receipt) of investment transactions
- Monthly statements
 - ✓ Securities held
 - ✓ Account activity
- Valuation

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Safekeeping services

Optional

- Customized services
 - ✓ Portfolio reporting
 - ✓ Variety of cash sweep options
 - ✓ Potential for on-line capabilities
 - ✓ Securities lending
- Other negotiated services

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Safekeeping services

- ❑ Settlement
 - ✓ DTC physically holds certificates
 - ✓ Maintains records of ownership digitally
 - ✓ Security transferred via book entry vs. money

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graph LR; Entity --> EntityBank[Entity's Bank]; EntityBank <--> DTC[Depository Trust Company]; DTC <--> BrokerDealer[Broker/Dealer]; BrokerDealer --> DealerBank[Dealer's Clearing Bank];
```

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Safekeeping services

DVP - Strongly recommend delivery vs payment **ONLY**

- ✓ Delivered to your custodian who is your agent
- ✓ Perfected ownership
- ✓ In your control through your custodian

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Your questions

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