



HISTORIC  
FRANKLIN  
TENNESSEE

ITEM #9  
FINANCE  
07-11-11

## MEMORANDUM

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June 30, 2011

TO: Board of Mayor and Aldermen

FROM: Eric Stuckey, City Administrator  
Russ Truell, ACA/CFO

SUBJECT: Minor Text Changes to Investment Policy

### **Purpose**

The purpose of this item is to report the need for some minor text changes to the City's Investment Policy for non-pension assets.

### **Background**

The Board of Mayor & Aldermen approved an investment policy for the City's non-pension assets in 2004. Periodically, the Finance Committee has reviewed the policy and elected not to make any substantial changes.

The City's policy is based heavily on the model investment policy recommended by the Government Finance Officers Association of the U.S. and Canada. At a recent meeting of the GFOA Treasury & Investment Management Committee, some text changes and language updates were made to the model policy. Maintaining consistency with the national model will require incorporation of those policy adjustments to the City's investment policy.

### **Recommendation**

It is the recommendation of City staff that the Committee instruct staff to incorporate model investment policy changes to the Franklin investment policy and bring the amended document back for adoption at the August meeting.

**Version**

**1.0**

INVESTMENT POLICY

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For Reserves and Temporarily Idle Funds

City of Franklin

CITY OF FRANKLIN

# **Investment Policy**

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Submitted June 29, 2004

Adopted by Finance Committee, July 6, 2004

Adopted by Board of Mayor & Aldermen, July 13, 2004

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# **I. GFOA Sample Investment Policy As Source Document**

This investment policy is derived from the model investment policy created by the Government Finance Officers Association (GFOA) to aid its general membership in the preparation of an investment policy. The sample policy was intended to help cities that invest to customize a policy to fit their particular needs, constraints and capabilities.

The Finance Department staff has amended and supplemented the sample policy to adjust for the goals and objectives of the City of Franklin and those circumstances that are unique to the City. These circumstances include: budget size, composition of departments, cash flow needs to support city services, current fund balance, current and estimated future demands for reserves, and market equilibrium.

The use of this sample policy as a foundation is intended to give a standardized presentation to the City policy, and to make certain that those issues identified at the national level as significant are included.

Management of the procedural details of investment of public funds is delegated to the Finance Department.

## II. Governing Authority

The investment program shall be operated in conformance with federal, state, and other legal requirements, including TCA 6-56-106, titled Authorized Investments, which governs the investment of public funds by cities and towns. (Appendix A)

## III. Scope

This policy applies to the investment of all funds, excluding the investment of the City of Franklin retirement funds. Retirement funds and proceeds from certain bond issues, as well as separate foundation or endowment assets, are covered by a separate policy.

### *1. Pooling of Funds*

Except for cash in certain restricted and special funds, the City will consolidate cash and reserve balances from all funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

### *2. Special Funds*

Those funds that are considered restricted and special funds are: City of Franklin Employee Retirement Fund, Adequate Facilities Tax Fund, Road Impact Fund, Stormwater Fund, and retainage accounts.

## IV. General Objectives

The primary objectives, in order of priority, of investment activities shall be safety, liquidity, and yield.

### 1. *Safety*

Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate credit risk and interest rate risk.

#### a. *Credit Risk*

The City will minimize credit risk, which is the risk of loss due to the failure of the security issuer or backer, by:

Limiting investments to the types of securities listed in Section VIII of this Investment Policy;

Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisers with which the City will do business in accordance with Section VI;

Diversifying the investment portfolio so that the impact of potential losses from any one type of security or from any one individual issuer will be minimized.

#### b. *Interest Rate Risk*

The City will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates, by:

Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity;

Investing operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools and limiting the average maturity of the portfolio in accordance with this policy.

### 2. *Liquidity*

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the

portfolio so that securities mature concurrent with cash needs to meet anticipated demands (static liquidity). Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity). Alternatively, a portion of the portfolio may be placed in money market mutual funds, bank repurchase agreements, or local government investment pools, which offer same-day liquidity for short-term funds.

### 3. *Yield*

The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The core of investments is limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall generally be held until maturity with the following exceptions:

A security with declining credit may be sold early to minimize loss of principal;

A security swap would improve the quality, yield, or target duration in the portfolio;

Liquidity needs of the portfolio require that the security be sold.

The City's cash management portfolio shall be designed with the objective of regularly meeting or exceeding a performance benchmark, such as the average return on three-month U.S. Treasury bills, the state investment pool, or the average rate on Fed funds, whichever is higher. These indices are considered benchmarks for lower risk investment transactions and therefore comprise a minimum standard for the portfolio's rate of return. The investment program shall seek to augment returns above this threshold, consistent with risk limitations identified herein and prudent investment principles.

### 4. *Local Considerations*

The City of Franklin seeks to promote local economic development through various programs and activities. Included is a program of rewarding local financial institutions that increase their commitments to private economic growth and local housing investment.

The City may accept a proposal from an eligible institution that provides for a reduced rate of interest provided that such institution documents the use of deposited funds for community development projects.

The Board of Mayor and Aldermen recognizes that a Linked Deposit Program might diminish short-term investment yields by up to 10 basis points in exchange for potential expansion of the tax base.

## V. Standards of Care

### 1. *Prudence*

The standard of prudence to be used by investment officials shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio.

Investment officers acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and the liquidity and the sale of securities are carried out in accordance with the terms of this policy.

The "prudent person" standard states that "investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived."

### 2. *Ethics and Conflicts of Interest*

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the City.

### 3. *Delegation of Authority*

Authority to manage the investment program is granted to Finance Director, hereinafter referred to as investment officer. Responsibility for the operation of the investment program is hereby delegated to the investment officer, who shall act in accordance with established written procedures and internal controls for the operation of the investment program consistent with this investment policy. Procedures should include references to: safekeeping, delivery vs. payment, investment accounting, repurchase agreements, wire transfer agreements, and collateral/depository



agreements. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the investment officer. The investment officer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

## **VI. Authorized Financial Institutions, Depositories, and Broker/Dealers**

### *1. Authorized Financial Institutions, Depositories, and Broker/Dealers*

A list will be maintained of financial institutions and depositories authorized to provide investment services. In addition, a list will be maintained of approved security broker/dealers selected by creditworthiness (e.g., a minimum capital requirement of \$10,000,000 and at least five years of operation). These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).

All financial institutions and broker/dealers who desire to become qualified for investment transactions must supply the following, as appropriate:

Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines;

Proof of National Association of Securities Dealers (NASD) certification (not applicable to Certificate of Deposit counterparties);

Proof of state registration;

Completed broker/dealer questionnaire (not applicable to Certificate of Deposit counterparties);

Certification of having read and understood and agreeing to comply with the City's investment policy;

Evidence of adequate insurance coverage.

An annual review of the financial condition and registration of all qualified financial institutions and broker/dealers will be conducted by the investment officer.

## *2. Minority and Community Financial Institutions*

From time to time, the investment officer may choose to invest in instruments offered by minority and community financial institutions. In such situations, a waiver to certain parts of the above criteria may be granted. All terms and relationships will be fully disclosed prior to purchase and will be reported to the Budget and Finance Committee on a regular basis and should be consistent with state or local law.

# **VII. Safekeeping and Custody**

## *1. Delivery vs. Payment*

All trades of marketable securities will be executed by delivery vs. payment (DVP) to ensure that securities are deposited in an eligible financial institution prior to the release of funds.

## *2. Safekeeping*

Securities will be held by a centralized independent third-party custodian selected by the City as evidenced by safekeeping receipts in the City's name. The safekeeping institution shall annually provide a copy of their most recent report on internal controls (Statement of Auditing Standards No. 70, or SAS 70).

## *3. Internal Controls*

The investment officer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft or misuse. Details of the internal controls system shall be documented in an investment procedures manual and shall be reviewed and updated annually. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived and (2) the valuation of costs and benefits requires estimates and judgments by management.

The internal controls structure shall address the following points:

Control of collusion

Separation of transaction authority from accounting and record keeping

Custodial safekeeping

Avoidance of physical delivery securities

Clear delegation of authority to subordinate staff members

Written confirmation of transactions for investments and wire transfers

Dual authorizations of wire transfers

Development of a wire transfer agreement with the City's lead bank and third-party custodian

The investment officer shall make certain that the internal controls are reviewed by the Finance committee and with the independent auditor. The controls shall be designed to prevent the loss of public funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of the City.

## **VIII. Suitable and Authorized Investments**

### *1. Investment Types*

Consistent with the GFOA Policy Statement on State and Local Laws Concerning Investment Practices, the following investments will be permitted by this policy and are those defined by state and local law where applicable:

U.S. Treasury obligations, which carry the full faith and credit guarantee of the United States government and are considered to be the most secure instruments available;

U.S. government agency and instrumentality obligations that have a liquid market with a readily determinable market value;

Canadian government obligations, if allowed by State law (payable in local currency);

Certificates of deposit and other evidences of deposit at financial institutions,

Bankers' acceptances;

Commercial paper, rated in the highest tier (e.g., A-1, P-1, F-1, or D-1 or higher) by a nationally recognized rating agency;

Investment-grade obligations of state, provincial and local governments and public authorities;

Repurchase agreements whose underlying purchased securities consist of the aforementioned instruments;

Money market mutual funds regulated by the Securities and Exchange Commission and whose portfolios consist only of dollar-denominated securities; and

Local government investment pools either state-administered or developed through joint powers statutes and other intergovernmental agreement legislation.

Investment in derivatives of the above instruments shall require authorization by the Finance Committee.

## *2. Collateralization*

In accordance with State law (TCA 9-4-105) and the GFOA Recommended Practices on the Collateralization of Public Deposits, full collateralization will be required on all demand deposit accounts, including checking accounts and non-negotiable certificates of deposit, except in the following instances: 1) when the institution issuing the certificate of deposit belongs to the State of Tennessee Collateral Pool, or 2) in the case where CDRS (Certificate of Deposit Account Registry Services) are used in lieu of collateralization.

## *3. Repurchase Agreements*

Repurchase agreements shall be consistent with GFOA Recommended Practices on Repurchase Agreements.

# IX. Investment Parameters

## 1. *Diversification*

It is the policy of the City to diversify its investment portfolios. To eliminate risk of loss resulting from the over-concentration of assets in a specific maturity, issuer, or class of securities, all cash and cash equivalent assets in all City funds shall be diversified by maturity, issuer, and class of security. Diversification strategies shall be determined and revised periodically by the investment committee/investment officer for all funds except for the employee retirement fund.

The investments shall be diversified by:

limiting investments to avoid over concentration in securities from a specific issuer or business sector (excluding U.S. Treasury securities),

limiting investment in securities that have higher credit risks,

investing in securities with varying maturities, and

continuously investing a portion of the portfolio in readily available funds such as local government investment pools (LGIPs), money market funds or overnight repurchase agreements to ensure that appropriate liquidity is maintained in order to meet ongoing obligations.

In establishing specific diversification strategies, the following general policies and constraints shall apply:

Portfolio maturities shall be staggered to avoid undue concentration of assets in a specific maturity sector. Maturities selected shall provide for stability of income and reasonable liquidity.

For cash management funds, liquidity shall be assured through practices ensuring that the next disbursement date and payroll date are covered through maturing investments or marketable U.S. Treasury bills.

Positions in securities having potential default risk (e.g., commercial paper) shall be limited in size so that in case of default, the portfolio's annual investment income will exceed a loss on a single issuer's securities.

Risks of market price volatility shall be controlled through maturity diversification such that aggregate price losses on instruments with maturities exceeding one year shall not be greater than coupon interest and investment income received from the balance of the portfolio.

The investment committee/investment officer shall establish strategies and guidelines for the percentage of the total portfolio that may be invested in securities other than repurchase agreements, Treasury bills or collateralized certificates of deposit. The committee shall conduct a quarterly review of these guidelines and evaluate the probability of market and default risk in various investment sectors as part of its considerations.

## *2. Maximum Maturities*

To the extent possible, the City shall attempt to match its investments with anticipated cash flow requirements.

Unless matched to a specific cash flow, the City will not directly invest in securities maturing more than four (4) years from the date of purchase, in accordance with state statutes and local ordinances. The City shall adopt weighted average maturity limitations (ranging from 90 days to 3 years), consistent with the investment objectives.

Reserve funds and other funds with longer-term investment horizons may be invested in securities exceeding four (4) years if 1) the maturities of such investments are made to coincide as nearly as practicable with the expected use of funds, 2) the intent to invest in securities with longer maturities are disclosed in writing and approved by the Finance Committee, and 3) the investment is approved by the Office of the Comptroller

Because of inherent difficulties in accurately forecasting cash flow requirements, a portion of the portfolio should be continuously invested in readily available funds such as local government investment pools, money market funds, or overnight repurchase agreements to ensure that appropriate liquidity is maintained to meet ongoing obligations.

## *3. Competitive Bids*

The investment officer shall obtain competitive bids from at least two brokers or financial institutions on all purchases of investment instruments purchased on the secondary market.

# X. Reporting

## 1. *Methods*

The investment officer shall prepare an investment report at least quarterly, including a management summary that provides an analysis of the status of the current investment portfolio and the individual transactions executed over the last quarter. This management summary will be prepared in a manner which will allow the City to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report should be provided to the City Administrator, the Board of Mayor and Aldermen, the Finance Committee. The report will include the following:

Listing of individual securities held at the end of the reporting period.

Realized and unrealized gains or losses resulting from appreciation or depreciation by listing the cost and market value of securities over one-year duration that are not intended to be held until maturity (in accordance with Governmental Accounting Standards Board (GASB) requirements).

Average weighted yield to maturity of portfolio on investments as compared to applicable benchmarks.

Listing of investment by maturity date.

Percentage of the total portfolio which each type of investment represents.

Each quarterly report shall indicate any areas of policy concern and suggested or planned revision of investment strategies. The report shall explain the quarter's total investment return and compare the return with budgetary expectations. The report shall be in compliance with state law and shall be distributed to the investment committee and others as required by law. Copies shall be transmitted to the independent auditor.

Within 40 days of the end of the fiscal year, the investment officer shall present a comprehensive annual report on the investment program and investment activity. The annual report shall include 12-month and separate quarterly comparisons of return and shall suggest policies and improvements that might be made in the investment program. Alternatively, this report may be included within the City annual Comprehensive Annual Financial Report.

## *2. Performance Standards*

The City's cash management portfolio shall be designed with the objective of regularly meeting or exceeding a selected performance benchmark, which could be the average return on three-month U.S. Treasury bills, the state investment pool, a money market mutual fund or the average rate of Fed funds. These indices are considered benchmarks for lower risk investment transactions and therefore comprise a minimum standard for the portfolio's rate of return.

## *3. Marking to Market*

The market value of the portfolio shall be calculated at least quarterly and a statement of the market value of the portfolio shall be issued at least quarterly. This will ensure that review of the investment portfolio, in terms of value and price volatility, has been performed consistent with the GFOA Recommended Practice on "Mark-to-Market Practices for State and Local Government Investment Portfolios and Investment Pools."

# **XI. Policy Considerations**

## *1. Exemption*

Any investment currently held that does not meet the guidelines of this policy shall be exempted from the requirements of this policy. At maturity or liquidation, such monies shall be reinvested only as provided by this policy.

## *2. Amendments*

This policy shall be reviewed on an annual basis. Any changes must be approved by the investment officer and the Finance Committee, as well as being reviewed by the individuals charged with maintaining internal controls.



### *Approval of Investment Policy*

on an annual basis.

The investment policy shall be formally approved and adopted by the governing body of the City and reviewed

## **XII. List of Attachments and Other Documentation**

The following documents are attached to this policy:

Appendix A: Investments authorized by State statute;

Appendix B: Collateralization required by State statute;

Appendix C: City ordinance on deposits and investments

## **GFOA Sample Investment Policy**

### **I. Introduction**

The intent of the Investment Policy of [entity] is to define the parameters within which funds are to be managed. In methods, procedures and practices, the policy formalizes the framework for the [entity's] investment activities that must be exercised to ensure effective and judicious fiscal and investment management of the [entity's] funds. The guidelines are intended to be broad enough to allow the investment officer to function properly within the parameters of responsibility and authority, yet specific enough to adequately safeguard the investment assets.

### **II. Governing Authority**

The investment program shall be operated in conformance with federal, state, and other legal requirements, including *[insert applicable citations governing the investment of public funds]*.

### **III. Scope**

This policy applies to activities of [entity] with regard to investing the financial assets of all funds. In addition, funds held by trustees or fiscal agents are excluded from these rules; however, all funds are subject to regulations established by the state of *[insert applicable state]*. The covered funds, and any new funds created by the [entity], unless specifically exempted by the oversight board and this policy, are defined in the [entity's] Comprehensive Annual Financial Report.

Note that any excluded funds such as employee retirement funds, proceeds from certain bond issues and foundation or endowment assets are covered by a separate policy/ies. *[This section should be modified to specify excluded assets. This can be removed if it is not applicable to the entity.]*

Except for funds in certain restricted and special funds, the [entity] commingles its funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles. *[This paragraph refers to the pooling of funds within a single governmental entity and implies no reference to local government investment pools]*

### **IV. General Objectives**

The primary objectives, in priority order, of investment activities shall be:

#### *1. Safety*

Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The goal will be to mitigate credit risk and interest rate risk.

#### *2. Liquidity*

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated.

#### *3. Return*

The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints of safety and liquidity needs.

#### *4. Special Considerations*

Where possible, funds may be invested for the betterment of the local economy or that of local entities within the State.

#### *Alternative sample language:*

The [entity] seeks to promote local economic development through various programs and activities.

Included is a program of rewarding local financial institutions that increase their commitments to private economic growth and local housing investment.

*[This objective is intended to cover any unique objectives an entity may wish to achieve.]*

### **V. Standards of Care**

#### *1. Prudence*

The standard of prudence to be used by investment officials shall be the “prudent person” standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal liability for an individual security’s credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments.

The "prudent person" standard states that,

“Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.”

*[This section should be modified to reflect standard specified in state statute if higher than prudent person.]*

#### *2. Ethics and Conflicts of Interest*

Officers and employees involved in the investment process shall refrain from personal activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. Disclosure shall be made to the governing body. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking any personal investment transactions with the same individual with whom business is conducted on behalf of the [entity].

#### *3. Delegation of Authority and Responsibilities*

### **Governing Body**

The governing body will retain ultimate fiduciary responsibility for the portfolios. The governing body will receive monthly reports, designate investment officers and [annually] review the investment policy making any changes necessary by adoption.

### **Investment Officers**

Authority to manage the investment program is granted to [designated official by title] hereinafter referred to as investment officer as designated by [governing body or Code citation, ordinances, charters or statutes].

Responsibility for the operation of the investment program is hereby delegated to the [e.g. Treasurer, Investment Officer, etc.] who shall act in accordance with established written procedures and internal controls for the operation of the investment program consistent with this Investment Policy. Officers will prepare monthly investment reports and other special reports as may be deemed necessary.

All participants in the investment process shall seek to act responsibly as custodians of the public trust. No officer or designee may engage in an investment transaction except as provided under the terms of this policy and supporting procedures.

### **Investment Committee**

The [entity] may seek to establish an investment committee to provide guidance to investment officers.

### **Investment Adviser**

The [entity] may engage the services of one or more external investment managers to assist in the management of the entity's investment portfolio in a manner consistent with the entity's objectives. Such external managers may be granted discretion to purchase and sell investment securities in accordance with this Investment Policy. Such managers must be registered under the Investment Advisers Act of 1940.

## **VI. Authorized Financial Institutions, Depositories, and Broker/Dealers**

### *1. Authorized Financial Institutions, Depositories, and Broker/Dealers*

A list will be maintained of financial institutions and depositories authorized to provide investment services. In addition, a list will be maintained of approved security broker/dealers selected by conducting a process of due diligence. These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).

- A. The investment officer shall determine which financial institutions are authorized to provide investment services to [entity]. Institutions eligible to transact investment business with [entity] include:
  - 1. Primary government dealers as designated by the Federal Reserve Bank;
  - 2. Nationally or state-chartered banks;
  - 3. The Federal Reserve Bank; and,
  - 4. Direct issuers of securities eligible for purchase.
- B. Selection of financial institutions and broker/dealers authorized to engage in transactions with the [entity] shall be at the sole discretion of the [entity].
- C. All ~~financial institutions and~~ broker/dealers who desire to become qualified for investment transactions must supply the following (as appropriate):

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- Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines
- Proof of FINRA certification (not applicable to Certificate of Deposit counterparties)
- Proof of state registration
- Completed broker/dealer questionnaire (not applicable to Certificate of Deposit counterparties)
- Certification of having read and understood and agreeing to comply with the [entity's] investment policy (not applicable to Certificate of Deposit counterparties).
- Evidence of adequate insurance coverage.

D. All financial institutions who desire to become depositories must supply the following (as appropriate):

- Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines
- Proof of state registration
- Evidence of adequate insurance coverage.

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E. A periodic review of the financial condition and registration of all qualified financial institutions and broker/dealers will be conducted by the investment officer.

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### 2. *Minority, Emerging and Community Financial Institutions*

From time to time, the investment officer may choose to invest in instruments offered by minority, emerging and community financial institutions. All terms and relationships will be fully disclosed prior to purchase and will be reported to the appropriate entity on a consistent basis and should be consistent with state or local law.

### 3. *Competitive Transactions*

- A. The investment officer shall obtain competitive bid information on all purchases of investment instruments purchased on the secondary market. A competitive bid can be executed through a bidding process involving at least three separate brokers/financial institutions or through the use of a nationally recognized trading platform.
- B. If the Entity is offered a security for which there is no readily available competitive offering on the same specific issue, then the Investment Officer shall document quotations for comparable or alternative securities. When purchasing original issue instrumentality securities, no competitive offerings will be required as all dealers in the selling group offer those securities at the same original issue price.
- C. If the Entity hires an investment adviser to provide investment management services, the adviser must provide documentation of competitive pricing execution on each transaction. The investment adviser will retain documentation and provide upon request. **(OPTIONAL)**

## VI. **Safekeeping and Custody**

### 1. *Delivery vs. Payment*

All trades of marketable securities will be executed (cleared and settled) on a delivery vs. payment (DVP) basis to ensure that securities are deposited in the [entity's] safekeeping institution prior to the release of funds.

### 2. *Third-Party Safekeeping*

Securities will be held by an independent third-party safekeeping institution selected by the [entity]. All securities will be evidenced by safekeeping receipts in the [entity's] name. The safekeeping institution shall annually provide a copy of its most recent report on internal controls - Service Organization Control Reports (formerly 70, or SAS 70) prepared in accordance with the Statement on Standards for Attestation Engagements (SSAE) No. 16 (effective June 15, 2011.)

### 3. Internal Controls

~~The investment officer~~ Management is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the [entity] are protected from loss, theft or misuse. Specifics for the internal controls shall be documented in an *investment procedures manual* that shall be reviewed and updated periodically by the Investment Officers.

The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived and the valuation of costs and benefits requires estimates and judgments by management. The internal controls shall address the following points at a minimum:

- Control of collusion
- Separation of transaction authority from accounting and recordkeeping
- Custodial safekeeping
- Avoidance of physical delivery securities
- Clear delegation of authority to subordinate staff members
- Written confirmation of transactions for investments and wire transfers
- Dual authorizations of wire transfers
- Staff training and
- Review, maintenance and monitoring of security procedures both manual and automated.

The external auditor shall provide an annual independent review to assure compliance with state law, policies and procedures.

#### *Alternative sample language:*

~~The~~ Management ~~investment officer~~ shall establish a system of internal controls, which shall be documented in writing. The internal controls shall be reviewed by the investment committee, where present, and with the independent auditor. The controls shall be designed to prevent the loss of public funds arising from fraud, employee error, and misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of the [entity.]

## VIII. Suitable and Authorized Investments

### 1. Investment Types and Credit Guidelines

Consistent with the GFOA Policy Statement on State and Local Laws Concerning Investment Practices, the following investments will be permitted by this policy and are those defined by state and local law where applicable. If additional types of securities are approved for investment by public funds by state statute, they will not be eligible for investment by the [entity] until this Policy has been amended and the amended version adopted by the governing body. Typical types of securities include:

- U.S. Treasury and other government obligations that carry the full faith and credit guarantee of the United States for the payment of principal and interest.
- Federal Agency or U.S. government sponsored enterprises (GSE) obligations, participations or other instruments

- Bankers' acceptances;
- Federally insured time deposits (Non-negotiable certificates of deposit) in state or federally chartered banks, savings and loans, or credit unions, provided that:
  - a. The amount per institution is limited to the maximum covered under federal insurance;
- **Time deposits (Non-negotiable certificates of deposit)** in state or federally chartered banks, savings and loans, or credit unions in excess of insured amounts which are fully collateralized with securities in accordance with state law
- **Negotiable certificates of deposit (NCDs)**
- **Commercial** paper, rated in the highest tier (e.g., A-1, P-1, F-1, or D-1 or higher) by a nationally recognized statistical rating organization;
- Investment-grade obligations of state, provincial and local governments and public authorities;
- Fully collateralized Repurchase agreements collateralized in compliance with this Policy, governed by a SIFMA Master Repurchase Agreement and with a maximum maturity. Capital project funds may be invested in a single flex repurchase agreement with a maximum stated maturity that shall be matched to the expenditure plan;
- SEC registered money market mutual funds; and
- Local government investment pools.

**IMPORTANT NOTE:** If the credit rating of a security is subsequently downgraded below the minimum rating level for a new investment of that security, the Investment Officer shall evaluate the downgrade on a case-by-case basis in order to determine if the security should be held or sold. The Investment Officer will apply the general objectives of safety, liquidity, yield and legality to make the decision.

## *2. Collateralization*

Where allowed or required by state law and in accordance with full collateralization will be required on all demand deposit accounts, including checking accounts and negotiable (as authorized by respective state statutes) and non-negotiable certificates of deposit.

### **Authorized Collateral**

Acceptable collateral for bank deposits and repurchase agreements shall include only:

- obligations of the U.S. Government, its agencies and GSEs, including mortgage backed securities
- obligations of any state, city, county or authority rated at least AA by two nationally recognized statistical rating organizations.
- 

## **IX. Investment Parameters**

### **1. Mitigating credit risk in the portfolio**

Credit risk is the risk that a security or a portfolio will lose some or all of its value due to a real or perceived change in the ability of the issuer to repay its debt. The [entity] shall mitigate credit risk by adopting the following:

#### *A. Diversification*

The investments shall be diversified by:

- limiting investments to avoid overconcentration in securities from a specific issuer or business sector (excluding U.S. Treasury securities),
- limiting investment in securities that have higher credit risks,

- investing in securities with varying maturities, and
- continuously investing a portion of the portfolio in readily available funds such as local government investment pools (LGIPs), money market funds or overnight repurchase agreements to ensure that appropriate liquidity is maintained in order to meet ongoing obligations.

**Alternative samples:**

**A. Diversification**

It is the policy of the [entity] to diversify its investment portfolios. To eliminate risk of loss resulting from the over-concentration of assets in a specific maturity, issuer, or class of securities, assets in all [entity] funds shall be diversified by maturity, issuer, and class of security. Diversification strategies shall be determined and revised periodically by the investment committee/investment officer for all funds.

**Diversification Constraints on Total Holdings (Refer to applicable State Statutes or other legal guidelines) :**

	Maximum % Holdings
<b>Issuer Type</b>	
US Treasury Obligations	
US Agency (GSE) Securities	
LGIP	
Bankers' Acceptances	
Commercial Paper	
TLGP (FDIC Guaranteed )	
Certificates of Deposit/Bank Deposits/Savings	
Repurchase Agreements	
Corporate Indebtedness	
Municipal Bonds	

Due to fluctuations in the aggregate surplus funds balance, maximum percentages for a particular issuer or investment type may be exceeded at a point in time subsequent to the purchase of a particular issuer or investment type. Securities need not be liquidated to realign the portfolio; however, consideration should be given to this matter when future purchases are made to ensure that appropriate diversification is maintained.

**B. Mitigating market risk in the portfolio**

Market risk is the risk that the portfolio value will fluctuate due to changes in the general level of interest rates. The [entity] recognizes that, over time, longer-term/core portfolios have the potential to achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The [entity] shall mitigate market risk by providing adequate liquidity for short-term cash needs, and by making longer-term investments only with funds that are not needed for current cash flow purposes. The [entity] further recognizes that certain types of securities, including variable rate securities, securities with principal paydowns prior to maturity, and securities with embedded options, will affect the market risk



profile of the portfolio differently in different interest rate environments. The [entity], therefore, adopts the following strategies to control and mitigate its exposure to market risk:

- The [entity] shall maintain a minimum of three months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements;
- The maximum percent of callable securities in the portfolio shall be 15%;
- The maximum stated final maturity of individual securities in the portfolio shall be five years, except as otherwise stated in this policy; and,
- Liquidity funds will be held in the State Pool or in money market instruments maturing one year and shorter.
- Longer term/Core funds will be defined as the funds in excess of liquidity requirements. The investments in this portion of the portfolio will have maturities between 1 day and 5 years and will be only invested in higher quality and liquid securities.
- The duration of the portfolio shall at all times be approximately equal to the duration (plus or minus 10%) of a Market Benchmark Index selected by the [entity] based on the [entity's] investment objectives, constraints and risk tolerances. The entity's current Benchmark shall be documented in an *Investment Procedures Manual*.

Total Portfolio Maturity Constraints:

	Minimum % of Total Portfolio
Under 30 days	
Under 1 year	
Under 5 years	
WAM (weighted average maturity)	

- i) Exception to 5-year maturity maximum: Reserve or Capital Improvement Project monies may be invested in securities exceeding five (5) years if the maturities of such investments are made to coincide as nearly as practicable with the expected use of the funds.
- ii) Due to fluctuations in the aggregate surplus funds balance, maximum percentages for a particular issuer or investment type may be exceeded at a point in time subsequent to the purchase of a particular issuer or investment type may be exceeded at a point in time subsequent to the purchase of a particular security. Securities need not be liquidated to realign the portfolio; however, consideration should be given to this matter when future purchases are made.

**X Performance Standards/ Evaluation**

The investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio should obtain a market average rate of return during a market/economic environment of stable interest rates. A series of appropriate benchmarks shall be established against which portfolio performance shall be compared on a regular basis. The benchmarks shall be reflective of the actual securities being purchased and risks undertaken and the benchmarks shall have a similar weighted average maturity and credit profile as the portfolio.

**Alternative sample:**

The [entity's] cash management portfolio shall be designed with the objective of regularly meeting or exceeding a selected performance benchmark, which could be the average return on three-month U.S. Treasury bills, the state investment pool, a money market mutual fund [specify] or the average rate of Fed funds. These indices are considered benchmarks for lower risk investment transactions

and therefore comprise a minimum standard for the portfolio's rate of return.

**Alternative sample**

The performance of investments will be measured against the performance of a combination of benchmarks: the Local Government Investment Pool, using monthly net yield of both portfolios as the yardstick. Preservation of capital and maintenance of sufficient liquidity will be considered prior to attainment of market return performance. Given these considerations, the Entity's portfolio should provide a net yield that is equal or better to that attained by the Local Government Investment Pool over interest rate cycles. Additionally, a market benchmark (i.e.: 0-3 or 0-5 Treasury or Agency Index) may be determined that is appropriate for longer term investments based on the Entity's risk and return profile. Return comparisons of the portfolio to the market benchmark will be calculated on a monthly basis. When comparing the performance of the Entity's portfolio, all fees and expenses involved with managing the portfolio shall be included in the computation of the portfolio's rate of return.

**XI. Reporting/ Disclosure**

**1. Methods**

The investment officer shall prepare an investment report at least quarterly [or monthly], including a management summary that provides an analysis of the status of the current investment portfolio and the individual transactions executed over the last quarter [or month]. This management summary will be prepared in a manner which will allow the [entity] to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report should be provided to the entity's chief administrative officer, the legislative body, the investment committee and any pool participants. The report will include, at a minimum, the following:

- a. An asset listing showing par value, cost and accurate and complete market value of each security, type of investment, issuer, and interest rate;
- a-b. Average maturity of the portfolio and modified duration of the portfolio;
- a-c. Maturity distribution of the portfolio;
- a-d. Average portfolio credit quality; and,
- e. Time-weighted total rate of return for the portfolio for the prior one month, three months, twelve months, year to date, and since inception compared to the Benchmark Index returns for the same periods;
- e-f. Average weighted yield to maturity of portfolio on investments as compared to applicable Benchmarks
- g. Distribution by type of investment.

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**Annual reports**

- 1 The investment policy shall be reviewed at least annually within 120 days of the end of the fiscal year to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends.
- 2. A comprehensive annual report shall be presented in conjunction with the investment policy review. This report shall include comparisons of City's return to the Benchmark Index return, shall suggest policies and improvements that might enhance the investment program, and shall include an investment plan for the coming year.

**Annual audit**

The ~~Management~~ investment officer shall establish an annual process of independent review by the external auditor to assure compliance with internal controls. Such audit will include tests deemed appropriate by the auditor.

**Alternative sample:**

1. The investment officer shall submit quarterly an investment report that summarizes recent market conditions, economic developments and anticipated investment conditions. The report shall summarize the investment strategies employed in the most recent quarter, and describe the portfolio in terms of investment securities, maturities, risk characteristics and other features. The report shall explain the quarter's total investment return and compare the return with budgetary expectations. The report shall include an appendix that discloses all transactions during the past quarter. The report shall be in compliance with state law and shall be distributed to the investment committee and others as required by law.

Each quarterly report shall indicate any areas of policy concern and suggested or planned revision of investment strategies. Copies shall be transmitted to the independent auditor. Within 40 days of the end of the fiscal year, the investment officer shall present a comprehensive annual report on the investment program and investment activity. The annual report shall include 12-month and separate quarterly comparisons of return and shall suggest policies and improvements that might be made in the investment program. Alternatively, this report may be included within the [entity] annual Comprehensive Annual Financial Report.

ALTERNATIVE

The ~~Officer~~ ~~CEO~~ Investment Officer will retain and periodically, at a minimum annually, provide the Governmental Board with investment reports. The reports also will be available upon request. Securities holdings, cash balances and market values in the investment portfolio will be provided on the month-end reports.

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<b>Book Yield</b>
<b>Holdings Report (including mark to market)</b>
<b>Transactions Report</b>
<b>Weighted Average Maturity or Duration</b>
<b>Compliance Report</b>

**XIII. Policy Considerations**

*1. Exemption*

Any investment currently held that does not meet the guidelines of this policy shall be exempted from the requirements of this policy. At maturity or liquidation, such monies shall be reinvested only as provided by this policy.

**Alternative sample:**

Any investment currently held that does not meet the guidelines of this policy shall be temporarily exempted from the requirements of this policy. Investments must come in conformance with the policy within six months of the policy's adoption or the governing body must be presented with a plan through which investments will come into conformance.

## *2. Amendments*

This policy shall be reviewed on an annual basis. Any changes must be approved by the investment officer and any other appropriate authority, as well as the individuals charged with maintaining internal controls.

## **XIV Approval of Investment Policy**

The investment policy and any modifications to that policy shall be formally approved and adopted by the governing body of the [entity].

## **XV. Miscellaneous**

### *1. List of Attachments*

The following documents, as applicable, are attached to this policy:

- Listing of authorized personnel,
- Relevant investment statutes and ordinances,
- Listing of authorized broker/dealers and financial institutions,
- Internal Controls
  - Investment Guidelines Manual
- Glossary

### *2. Other Documentation*

- Master Repurchase Agreement, other repurchase agreements and tri-party agreements
- Broker/Dealer Questionnaire, (in *GFOA Introduction to Broker-Dealers for State and Local Governments, Second edition*)
- Broker –dealer certification (in *GFOA Introduction to Broker-Dealers for State and Local Governments, Second edition*)
- Safekeeping agreements,
- Wire transfer agreements,
- Sample investment reports,
- Methodology for calculating rate of return,
- GFOA Best Practices and Advisories.

### **GFOA Best Practices and Advisories:**

- Government Relationships with Securities Dealers (1986, 1987, 1993, 2000, 2007 and 2010 – GFOA TIM Committee).
- Using Mutual Funds for Cash Management Purposes (1987, 2003 and 2006 – GFOA TIM Committee).
- Establishing a Policy for Repurchase Agreements (1986, 1995, 1998, 2000, 2003, 2006, 2008, and 2010 – GFOA TIM Committee).
- Establishing a Policy for Reverse Agreements (2010).
- Considerations for Using of Local Government Investment Pools (2007 and 2008 - GFOA TIM Committee).

- Collateralization of Public Deposits (1984, 1987, 1993, 2000 and 2007 – GFOA TIM Committee).

▪ Glossary

<b>US Treasury Obligation</b>	Direct obligations of the United States Treasury whose payment is guaranteed by the United States. (State Statute Note)
<b>GSE – Agency Obligations</b>	US Government Agencies, Government Sponsored Enterprises ( <i>GSEs</i> ), Corporations or Instrumentalities of the US Government – Federal Instrumentality Securities include, but are not limited to Federal National Mortgage Association ( <i>FNMA</i> ), the Federal Home Loan Mortgage Corporation ( <i>FHLMC</i> ), Federal Home Loan Banks ( <i>FHLB</i> ), and the Federal Farm Credit Bureau (FFCB). (State Statute)
<b>TLGP Debt Obligations</b>	Senior unsecured debt obligations guaranteed by the Federal Deposit Insurance Corporation under the Temporary Liquidity Guarantee Program (TLGP) or other federal government guaranteed programs; Eligible debt obligations must carry the full faith and credit of the United States Government. (if ALLOWABLE)

**Commercial Paper** Commercial Paper\* that is rated A1/P1 and has long term bonds which have a minimum rating of AA- by Standard and Poor's and Aa3 by Moody's

**Bankers' Acceptances** Bankers' acceptances, if the bankers' acceptances are: (i) Guaranteed by, and carried on the books of, a qualified financial institution; (ii) Eligible for discount by the Federal Reserve System; and (iii) Issued by a qualified financial institution whose short-term letter of credit rating is rated in the highest category by one or more nationally recognized statistical rating organizations.

For the purposes of this paragraph, "qualified financial institution" means: (i) A financial institution that is located and licensed to do banking business in the State; or (ii) A financial institution that is wholly owned by a financial holding company or a bank holding company that owns a financial institution that is located and licensed to do banking business in the State of XXX.

**Repurchase Agreements** An agreement with a approved broker/dealer that provides for sell and simultaneous purchase of a allowable collateral security. The difference in the sales and purchase price is the earning rate on the agreement. A master repurchase agreement must be in place with the approved broker dealer.

<b>Corporate Indebtedness</b>	Corporate Indebtedness* that has a minimum long term debt rating of AA-rated by Standard and Poor's and a Aa3 rating by Moody's and must be rated on the settlement date P-1 or Aa or better by Moody's Investors Service or A-1 or AA or better by Standard & Poor's Corporation or equivalent rating by any nationally recognized statistical rating organization. [State Statue] IF ALLOWABLE
<b>Local Government Investment Pool</b>	State treasurer's local short-term investment fund up to the statutory limit per state statute

<b>Certificates of Deposit/Bank Deposit/Savings Accounts</b>	Time deposit open accounts, certificates of deposit and savings accounts in insured institutions as defined in State Statue, in credit unions as defined in State statute or in federal credit unions, if the institution or credit union maintains a head office or a branch in this state. [State Statue
<b>Municipal Obligations</b>	Lawfully issued debt obligations of the agencies and instrumentalities of the State of XXX and its political subdivisions that have a long-term rating of A or an equivalent rating or better or are rated on the settlement date in the highest category for short-term municipal debt by a nationally recognized statistical rating organization. [State Statue - NOTE SPECIFIC TO EACH STATE]