



Public Funds Investment Act

Chapter 2256 | Investment Policy

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Objectives of this Session

- Understand the General Requirements of PFIA

- Investment Policies - Requirements

- Written policy

- Written investment strategy

- Investment officials

- Investment training

- Internal management reports

- Disclosure of personal business interest

- Authorized investments

- Mark-to-market

- Safe keeping and custody

General Requirements of PFIA Investment Policy (Sec. 2256.005)

- Written policy required
- Prioritize
 - Safety of principal
 - Liquidity
 - Yield



General Requirements of PFIA Investment Policy (Sec. 2256.005)

Must address the following:

- Authorized investments
- Maturity/WAM/average life limits
- Methods for monitoring market valuations
- Requirement of DVP settlement

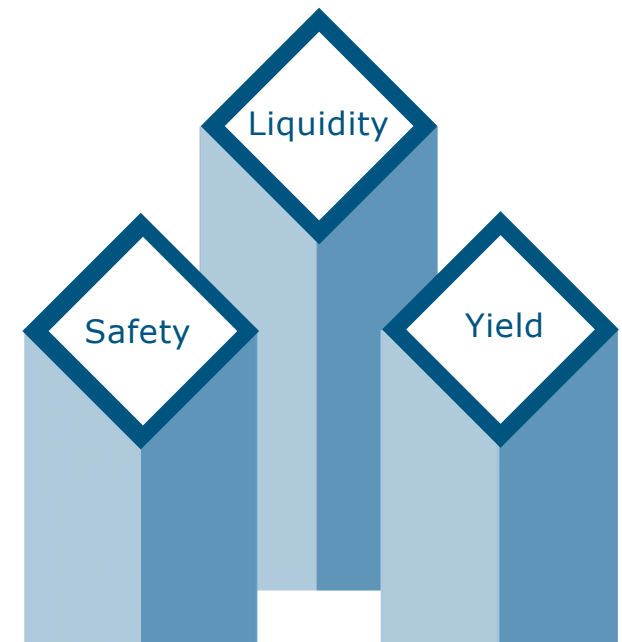


General Requirements of PFIA

Investment Policy (Sec. 2256.005)

STANDARD OF CARE. (a) Investments shall be made with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived. Investment of funds shall be governed by the following investment objectives, in order of priority:

- 1) preservation and safety of principal;
- 2) liquidity; and
- 3) yield.



General Requirements of PFIA

Investment Strategies (Sec. 2256.005 (d))

- Separate written investment strategy may be adopted
- Must be reviewed at least annually
- Investment officer(s) can be designated – various restrictions placed on such person(s)



General Requirements of PFIA

Investment Strategies (Sec. 2256.005 (d))

Priority of objectives

- Suitability of investments
- Preservation and safety of principal
- Liquidity
 - Marketability of the investment
- Diversification of the portfolio
- Yield



Investment Diversification: Examples

- Up to 90% par of the portfolio may be invested in direct obligations of the U.S. or its agencies/instrumentalities.
- No more than 50% par of the portfolio may be invested in certificates of deposit.
- No more than 80% par may be invested in investment pools.
- No more than 55% par of the portfolio may be invested any one institution excluding bond proceeds.
- Additionally, these investments shall not exceed 10% of the capitalization of the financial institution.

Maturity | WAM | Average Life Limits

In the PFIA Act, there are no minimum or maximum maturities.

In the Investment Policy, the length of any investment must be addressed:

- Twelve months, two years, three years, or ten years.

The WAM (weighted average maturity) must also be stated.

- WAM:
 - 1 year
 - 1.5 year
 - 2 years

Diversification of the Portfolio: Investments

Govt Bonds – U.S. Treasuries & Agencies

Certificates of Deposits or CDs (Direct or Brokered)

Municipals (Tax Free or Taxable)

Commercial Paper (CP)

Local Governmental Investment Pools (LGIP)

Authorized Investments:

Overview Sec. 2256.009 (a)(1)-(6)

1. Obligations, including letters of credit, of the United States or its agencies and instrumentalities
2. Direct obligations of this state of its agencies and instrumentalities
3. Collateralized mortgage obligations (CMO) directly issued by a Federal agency or instrumentality of the U.S.

Authorized Investments:

Overview Sec. 2256.009 (a)(1)-(6)

4. Other obligations where by the principal and interest payments are backed by the full faith & credit of this state or the U.S. government or their respective agencies and instrumentalities including obligations fully guaranteed by the FDIC.
5. Obligations of other state, agencies, counties, cities, and other political subdivisions rated "A" or better by a nationally recognized rating firm.
6. Bonds issued, assumed, or guaranteed by the state of Israel.

Authorized Investments: Agency Bonds

Non-amortizing – generally pay interest semi-annually

GSE Issuers (Established)

- Federal Home Loan Banks (1932)
- Fannie Mae (1938/68)
- Freddie Mac (1970/88)
- Farm Credit (1916)
- Farmer Mac (1987)

Structures

- Discount notes
- Fixed maturity - bullets
- Callable

Authorized Investments: Agency Bonds

Federal Government Sponsored Entities (GSEs)

| | |
|--|--|
| Federal National Mortgage Association (Fannie Mae – FNMA) | Support the nation’s housing finance system through the secondary mortgage market |
| Federal Home Loan Mortgage Corporation (Freddie Mac- FHLMC) | Support the nation’s housing finance system through the secondary mortgage market |
| Federal Home Loan Bank (FHLB) | Provides financing to its member depositories to fund housing |
| Federal Farm Credit Bank Funding Corp. (FFCB) | Provides financing to the Farm Credit System, a leading provider of loans and leases to U.S. agriculture and rural America |

Authorized Investments:

Collateralized Mortgage Obligations (CMOs)

- Only bonds with stated maturity of <10 years are authorized under PFIA
- Cannot be interest only (IO)
- Principal only (PO)
- Inverse floating structures

Authorized Investments:

Obligations of the State of Texas or Other States

Municipal Bonds

- Issued by political subdivisions
- Maturities typically out to 30 years
- Tax-free & taxable issues available
- State of Texas – does not have to be rated
 - If out of state, must be rated 'A' or better

Authorized Investments:

Certificates of Deposit | Requirements

Issuing institution has main office or a branch office in Texas and is:

- Guaranteed or insured by FDIC or NCUSIF or successors
- Collateralized by PFIA authorized investments
- Secured in any other manner and amount provided by law

Funds may also be invested in CDs through CD brokerage services like CDARS provided that the broker has its main office or a branch in Texas and is selected from a list adopted by the investing entity

- Full amount of the principal and accrued interest of each CD must be insured by the U.S. or an instrumentality of the U.S.

Other Authorized Investments:

Repurchase Agreements | Basics & Requirements

- Also known as repos
- Short-term borrowing arrangements for broker/dealer and other entities that hold positions in government securities
- Must be fully collateralized by a combination of cash and PFIA authorized investments
- Must have a defined termination date
- Positions must be pledged to the entity (county), held in the entity's name, and deposited at the time the investment is made
- Requires third party safekeeping arrangement
- Counterparty must be a primary dealer or financial institution doing business in this state
- Other restrictions defined in 2256.011

Other Authorized Investments:

Securities Lending Program | Basics & Requirements

- The act of loaning a security to another investor or dealer
- Authorized under 2256.0115(a)
- Value of securities loaned under the program must be not less than 100% collateralized including accrued income
- Must allow for termination of the loan at any time
- Must be secured by pledged securities authorized under PFIA, pledged irrevocable letters of credit issued by a bank with restrictions or cash
- Loan must be placed through a primary government securities dealer or a financial institution doing business in Texas
- Must have a term of one year or less

Other Authorized Investments:

Bankers' Acceptances | Basics & Requirements

- Short-term debt instruments issued by a company that is guaranteed by a commercial bank
- Similar to T-bills – trade at a discount to par
- Must have a stated maturity of 270 days or fewer from date of issuance
- Liquidated in full at maturity
- Eligible for collateral for borrowing from Federal Reserve Bank
- Accepted by a bank that is rated not less than A-1 or P-1 or an equivalent rating

Other Authorized Investments:

Commercial Paper

- Unsecured, short-term debt instrument issued by a corporation typically for the financing of short term liabilities (accounts receivable, inventory, etc.)
- Must have a stated final maturity of 270 days or fewer
- Issuer must be rated not less than A-1 or P-1 or an equivalent rating by at least:
 - A. Two nationally recognized statistical rating organizations
 - B. One nationally recognized credit rating organization and is fully secured by an irrevocable letter of credit

Other Authorized Investments:

Mutual Funds | Basics & Requirements

- Investment made up of a pool of money invested in a basket of securities
- Shares are redeemed at a Net Asset Value (NAV)
- Offer diversification and professional management for a fee

Other Authorized Investments:

Mutual Funds | Basics & Requirements

- SEC registered no-load money market mutual funds
 - Must provide a prospectus and other information required by Federal law
 - Must have a dollar-weighted average stated maturity of 90 days or fewer
 - Must seek the objective of maintaining a stable NAV of \$1/share
 - Investing entity (county) must not own more than 10% of the fund's total assets

Other Authorized Investments:

Mutual Funds | Basics & Requirements

SEC registered no-load mutual fund

- WAM less than two years
- Must be invested exclusively in obligations that are PFIA approved
- Must be continuously rated no less than 'AAA' or equivalent by a nationally recognized statistical ratings organization
- Must conform to requirements in section 2256.016(b)

Not Authorized

- Entity must not invest in the aggregate more than 15% of its monthly average fund balance excluding bond proceeds, reserves, and other funds held for debt services
- Must not own more than 10% of the mutual fund's total assets

More commonly known pools



Super Bowl Squares
 Indianapolis Colts

| | | | | | | | | | | |
|---|-----------------|-------------------|--------------------|------------------|-----------------|-----------------|------------------|--------------|----------------|---------------------|
| | 2 | 8 | 7 | 3 | 5 | 0 | 9 | 4 | 1 | 6 |
| 6 | David Elliott | Jeaniah Evans | YeVONNIE Middleton | Tony Bingham | Chris Ellison | Peggy Smith | Shawn Person | Shane Tarvin | Shawn Person | Chris Elliott |
| 7 | Alyssa Peace | Rachel Jackson | Angela Peace | Malachi Jackson | Gail Perkins | Mike Smith | Lucinda Densmore | James Cash | Aimee Bush | Jeremiah Williamson |
| 1 | Lilly Harris | Matthew Mills | Mike Taylor | Danna Gray | Bill Wright | Matthew Bargo | Loren Joyce | Alex Smith | Michael Keith | Jamie Tunstall |
| 5 | Bobby Baker | Eli Moore | Kathy Jones | Krystal Collett | Sue Wetter | Nicole Hill | Curtis Partin | Josh Allen | Jessica Morris | Brittany Justice |
| 9 | Bob Seger | Winston Shelton | Lynn Lowery | Bryan Roberts | Michael Cornett | Kristin Roberts | Matt Hibbard | Karen Asher | Martha Nipper | Charlie Archer |
| 2 | Courtney Smith | Angela Veach | September Williams | Tony Yother | Nicole Williams | Jerry Yeager | Aaron Brown | Jim Sprale | Luke Owens | Lannie Lockford |
| 0 | Elizabeth Mills | Jeffery Napier | Jamie Hembree | James Ledington | Melissa Sanders | Charles Newkirk | Amy Gray | Amy Buford | Crystal Saylor | Michael Saylor |
| 4 | Hope Mills | Travis Warren | Melissa Mills | Beulah Honeycott | Marion Sowdus | Alana Hammons | Andrea Hillard | Darin Wilson | Wesley Bruner | James Holstein |
| 8 | John Gray | Brian Crawford | Richard Tye | Jerry Smith | Tommy Reid | Linda Mills | Frank McQueen | Nelva Warren | Penny Jordan | Diane Stampfer |
| 3 | Sharon Hood | Lonnie Williamson | Nibardo Zanchez | Daniel Hatfield | Rhonda Clouse | William Gurnard | Lester Elliott | Cindy Petrus | Nick Goin | Chris Elliott |

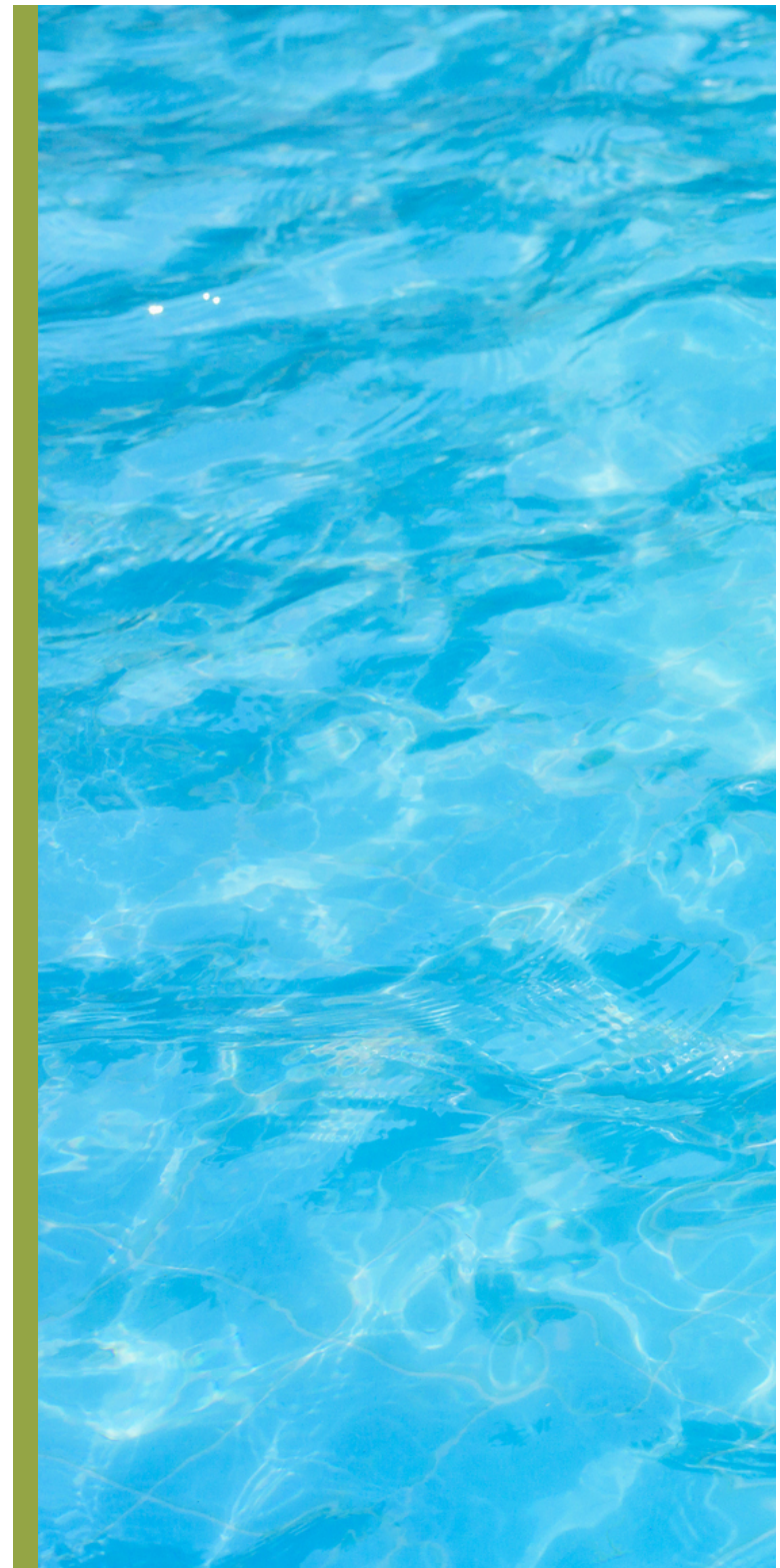
Other Authorized Investments:

LGIPs | Basics & Requirements

State or local pool offered to public entities:

- Texas CLASS
- TexPool
- TexStar
- Logic
- Lone Star
- TX-FIT

Government pools vs “prime” pools



Other Authorized Investments:

LGIPs | Basics & Requirements

Pool manager must furnish the following:

- Types of investments in pool
- Maximum dollar-weighted maturity allowed
- Maximum state maturity allowed
- Objectives of the pool
- Size of the pool
- Names of the members on the advisory board
- Custodian bank & independent auditor
- Existence of insurance or guarantees held as a source of secondary payment
- Requirements for the deposit and withdrawal of funds
- Historical performance of the pool
 - Yields
 - WAM
 - Expense ratios

Other Authorized Investments:

LGIPs | Basics & Requirements

- To maintain eligibility, pool must furnish:
 - Transaction confirms
 - Monthly report that contains:
 - Breakdown of securities held
 - WAM of assets
 - % of pool's portfolio invested in assets with maturities longer than one year
 - Book value vs market value
 - Size of pool and number of participants
 - Custodian bank that is safekeeping the assets
 - Listing of daily transaction activity
 - Yield and expense ratios
 - Names of portfolio managers
 - Any changes to addendum to the offering circular

Other Authorized Investments:

LGIPs | Basics & Requirements

Advisory Board must be composed:

1. Equally of participants in the pool and other persons who do not have a business relationship with the pool and are qualified to advise the pool for a public funds investment pool created under Chapter 791 and managed by a state agency; or,
2. Of participants in the pool and other persons who do not have a business relationship with the pool and are qualified to advise the pool for other investment pools

Must be rated no lower than 'AAA,' 'AAAm,' or equivalent by at least one nationally recognized statistical rating organization

If pool offers breakpoints, they must provide information on all levels of return based on breakpoints or state the lowest possible level of return based on breakpoints in advertising investment rates

Methods for Monitoring Market Valuations

- Bank
- Brokers
- Safekeeping account



Safe Keeping and Custody

- All security transactions entered into by the public fund shall be conducted on delivery-versus-payment (DVP).
- Funds shall not be wired or paid until verification has been made that the security was received by safekeeping institution.
- This must be stated in the investment policy.



General Requirements of PFIA

Compliance Audit & Investment Training

Compliance audit of management controls

- Once every two years
- Internal or private auditor
- Ensure compliance to established investment policies

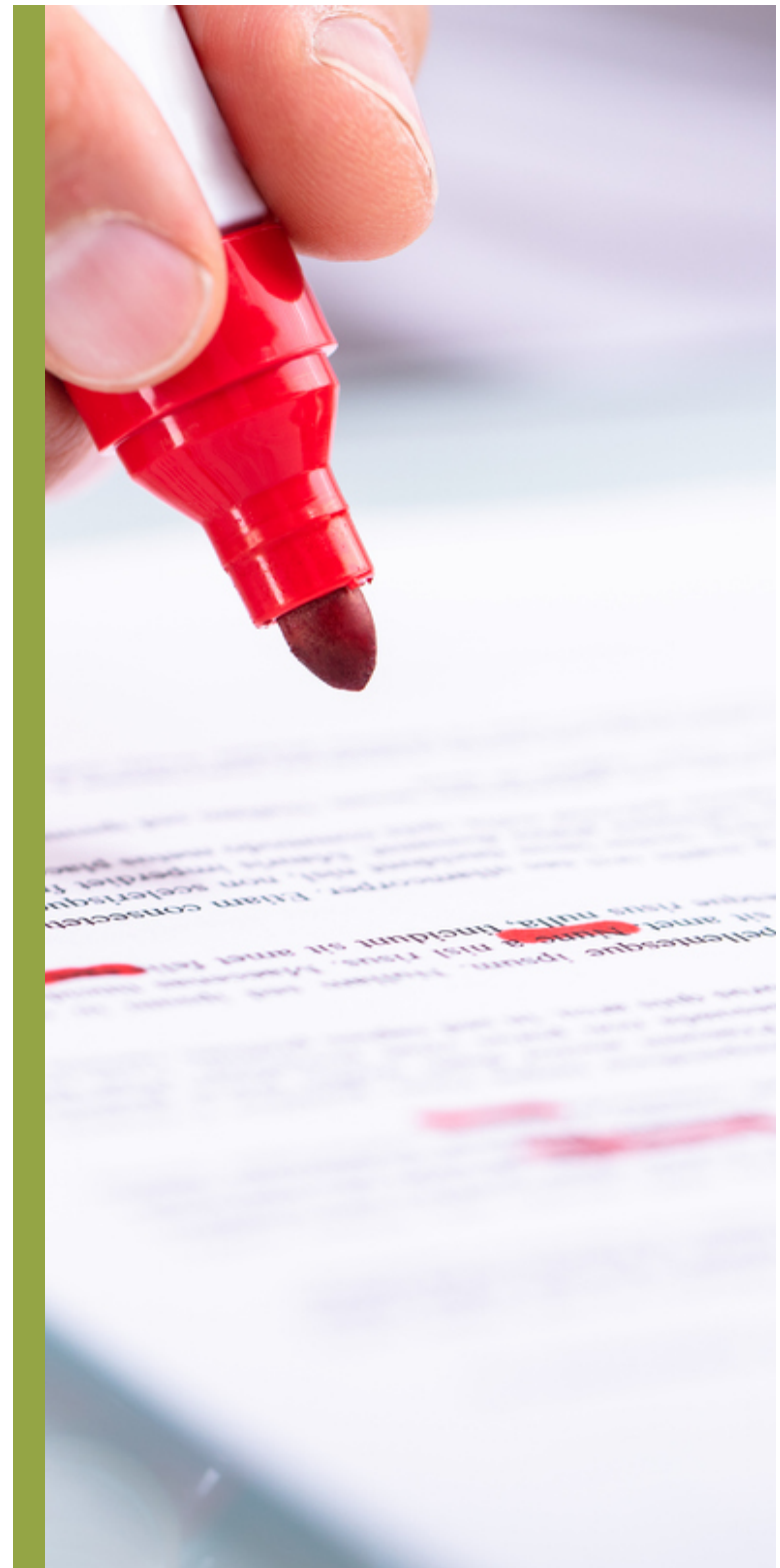
Investment training – local governments

- Required if investing public funds in anything other than CDs
- Treasurer, CFO (if treasurer is not CFO), & Investment Officer
- Investment training must be from an independent and approved source



Additional Items that can be in the Investment Policy

- Definitions or glossary
- List of Broker/Dealers
- List of Investment Pools
- Addendums



Investment Policy - Review

Written policy

Written investment strategy

Investment officials

Investment training

Internal management reports

Disclosure of personal business interest

Authorized investments

Mark-to-market

Safe keeping and custody



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