



ERIC SCHMITT
MISSOURI STATE TREASURER
MODEL INVESTMENT POLICY

I. Scope

This policy applies to the investment of all operating funds of the [entity]. Longer-term funds, including investment of employees' retirement funds and proceeds from certain bond issues, are covered by a separate policy.

Pooling of Funds

Except for cash in certain restricted and special funds, the [entity] will consolidate cash balances from all funds to maximize investment earnings. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

External Management of Funds

Investment through external programs, facilities and professionals operating in a manner consistent with this policy will constitute compliance.

II. General Objectives

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

A. 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.

1. Credit Risk

The [entity] will minimize credit risk, the risk of loss due to the failure of the security issuer or backer, by:

- Pre-qualifying the financial institutions, broker/dealers, intermediaries and advisors with which the [entity] will do business.
- Diversifying the portfolio so that potential losses on individual securities will be minimized.

2. Interest Rate Risk

The [entity] will minimize the risk that the market value of securities in the portfolio will fall due to changes in general 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.

B. 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). A portion of the portfolio also may be placed in bank deposits or repurchase agreements that offer same-day liquidity for short-term funds.

C. 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 not be sold prior to 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.

III. Standards of Care

A. Prudence

All participants in the investment process shall act responsibly as custodians of the public trust. The standard of prudence to be applied by the personnel of the Investment Division is the “prudent investor” rule, which states, “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.”

B. 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 which business is conducted on behalf of the [entity].

C. Delegation of Authority

Authority to manage the investment program is granted to [designated official or external professional, hereinafter referred to as investment officer] and derived from the following [insert code citation, ordinances, charters, statutes or constitution]. Responsibility for the operation of the investment program is hereby delegated to the investment officer, who shall act in accordance with the 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.

IV. Investment Transactions

A. Authorized Financial Dealers and Institutions

A list will be maintained of financial institutions authorized to provide investment transactions. In addition, a list also will be maintained of approved security broker/dealers selected by creditworthiness as determined by the investment officer and approved by the governing body. 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.
- Proof of National Association of Securities Dealers (NASD) certification.
- Proof of state registration.
- Completed broker/dealer questionnaire.

- Certification of having read and understood and agreeing to comply with the [entity's] investment policy.

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

B. Internal Controls

The investment officer/internal auditor/director of accounting is responsible for establishing and maintaining an internal control structure that will be reviewed annually with the [entity's] independent auditor. The internal control structure shall be designed to ensure that the assets of the [entity] are protected from loss, theft or misuse and to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of control should not exceed the benefits likely to be derived and (2) the valuation of costs and benefits require estimates and judgements by management.

The internal controls 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 investment and wire transfers.
- Development of a wire transfer agreement with the lead bank and third party custodian.

C. Delivery vs. Payment

All trades where applicable will be executed by delivery vs. payment (DVP) to ensure that securities are deposited in eligible financial institutions prior to the release of funds. All securities shall be perfected in the name for the account of the [entity] and shall be held by a third-party custodian as evidenced by safekeeping receipts.

V. Suitable and Authorized Investments

A. Investment types

In accordance with and subject to restrictions imposed by current statutes, the following list represents the entire range of investments that [entity] will consider and which shall be authorized for the investments of funds by the [entity].

1. *Governmental and Agency Debt – those securities issued by and or guaranteed by the Federal Government or an Agency or Instrumentality of the Federal Government:*

- a. **United States Treasury Securities.** The [entity] may invest in obligations of the United States government for which the full faith and credit of the United States are pledged for the payment of principal and interest.
- b. **United States Agency Securities.** The [entity] may invest in obligations issued or guaranteed by any agency of the United States Government as described in V (B).

2. *Fixed Income Investments secured by the FDIC insurance and/or Collateral:*

- a. **Repurchase Agreements.** The [entity] may invest in contractual agreements between the [entity] and commercial banks or primary government securities dealers. The purchaser in a repurchase agreement (repo) enters into a contractual agreement to purchase U.S Treasury and government agency securities while simultaneously agreeing to resell the securities at predetermined dates and prices.
- b. **Collateralized Public Deposits (Certificates of Deposit).** Instruments issued by financial institutions which state that specified sums have been deposited for specific periods of time and at specified rates of interest. The certificates of deposit are required to be backed by acceptable collateral securities as dictated by State statute.

3. *Other Fixed Income Debt Issued by Commercial Enterprises:* It should be noted that investments in the following instruments require an additional level of care and prudence when undertaken by the Investment Officer. Because these investments are in commercial credits as opposed to governmental credit, or subject to the added safety of collateral, the risk of loss of principal is significantly higher for the following investments than in the four prior categories. Added financial training and education is recommended for the Investment Officer wishing to participate in and/or manage a commercial paper program. Outside professional management of your commercial paper program is highly recommended.

- a. **Bankers Acceptances.** Bills of exchange or time drafts on and accepted by a commercial bank, otherwise known as bankers' acceptances. An issuing bank must have received the highest letter and numeral ranking (i.e., A1 / P1) by at least two nationally recognized statistical rating organizations (NRSRO's). Must be issued by domestic commercial banks. Purchases of bankers'

acceptances may not exceed 180 days to maturity. No more than 5% of the total market value of the portfolio may be invested in the bankers' acceptances of any one issuer and no more than 25% of the entire portfolio may be invested in banker's acceptances.

- b. **Commercial Paper**. Commercial paper which has received the highest letter and numeral ranking (i.e., A1 / P1) by at least two nationally recognized statistical rating organizations (NRSRO's). Eligible paper is further limited to issuing corporations that have a total commercial paper program size in excess of \$250,000,000 and have long term debt ratings, if any, of "A" or better from at least one NRSRO. Purchases of commercial paper may not exceed 180 days to maturity. Approved commercial paper programs should provide some diversification by industry. Additionally, purchases of commercial paper in the industry sectors that may from time to time be subject to undue risk and potential illiquidity should be avoided. The only asset-backed commercial paper programs that are eligible for purchase are fully supported programs that provide adequate diversification by asset type (trade receivables, credit card receivables, auto loans, etc.) No securities arbitrage programs or commercial paper issued by Structured Investment Vehicles (SIV's) shall be considered. No more than 5% of the total market value of the portfolio may be invested in the commercial paper of any one issuer. No more than 25% of the entire investment portfolio may be invested in Commercial Paper. Commercial paper issuers must be subject to weekly credit reviews and daily news research and analysis and a monitoring program must be established to promulgate best practices credit monitoring.

B. Security Selection

The following list represents the entire range of United States Agency Securities that the [entity] will consider and which shall be authorized for the investment of funds by the [entity]. Additionally, the following definitions and guidelines should be used in purchasing the instruments:

- U.S Govt. Agency Coupon and Zero Coupon Securities. Bullet coupon bonds with no embedded options with maturities of five (5) years or less.
- U.S Govt. Agency Discount Notes. Purchased at a discount with maximum maturities of one (1) year.
- U.S Govt. Agency Callable Securities. Restricted to securities callable at par only with final maturities of five (5) years or less.
- U.S Govt. Agency Step-up Securities. The coupon rate is fixed for an initial term. At coupon date, the coupon rate rises to a new higher fixed term. Restricted to securities with final maturities of five (5) years or less.

C. Investment Restrictions and Prohibited Transactions

To provide for the safety and liquidity of the [entity's] funds, the investment portfolio will be subject to the following restrictions:

- Borrowing for investment purposes (“Leverage”) is prohibited.
- Instruments known as variable rate demand notes, floaters, inverse floaters, leveraged floaters, and equity-linked securities are not permitted. Investment in any instrument, which is commonly considered a “derivative” instrument (e.g. options, futures, swaps, caps, floors, and collars), is prohibited.
- Contracting to sell securities not yet acquired in order to purchase other securities for purpose of speculating on developments or trends in the market is prohibited.

D. Collateralization

Collateralization will be required on two types of investments: certificates of deposit and repurchase agreements. The market value (including accrued interest) of the collateral should be at least 100%.

For certificates of deposit, the market value of collateral must be at least 100% or greater of the amount of certificates of deposits plus demand deposits with the depository, less the amount, if any, which is insured by the Federal Deposit Insurance Corporation, or the National Credit Unions Share Insurance Fund.

All securities, which serve as collateral against the deposits of a depository institution, must be safekept at a non-affiliated custodial facility. Depository institutions pledging collateral against deposits must, in conjunction with the custodial agent, furnish the necessary custodial receipts with five business days from the settlement date.

The [entity] shall have a depository contract and pledge agreement with each safekeeping bank that will comply with the Financial Institutions, Reform, Recovery, and Enforcement Act of 1989 (FIRREA). This will ensure that the [entity's] security interest in collateral pledged to secure deposits is enforceable against the receiver of a failed financial institution.

E. Repurchase Agreements

These securities for which repurchase agreements will be transacted will be limited to U.S Treasury and government agency securities that are eligible to be delivered via the Federal Reserve Fedwire book entry system. Securities will be delivered to the [entity's] designated Custodial Agent. Funds and securities will be transformed on a delivery vs. payment basis.

VI. Investment Parameters

A. Diversification

The investments shall be diversified to minimize the risk of loss resulting from over concentration of assets in specific maturity, specific issuer, or specific class of securities. Diversification strategies shall be established and periodically reviewed. At a minimum, diversification standards by security type and issuer shall be:

- U.S treasuries and securities having principal and/or interest guaranteed by the U.S government.....100%
- Collateralized time and demand deposits.....100%
- U.S Government agencies, and government sponsored enterprises.....no more than 70%
- Collateralization repurchase agreements.....no more than 50%
- U.S Government agency callable securities.....no more than 50%

B. Maximum Maturities

To the extent possible, the [entity] shall attempt to match its investments with anticipated cash flow requirements. Investments in repurchase agreements shall mature and become payable not more than ninety days (90) from the date of purchase. The [entity] shall adopt weighted average maturity limitations that should not exceed three (3) years and is consistent with the investment objectives.

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 in bank deposits or overnight repurchase agreements to ensure that appropriate liquidity is maintained to meet ongoing obligations.

VII. Reporting

A. 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 transactions made over the last quarter. This management summary will be

prepared in a manner that 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 governing body of the [entity]. 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 (in accordance with Government Accounting Standards Board (GASB) 31 requirements). [Note, this is only required annually]
- Average weighted yield to maturity of portfolio an investments as compared to applicable benchmarks.
- Listing of investment by maturity date.
- Percentage of the total portfolio which each type of investment represents.

B. Performance Standards

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 may be established against which portfolio performance shall be compared on a regular basis.

C. 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 annually to the governing body of the [entity]. This will ensure that review of the investment portfolio, in terms of value and price volatility, has been performed.

VIII. Policy Considerations

Exemption

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

IX. List of Attachments

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

- Securities acceptable as collateral to secure deposits
- Listing of authorized personnel



- Relevant investment statutes and ordinances
- Repurchase agreements and tri-party agreements
- Listing of authorized broker/dealers and financial institutions
- Safekeeping agreements
- Wire transfer agreements
- Sample investment reports
- Glossary