

STANDARD INVESTMENT POLICY – DEFINITIONS

Below is the rationale for the various elements of the model policy. The policy adopted by each entity will, by definition, have some variation with those policies adopted by others. The policy should be a reflection of what actually happens within each organization. Every effort should be made by Treasurers, finance officers and approving authorities to understand the philosophy and reasons behind each element of the policy. Merely copying the Model Policy will not insure that the theory is internalized within the organization and that the policy will have an impact on the financial health of the investment portfolio.

1. Policy

The overall policy statement should be summarized and condensed in the opening section. Important considerations include the name of the entity, safety, liquidity and yield of public funds managed by the entity.

2. Scope

An investment policy should explain its scope. Does the policy apply to all funds held in the custody of the government jurisdiction and all of its offices? If certain funds are excluded, provide an explanation of guidance of investment of those funds.

3. Prudence

To burden a conscientious professional with personal responsibility for default on a single item within a diversified portfolio seems unduly severe. Accordingly, public entities with portfolios of sufficient size are urged to apply the prudence concept to the overall portfolio.

4. Objective

Every investment policy must contain a concise and clear statement of objectives regarding safety of capital, liquidity and return on investment. The effectiveness of the investment program is set by the caliber of the staff, the procedures used, the working environment and the policy guidance provided by governing officials. Through its statement of objectives, the governing body sets the tone and direction of the policy and the investment program.

5. Delegation of Authority

After the investment objectives have been identified, the next logical element of an investment policy is an explicit delegation of authority to specific investment officials responsible for conducting transactions and managing the entity's investment program.

6. Ethics and Conflicts of Interest

Some governments have adopted conflict of interest legislation that regulates the activities of certain officers and employees. In the investment area, some conflicts may be governed by general code provisions, making separate policies redundant. Some jurisdictions, however, may seek to adopt policies regarding ethical behavior and conflicts of interest.

7. Authorized Financial Dealers and Institutions

The investment policy should require that a set formal process be used to select depositories and brokers/dealers. Because the policy is intended to endure, it should not mention specific firms or depositories. Rather, it should provide for a process that will screen out institutions that lack economic viability or whose past practices suggests that the safety of public capital would be impaired if transactions were directed to or through such firms.

8. Authorized and Suitable Investments

The selection of investment instruments to be allowed for investment purposes is a significant policy issue for many governments. Although day-to-day selection of specific instruments should be treated as a management function, the policy should define the general universe. Direction should be specifically given to funds that receive bond proceeds subject to arbitrage considerations.

From the approving authority's perspective, special care must be taken to ensure that the list of instruments includes only those allowed by law and those that local investment managers are trained and competent to handle. Cite the appropriate statutes for the particular entity as attachments.

In selecting authorized investments, consideration should be given to credit ratings on bankers' acceptances and collateralization of applicable instruments.

8.1 If repurchase agreements are authorized, a Master Repurchase Agreement must be signed with the bank or dealer.

9. Collateralization

Collateralization must be required on any repurchase agreement. The policy should address such points as market valuation responsibility and timing, safekeeping by an independent third party and evidence of ownership.

10. Safekeeping and Custody

Like private investors, governing officials feel more secure about their entity's investments if they know that the securities are physically safe. The investment policy must include a clause regarding third-party safekeeping and custody of securities and collateral. The policy must also address the delivery of securities, where Delivery Versus Payment (DVP) is a requirement (i.e. Delivery of securities with a subsequent exchange of money for the securities).

11. Diversification

The Investment Policy should state the purpose of diversification --to reduce overall portfolio risks while attaining market average rates of return. Diversification should be conceptualized in terms of maturity as well as instrument type and issuer. Thus, the diversification concept in a cash management fund should include prohibition against over concentration in a specific maturity sector, as well as constraining the reliance on specific risky instruments and issuers.

12. Maximum Maturities

To protect public funds from market price losses resulting from rising interest rates, the entity may wish to limit the maximum term to maturity on current operating funds' investment to 12 months --the operating budget cycle. Some may find this term unduly restrictive and may employ a two-year (or longer) rule. The latter only appears reasonable if a portion of the assets are not required for expenditure within the one-year budget cycle.

13. Internal Controls

The development of internal controls remains a management function. The specific internal control measures are beyond the scope of the investment policy and should be subject of the normal operating procedures of the Treasury. The investment policy merely should require that a system of internal controls should be established. The policy can, of course, provide for the timing of periodic reviews and monitoring of controls. The review of internal controls should not be left up to the periodic examination by the Office of the State Auditor but review of controls is an ongoing responsibility of the entity.

14. Performance Standards

Much of the investment policy focus is directed toward controls. Yield objectives are also quite important. The long-run interests of the jurisdiction go beyond simple prudence and safety of funds. The investment policy should provide a formal evaluation of performance and occasional operational audits. Market Yield (Benchmark): entity's investment strategy is either passive or active. Given the strategy, define the basis used by the Treasurer to determine whether average yields are being achieved by comparison to a benchmark. List a recognized and verifiable index, e.g., six month U.S. Treasury Bill, average Fed Funds rate, the Local Government Investment Pool, etc.

15. Reporting

Investment reports provide a mechanism for monitoring by the governing body. Periodic flows of information are needed to consider the impact of economic conditions, portfolio changes and the results of investment operations. Reporting also provides written communication regarding investment performance, compliance, and a clear representation of the investment portfolio.

16. Investment Advisors

If an entity will be utilizing investment advisors for assistance in their investment practices and portfolio management, it should be included in the policy.

17. Accounting Method

A public entity must comply with Generally Accepted Accounting Principles.

18. Investment Policy Adoption

It is best to have the policy certified by the board or certification committee prior to taking the policy to the statutory governing body, the Oregon Short Term Investment Board. In order for the investment policy to receive certification, these items MUST be included.