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**TREASURY / TRUST**  
*PORTFOLIO*

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**Investment Policy**

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**September 2011**



*James L. McIntire*  
*Washington State Treasurer*

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Office of the Washington State Treasurer

TREASURY / TRUST PORTFOLIO

INVESTMENT POLICY

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**I. STATEMENT OF PURPOSE**

**STATEMENT OF PURPOSE**

This statement is intended to describe the policies that the State Treasurer has established as useful and prescribed guidelines for the prudent management of state funds. This statement also lists and describes realistic parameters and goals in investing those public funds.

It aims to establish reasonable expectations, objectives and guidelines in the investment process. It will set forth an investment structure detailing the universe of permitted investments and restrictions for their utilization. Creating this framework will lessen confusion as it sets expectations of generally acceptable returns at a level of risk suitable to the stated funds.

The goal of this investment policy and the corresponding investment function is to clarify the prescribed duties delegated to the State Treasurer with regards to the investment of public funds.

This statement is intended to be an abstract of the investment philosophy that serves as a general guidance to individuals so authorized. The Treasurer has liberty to make amendments as deemed necessary.

**II. IDENTIFICATION OF FUNDS**

This policy applies to the investment of all Treasury and Trust Funds managed by the State Treasurer, with the following exceptions:

- the Local Government Investment Pool, which is governed by separate statute (RCW 43.250) and by separate policy;
- the Time Certificate of Deposit and Linked Deposit programs, which are governed by separate statute (RCW 43.86A);
- funds held by the Department of Labor and Industries as trustee for the U.S. Department of Energy, which are governed by agreement between the Department of Labor and Industries and the U.S. Department of Energy.

**III. OBJECTIVES**

All funds will be invested in a manner that is in conformance with federal, state and other legal requirements. In addition, the objectives, in order of priority, of the investment activities will be as follows:

1. **Safety:** Safety of principal is the primary objective of the State Treasurer. Investments shall be undertaken in a manner that seeks to ensure preservation of capital in the overall portfolio. To obtain this objective, funds will be diversified, utilizing highly rated securities, by investing among a variety of securities and financial institutions offering independent returns.
2. **Liquidity:** The investment portfolio will remain liquid to enable the State Treasurer to meet all cash requirements that might reasonably be anticipated. Therefore, the investments shall be managed to maintain a balance to meet daily obligations. These funds will be dedicated to the STIF portfolio.
3. **Return on Investment:** The investment portfolio will be structured with the objective of attaining a market rate of return throughout budgetary and economic cycles, commensurate with the investment risk parameters and the cash flow characteristics of the portfolio. These funds will be dedicated to the core portfolio.

The Treasury/Trust's investments are separated into two main portfolios to manage, and meet the objectives of safety, liquidity and return. Objective by portfolio are as follows:

1. **The STIF portfolio.** The main objectives of this portfolio are to meet the liquidity needs of the Treasury/Trust, and to manage the temporary cash positions of the core portfolio. All daily cash requirements are to be met by assets in this portfolio. It has an expected risk objective of zero liquidity risk, which is quantified by maintaining a dollar price of \$1.00 in the same sense that a Rule 2a-7 money market fund does. Consistent with that risk objective, the benchmark for the portfolio will be the net yield of the Donoghue Government Only, Institutional Only group of funds. Return/earnings are calculated on an accrued basis.
2. **The core portfolio.** The core portfolio is comprised of cash that is not reasonably expected to be necessary to meet the short- or intermediate-term liquidity needs of the Treasury/Trust. Accordingly, this cash may be invested further out the yield curve where, over a market cycle, it is expected to provide a higher return than the STIF portfolio. Return will be paid on an accrual basis. The benchmark of the core portfolio is the total return of the Merrill Lynch Intermediate Term Government Index (1-2.99 years). The core portfolio may have a maximum modified duration of no longer than 3.5 years. A portion of the portfolio may be managed on a total return basis within these guidelines.

#### IV. STANDARDS OF CARE

##### 1. Delegation of Authority

The State Treasurer is an executive officer of the state established by the Constitution of the State of Washington (Article III, Section 1), and "will perform such duties as will be prescribed by law" (Article III, Section 19).

As prescribed by the Revised Code of Washington, "Whenever there is in any fund or in cash balances in the state treasury more than sufficient to meet the current expenditures properly payable there from, the state treasurer may invest or reinvest such portion of such funds or balances as the State Treasurer deems expedient." (RCW 43.84.080)

To "ensure effective cash management of public funds" (RCW 43.08.015), the State Treasurer may designate investment officers who will have the authority to perform the duties of the State Treasurer, and will maintain a current list (available upon request) of those individuals so authorized.

## **2. Prudence.**

The State Treasurer and authorized investment officers shall perform their investment duties in a manner consistent with this policy and the standard of a prudent investor, in light of the purposes, terms, requirements and other circumstances then prevailing as to the assets entrusted to them.

In investing, they shall exercise reasonable care, skill, diligence, and prudence, considering investments not in isolation, but in the context of the portfolio as a whole and of an overall investment strategy. That strategy should incorporate the risk and return objectives set forth in this policy.

They shall act with undivided loyalty and impartiality; incur only costs which are reasonable in amount and which are appropriate to their investment responsibilities; and they shall seek to minimize costs whenever they deem it prudent to do so.

Authorized investment officers acting in accordance with this policy and exercising due diligence shall be relieved of personal responsibility for credit and market risks encountered in the performance of their investment duties. Due diligence requires timely reporting of material deviation from expectations and such other actions to control adverse developments as may be possible in consideration of the particular circumstances and within other provisions of this policy.

Given the legal list of authorized investments and other restrictions contained in this policy, they shall be deemed to have met any requirement for diversification so long as they are in compliance with this policy.

In the case of investments made in accordance with statute for objectives other than those specified in Section 3 above, such as in the case of the Linked Deposit Program (RCW 43.86A.060) or as otherwise provided in statute, this policy and its standard of care are restricted to the express provisions of the statutes directing such investments.

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

The State Treasurer, assistant treasurer, and authorized investment officers will adhere to standards of conduct as stipulated by the following:

- Public Disclosure Act, RCW 42.16;
- Ethics in Public Service Act, RCW 42.52 and section 292-110-010 Washington Administrative Code; and,

- Standards of Conduct for Executive Branch Employees, Executive Order 93-02.

All authorized investment officers will file personal financial disclosure forms with the Public Disclosure Commission consistent with the provisions of RCW 42.17.

## **V. CONTROLS**

### **1. Custody**

Safekeeping and Custody of Securities. Prudent treasury management dictates that all purchased securities be bought on a delivery versus payment (DVP) basis and be held in safekeeping by an independent third-party financial institution. Deposits will only be made in depositories approved by the Washington Public Deposit Protection Commission.

The State Treasurer's shall designate all safekeeping arrangements and an agreement of the terms executed in writing. The third-party custodian shall be required to provide a statement to the State Treasurer listing at a minimum each specific security, description, maturity date, market value, par value, purchase date, and cusip number.

### **2. Authorized Financial Dealers and Institutions.**

The State Treasurer will maintain a list of broker/dealers and financial institutions authorized to provide investment services to the state. Authorized broker/dealers and financial institutions will be limited to those that meet one or more of the following:

- financial institutions approved by the Washington Public Deposit Protection Commission (RCW 39.58); or,
- primary dealers recognized by the Federal Reserve Bank; or,
- non-primary dealers qualified under U.S. Securities and Exchange Commission Rule 15C3-1, the Uniform Net Capital Rule, and a certified member of the National Association of Securities Dealers.

Each authorized dealer or institution will make available annual reports, including audited financial statements, and other information as determined by the State Treasurer.

### **3. Competitive Transactions**

- It will be the policy of the state treasurer to transact securities purchases or sales through appropriately competitive processes.
- Electronic trading is the preferred option for the purchase and sale of investment instruments.
- Offers or bids for securities may be received from approved broker/dealers by the following means:
  - a. by phone
  - b. by e-mail or other electronic communication
  - c. through electronic trading platform

d. from inventory listings supplied by approved broker/dealers for underwritten new issues.

#### **4. Internal Controls**

The State Treasurer will maintain internal controls to protect against the loss of public funds arising from negligence, theft, or misuse. These controls will include, but not be limited to:

- the use of a third party custody and safekeeping;
- the execution of all securities transactions on a DVP basis;
- the clear delegation of investment authority;
- the separation transaction authority from record keeping;
- the use of objective criteria in selecting financial institutions and dealers authorized to provide investment services to the state; and,
- the use of objective criteria in awarding investment purchases and sales to authorized financial institutions and dealers.

An investment policy committee, composed of the assistant treasurer, the deputy treasurer for investments, and authorized investment officers, will regularly review this policy.

Daily compliance reports, as well as monthly performance reports, will be provided to the treasurer and assistant treasurer.

#### **5. External Controls**

As prescribed by RCW 43.09.050, the state auditor will “audit the accounts” and “inspect the books” of the State Treasurer to determine the compliance of investment activities with state statutes and this policy.

The market value of the portfolio will be calculated monthly by the master custodian or by an independent pricing service under contract with the State Treasurer’s Office.

This policy will be reviewed/ revised at least annually. The State Treasurer will formally approve any changes to this policy.

### **VI. ELIGIBLE AND SUITABLE INVESTMENTS**

#### **1. Eligible Investments**

Eligible investments are only those securities and deposits authorized by statute (RCW 39.58, 39.59, 43.84.080 and 43.250). Eligible investments include, but are not limited to:

- obligations of the U.S. government;
- obligations of U.S. government agencies, or of corporations wholly owned by the U.S. government;

- obligations of government sponsored corporations which are or may become eligible as collateral for advances to member banks as determined by the board of governors of the Federal Reserve;
- banker's acceptances purchased on the secondary market rated with the highest short-term credit rating of any two Nationally Recognized Statistical Rating Organizations (NRSROs), at the time of purchase. If the banker's acceptance is rated by more than two NRSROs, it must have the highest rating from all of the organizations;
- commercial paper, provided that the State Treasurer adheres with policies and procedures of the State Investment Board regarding commercial paper (RCW 43.84.080(7));
- certificates of deposit with financial institutions qualified by the Washington Public Deposit Protection Commission;
- Local Government Investment Pool; and
- obligations of the state of Washington or its political sub-divisions.

## **2. Repurchase and Reverse Repurchase Agreements**

Repurchase and reverse repurchase agreements will be subject to the following additional restrictions:

- transactions will be conducted only with primary dealer's, the state's bank of record, or master custodial bank, and under the terms of a written master repurchase agreements;
- repurchase agreements with any single primary dealer or financial institution will not exceed 20% of the portfolio or \$600 million, whichever is greater;
- the maximum term of repurchase agreements will be 180 days;
- the share of the portfolio allocated to repurchase agreements with maturities beyond 30 days will not exceed 30% of the total portfolio;
- the maximum term of reverse repurchase agreements will be 180 days and must be matched to anticipated cash flows adequate to liquidate the transaction; and,
- the maximum portion of the portfolio allocated to reverse repurchase agreements will not exceed 30% of the total portfolio.
- Tri-Party Repo may be entered into with a contracted custodial bank for this purpose, as long all securities meet the below requirements.

Securities accepted for repurchase agreements will be subject to the following additional restrictions:

- Securities utilized in a repurchase agreement with a maturity date longer than seven days will be priced at least weekly;
- all substitutions will be approved by the The office of the State Treasurer OST before the existing purchased security is released to the broker/dealer;
- Treasury, agency and money market securities will be priced at 102% of market value, plus accrued income;
- Mortgage-backed repurchase agreements with a maturity date longer than seven days will be priced at 105% of market value, plus accrued income;
- collateralized mortgage obligation (CMO) securities utilized in repurchase agreements must pass the Federal Financial Institutions Examination Council (FFIEC) test, or not exceed a volatility rating of V-5 by Fitch Investor Services, or a similar rating of a nationally recognized rating agency; and,

- only securities authorized in statute for the investment of public funds will be utilized in repurchase agreements.

Additional operating guidelines will provide details relating to the frequency of security pricing, substitutions, and margin calls.

## VII. INVESTMENT PARAMETERS

To provide for the safety and liquidity funds, the investment portfolio will be subject to the restrictions listed below. These represent minimum investment restrictions under this formal investment policy and there may be separate guidelines containing additional, more restrictive limitations for certain investment instruments. All restrictions are based on a settlement date basis. The investments of cash collateral and securities accepted as collateral by a securities lending agent are subject to the restrictions and limits of sections VI and VII of this policy.

Maximum percentages for a particular issuer, investment type or liquidity constraints may on occasion be exceeded, e.g., due to fluctuations in fund balances. Securities need not be liquidated to realign the portfolio; however, consideration will be given to this matter when future purchases are made

### 1. Non-government Securities and Deposits

Investments in non-government securities, excluding securities utilized in repurchase agreements, will not exceed the following percentages of the total daily portfolio size:

Bankers Acceptances	25%
Commercial Paper	25%
Certificates of Deposit*	10%

\* Not including Certificates of Deposit purchased in accordance with RCW 43.86A.030.

The aggregate amount for commercial paper and banker's acceptances will not exceed 35% of the portfolio. Additionally, individual issuers of commercial paper or banker's acceptances will be limited to no more than 5% of the portfolio.

The balance in the LGIP will not exceed 10% of the total size of the LGIP.

### 2. Investment Maturity

- ***The STIF portfolio.***
  - Maximum single maturity 1 year
  - Maximum weighted average maturity 120 Days
- ***The core portfolio.***

- Maximum single maturity 10 years
- Maximum modified duration not longer than 3.5 years.

### **3. Prohibited Investments**

To provide for the safety and liquidity of Treasury and Trust Funds, the investment portfolio will be subject to the following restrictions:

- purchase of collateralized mortgage obligations (CMO) is not allowed; and
- allocation to investments subject to high price sensitivity or reduced marketability will not exceed 15% of the daily balance of the portfolio. For the purposes of this policy investments subject to high price sensitivity or reduced marketability will be defined as structured notes, with the exception of generic callable securities, and floating rate notes which may be reasonably expected to reset at or near par on their reset dates. A structured note is a debt security whose cash flow characteristics (coupon rate, redemption amount, or stated maturity) depend on one or more indices and which may have embedded forwards or options. Structured notes whose cash flows can no longer fluctuate would not count against the 15% allocation.

## **VIII. PROFESSIONAL SERVICES**

The State Treasurer may contract for professional services as necessary for the efficient management of investments.

### **1. Appointment of Master Custodian**

The State Treasurer may select one or more firms to provide the state with master custodial services. Master custodial services will include, but not be limited to:

- executing transactions involving all securities held in custody, including on-line security clearing, settlement of securities on a delivery-versus-payment basis (DVP), and settlement of physically-held securities;
- providing regular reports on the activity and value of the securities in custody; and
- providing for the safekeeping of all documents and financial instruments physically held in custody.

### **2. Appointment of Securities Lending Agent**

The State Treasurer may select one or more firms to provide securities lending management services. Securities lending services will include, but not be limited to:

- ensuring all loans of coupon-bearing securities are supported by collateral valued at not less than 102% of market value of the securities, including accrued income;
- ensuring all loans of non coupon-bearing securities supported by cash collateral, shall not be valued at less than 102% of market value, but not to exceed par;

- ensuring all loans of non coupon-bearing securities supported by non-cash collateral, shall not be valued at less than 102% of market value;
  - ensuring the average maturity of securities on loan and of the securities purchased are for 14 days or less;
  - ensuring that the investment of cash collateral be only in securities authorized in this policy, and that the restrictions on investments found in sections V and VI of this policy also apply to investments made by a securities lending agent;
  - providing next day liquidity for all securities on loan; and,
  - providing monthly accounting, performance, compliance, and management reports.
- The services of a master custodian and securities lending agent will be obtained through an evaluation of competitive proposals submitted in response to a regularly issued request for proposals.

## IX. Reporting

The State Treasurer will prepare regular reports summarizing investment activity of the portfolio. The reports also will include: Securities holdings, cash balances, and market values in the investment portfolio.

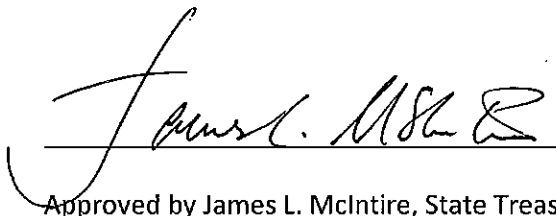
### 1. Specific Requirements

#### SPECIFIC REQUIREMENTS:

- Book Yield
- Holdings Report including mark to market and security description
- Transactions Report
- Weighted Average Maturity or Duration

### 2. Performance Standards

- The investment portfolio will be designed to obtain a market average rate of return during budgetary and economic cycles, taking into account investment risk constraints and cash flow needs.
- The earnings benchmark will be a market benchmark that appropriately models the risk and return of the portfolios.

  
 Approved by James L. McIntire, State Treasurer

9-7-11  
 Date

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