

## INVESTMENT POLICY

### I. 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 the funds in the Local Government Investment Pool (LGIP). 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 LGIP 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 all public funds on deposit with the Local Government Investment Pool (LGIP) as defined by RCW 43.250.020.

### III. Objectives

The LGIP is comparable to a Rule 2a-7 money market fund recognized by the Securities and Exchange Commission (17CFR.270.2a-7). Rule 2a-7 funds are limited to high quality obligations with limited maximum and average maturities, the effect of which is to minimize both market and credit risk.

The objectives of the State Treasurer's investment practices for the LGIP, in priority order, will be: safety, liquidity, and return on investment.

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 the OST portfolio manager will :
  - limit the purchase of investments to securities that have a maximum final maturity of 397 days, with the exceptions listed in Section VII of this policy;
  - maintain a Weighted Average Maturity (WAM) of 60 days or shorter, as described in Section VII.3;
  - maintain a Weighted Average Life (WAL) of 120 days, as described in Section VII.3;
  - limit the purchase of investments in securities other than those issued by the U.S. government or its agencies; and,
  - prepare regular reports of portfolio activity.

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.
  - OST will have an understanding of historical cash flow patterns to manage expectations.
  - OST will hold securities that can be converted to liquid cash to be incorporated in liquidity structure.
3. **Return on Investment:** The LGIP 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 pool.

#### IV. Standards of Care

##### 1. Delegation of Authority.

The State Treasurer is an executive officer of the state, as 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 (RCW), “The legislature finds and declares that the public interest is found in providing maximum prudent investment of surplus funds, thereby reducing the need for additional taxation. The legislature also recognizes that not all political subdivisions are able to maximize the return on their temporary surplus funds. The legislature therefore provides in this chapter a mechanism whereby political subdivisions may, at their option, utilize the resources of the Office of the State Treasurer (OST) to maximize the potential surplus funds while ensuring the safety of public funds” (RCW 43.250.010).

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 will perform their duties in a manner consistent with the standard of a “prudent person,” as defined by RCW 43.250.040:

“In investing and reinvesting moneys in the public funds investment account and in acquiring, retaining, managing, and disposing of investments of the investment pool, there shall be exercised the judgment and care under the circumstances then prevailing which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of the funds considering the probable income as well as the probable safety of the capital.”

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.

### **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: 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 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, when appropriate.
- 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. Share Price Calculation.**

The current price per share, for purposes of distribution, redemption and repurchase, will be computed by use of the Amortized Cost Method. It is the intent to manage the portfolio to maintain a stable net asset value at \$1.00, like 2a7 funds. However maintenance of a stable net asset value at 1.00 is not guaranteed.

#### **5. 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 third party custody and safekeeping;
- the execution of all securities transactions on a DVP basis;
- the clear delegation of investment authority;
- the separation of 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.

Daily reports monitoring investment operations to ensure compliance with the terms of this policy will be produced and provided to staff responsible for oversight of the LGIP.

#### **6. 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. In addition, the LGIP will contract for an outside independent audit of LGIP financial statements.

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 after consultation with the LGIP Advisory Committee.

## **VI. Eligible and Suitable Investments**

### **1. Eligible Investments**

Eligible investments are only those securities and deposits authorized by statute. (RCW 39.58, 39.59, and 43.84.080) 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 designated 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 OST adheres with policies and procedures of the State Investment Board regarding commercial paper (RCW 43.84.080(7));
- certificates of deposit or demand deposits with financial institutions qualified by the Washington Public Deposit Protection Commission and made in accordance with the provisions of RCW 39.58; and,
- obligations of the state of Washington or its political subdivisions.

## **VII. Investment Parameters**

To provide for the safety and liquidity of LGIP 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. Liquidity Provisions**

The fund will be structured to maintain a sufficient degree of liquidity necessary to meet reasonably foreseeable redemption requests and reduce the likelihood that a fund will have to meet redemptions by selling portfolio securities into a declining market.

- 10% will be maintained in “daily liquid assets” and that includes (i) cash (ii) direct obligations of the US Government, (iii) demand deposits, (iv) overnight repurchase agreements and (v) securities that mature that day.
- 30% of the portfolio will be maintained in “weekly liquid assets” — and includes (i) cash, (ii) direct obligations of the US Government, (iii) Government Agency discount notes that have remaining maturity of 60 days or less and (iv) securities that will mature, or have a demand feature exercisable and payable within 5 business days.

### **2. Diversification and Percentage Limitations**

Cash raised as a result of securities lending or reverse repurchase agreement transactions will not increase the dollar amount of the following limitations.

**a. Government Securities**

Investments in government securities will not exceed the following percentages of the total daily portfolio balance at amortized cost:

Floating and Variable Rate Notes (aggregate total)	30%
Other Structured Notes	10%

For the purposes of this policy the following definitions shall apply:

Floating Rate Note: securities which at all times can reasonably be expected to have a market value that approximates their amortized cost. This would include those who reset based on indices such as Fed Funds or the prime lending rate. Floating Rate Notes that reset based on any other index must be approved by either the state treasurer or the assistant state treasurer prior to purchase.

Variable Rate Notes: securities which on any reset date can reasonably be expected to have a market value that approximates their amortized cost. This would include those who reset based on indices such as LIBOR or US Treasury Bills. Variable Rate Notes that reset based on any other index must be approved by either the state treasurer or the assistant state treasurer prior to purchase.

Other Structured Notes: all other debt securities 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 will not count against the 10% limitation.

**b. Non-government Securities**

Investments in non-government securities will not exceed the following percentages of the total daily portfolio balance at amortized cost:

Bankers Acceptances	20%
Commercial Paper	25%
Certificates of Deposit	10%
Demand Deposit Accounts	50%

The aggregate amount for Commercial Paper and Bankers Acceptances will not exceed 35% of the portfolio. Additionally, individual issuers of commercial paper or bankers acceptances will be limited to no more than 5% of the portfolio.

**3. Investment Maturity**

**A. Maximum Final Maturity** The maximum final maturity of any security will not exceed 397 days, with the following exceptions:

- The maximum maturity of the variable rate and floating rate securities meeting the requirements listed above will not exceed 762 days; and
- Securities utilized in repurchase agreements

**B. Weighted Average Maturity (WAM)**

The weighted average maturity (WAM) of the portfolio will not exceed 60 days. For the purposes of calculating the WAM:

- A variable rate security meeting the requirements listed above will be deemed to have a maturity equal to the period remaining to the next reset date, provided that on any reset date such security can be reasonably expected to have a market value that approximates its amortized cost; and
- A floating rate security meeting the requirements listed above will be deemed to have a remaining maturity of one day, provided that at any time prior to maturity such security can reasonably be expected to have a market value that approximates its amortized cost.

### **C. Weighted Average Life (WAL)**

The weighted average life (WAL) of the portfolio shall not exceed 120 days. For the purpose of calculating the WAL:

- A variable rate security will be calculated using its final maturity; and,
- A floating rate security will be calculated using its final maturity.

### **D. 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 dealers, the state's bank of record, or master custodial bank, and under the terms of a written master repurchase agreement approved by the Public Securities Association;
- repurchase agreements with any single primary dealer or financial institution will not exceed 20% of the portfolio;
- 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 90 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 or engaged in a securities lending program will not exceed 30% of the total portfolio.

Securities utilized in 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 OST before the existing purchased security is released to the broker/dealer;
- the market value, plus accrued income, of treasury, agency and money market securities utilized in repurchase agreements will be 102% of the value of the repurchase agreement;
- the market value, plus accrued income, of mortgage-backed securities utilized in repurchase agreements with more than seven days remaining until maturity will be 105% of the value of the repurchase agreement;
- collateralized mortgage obligation (CMO) securities utilized in repurchase agreements must pass the Federal Financial Institutions Examination Council (FFIEC) test, or will 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.

## **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.

Securities purchased by the office are to be held by the master custodian, acting as an independent third party, in its safekeeping or trust department.

Collateral is to be similarly held or held by an independent third party with whom the office has a current master repurchase agreement.

All securities transactions are to be conducted on a DVP basis only, and a trade confirm/safekeeping receipt is to be provided to the Treasurer's Office.

## **IX. Advisory Committee**

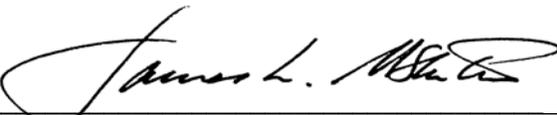
The State Treasurer created the LGIP Advisory Committee to provide advice on the operation of the pool. Of the committee members, all of whom are active LGIP participants, some members are appointed by participant associations, and some members are appointed by the State Treasurer. The LGIP Advisory Committee will meet quarterly or at the discretion of the State Treasurer.

## **X. Performance Benchmark**

A performance benchmark provides an appropriate comparison of risk and return based on a investment funds policy criteria. The imoney.net, Govt Only Institutional Index is an index that is comprised of 2a7 government only portfolios and represents the LGIP investment objectives. Therefore, this index will be used as a comparison for risk and return results.

## **XI. Reporting Requirements**

The State Treasurer will prepare regular reports summarizing characteristics and holdings in the fund. In accordance with Washington Administrative Code 210-01-110, each pool participant will be provided a monthly statement of account. In accordance with RCW 43.250.080, the State Treasurer will submit an annual summary of LGIP activity to the governor, the state auditor, and the Joint Legislative Audit and Review Committee.

  
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Approved by James L. McIntire, State Treasurer

11-15-10  
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Date

Effective Date: November 10, 2010