



Revised
ACTION ITEM
May 18, 2011

TO: Board of Directors

FROM: **Administration & Finance Committee**
(Directors Thomas, Royce, Barbre)

Kevin Hunt
General Manager

Staff Contact:
Phil Letrong

SUBJECT: **Annual Review of District Investment Policy and Guidelines**

STAFF RECOMMENDATION

Staff recommends the Board of Directors: Adopt Resolution establishing the District's Investment Policy and Guidelines, and incorporate these changes to the District's Administrative Code accordingly.

COMMITTEE RECOMMENDATION

Committee recommends (To be determined at Committee Meeting)

SUMMARY

Since the posting of this action item, legal counsel has made some revisions to the proposed Investment Policy. Revised document is attached for the committee review.

The Board adopted Resolution No. 1736 in May of 2004 and the Administrative Code requires that the Board conduct an annual review of its investment policies and guidelines. We have reviewed the policy each year, but only some minor changes have been made since 2004.

Staff had a chance to work with Mr. Michael Swan from Mutual Securities on reviewing and updating the District Investment Policy. Mr. Swan is a reviewer on the Investment Policy Review and Certification Committee for the Association of Public Treasurers of the U.S. and Canada and offered to review our policy in that capacity.

Budgeted (Y/N):	Budgeted amount: N/A
Action item amount:	Line item:
Fiscal Impact (explain if unbudgeted):	

The proposed changes made to the Investment Policy can be summarized as follow:

1. Investment officer responsibility is more clearly defined based on standard industry practice.
2. Surplus Funds (Reserves) terminology is replaced with Reserve Funds to be consistent with the Administrative Code.
3. Investment Objectives are clearly defined in section 2105.
4. Permissible investment compositions are revised to eliminate redundancy and repetition.
5. In order to obtain a better return on investment, staff recommends to extend the maturity of the following Permissible investments for the Operating and Fiduciary funds such as:
 - a) U.S. Treasury obligations maturity changes from one year to two years.
 - b) U. S. Government Agency obligations maturity changes from one year to two years.
 - c) Prime Commercial Paper maturity changes from 31 days to 90 days.
6. Stricter guidelines are proposed on Repurchase Agreements, U.S. Treasury and Agency collateral markets requiring that the value should be at least 102% of the value of the Repurchase Agreement.
7. "National Association of Security Dealers" is replaced with its new name "Financial Industry Regulatory Authority (FINRA)" in section 2108.

Staff recommends the revised Resolution be adopted (superseding Resolution 1736) and incorporated into the District's Administrative Code.

**MUNICIPAL WATER DISTRICT OF ORANGE COUNTY
ADMINISTRATIVE CODE**

INVESTMENT POLICY AND GUIDELINES	§2100-§2109
---	--------------------

§2100 PURPOSE

The purpose of this policy ~~statement~~ is to set forth the investment and operational policies for the management of the public funds of Municipal Water District of Orange County. These policies have been adopted by, and can be changed only by a majority vote of the Board of Directors.

These policies are designed to ensure the prudent management of public funds, the safety of principal, the availability of operating funds when needed, and an investment return competitive with those of comparable funds and financial market indexes.

A copy of this statement policy will be provided to all investment dealers and investment managers doing business with the Municipal Water District of Orange County. Receipt of this policy, including confirmation that it has been reviewed by persons dealing directly with the Municipal Water District of Orange County's account will be received prior to any organization providing investment services to the Municipal Water District of Orange County.

§2101 STATUTORY AND DELEGATED AUTHORITY

Authority to manage the investment of surplus funds is derived from California Government Code Sections 53601, et seq. In accordance with Section 53607 of the Government Code of the State of California, the authority of the Board of Directors to invest public funds may be delegated to the Treasurer.

The Municipal Water District of Orange County (MWDOC) Board of Directors has expressly delegated the investment authority of the Board of Directors to the Treasurer pursuant to Resolution No. 1166. By Resolution No. 1277, the Board of Directors created the office of Deputy Treasurer and delegated to the Deputy Treasurer the authority to direct investment of MWDOC funds under the circumstances set forth in said Resolution. The Board of Directors created the office of Alternate Deputy Treasurer by Resolution No. 1434 and specified circumstances under which the Alternate Deputy Treasurer would have authority to direct the investment of MWDOC funds.

No person may engage in an investment transaction on behalf of MWDOC unless he or she has been duly appointed by the Board of Directors to the office of Treasurer, Deputy Treasurer, or Alternate Deputy Treasurer, and subject to the limitations and conditions set forth in the Resolutions establishing those offices and the terms of this policy. Notwithstanding the foregoing, upon the occurrence of a vacancy in the office of

Treasurer, the Board of Directors may appoint an Acting Treasurer, who shall have and exercise the authority delegated to the Treasurer until appointment of a successor Treasurer by the Board of Directors.

The Treasurer shall be responsible for all transactions undertaken and shall establish procedures and a system of internal controls to regulate the activities of subordinate officials.

§2102 ORGANIZATION

The organizational structure of the investment functions of MWDOC shall consist of the Board of Directors, the Administration & Finance Committee, the Treasurer and Deputy Treasurers. The responsibilities of these groups are as follows:

Board of Directors - the elected body responsible for the administration and investment of the assets of MWDOC. The Board may acquire, hold, manage, purchase, sell, assign, trade, transfer and/or dispose of any security, evidence of debt, or other investment in which MWDOC's assets may be invested by law. To assist them in discharging their responsibilities, the Board shall appoint a Treasurer, Deputy Treasurers and custodians of assets.

Administration & Finance Committee - appointed by the Board to review transactions, performance and asset mix, monitor, recommend policy, and propose adjustments for Board approval.

Treasurer ~~is~~ responsible for the administration ~~of the funds~~ and the investment of ~~those the~~ funds, subject to the policies and restrictions set by the Board. The Treasurer as investment officer of MWDOC is granted full authority and responsibility by the Board in the purchase, sale, assignment, exchange and transfer of securities and for the safe custody of security holdings, subject to Board policies, rules, regulations and directives consistent with regulatory and statutory limitations. The Treasurer is responsible for interpreting, administering and advising on legal requirements, investment policies and strategies; collecting income, preparation of reports. Also responsible for ~~the~~ Deputy Treasurers, and ~~other~~ investment staff compliance with ~~the~~ this investment policy and guidelines.

Deputy Treasurers - act in the absence of the Treasurer as specified within the Resolution of appointment to fulfill the duties and responsibilities as assigned by the Treasurer.

§2103 INVESTMENT PHILOSOPHY

Except where specifically directed by the State Constitution, statutes or regulations, the general investment policies of MWDOC will be guided by the ~~prudent-person rule~~ Prudent Investor Standard ("Standard") set forth in (California Government Code Section 53600.3). Under this Standard, ~~Those~~ with investment responsibility for public funds are trustees and, as trustees, such shall act with ~~exercise the~~ care, skill, prudence

and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of MWDOC, that a prudent person acting in a like capacity and familiarity with those matters would use persons' of prudence discretion and intelligence, exercise in the conduct of funds of a like character and with like aims to safeguard the principal and maintain the liquidity needs of the agency.

This sStandard shall be applied in the context of managing the overall investment portfolio. The investment officers, acting in accordance with written procedures and this investment policy and exercising the above standard of due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments.

§2104 SCOPE

It is intended that this Investment Policy cover all funds and investment activities of MWDOC. Any reference to the portfolio shall mean the collection of MWDOC securities held by the Treasurer. Those securities held in Trust or escrow by a third-party Trustee or escrow agent on behalf of MWDOCWFC are invested under the Treasurer's direction in accordance with this investment policy and the ~~authority and~~ terms of the specific escrow or trust agreements related to the funds.

MWDOC funds are divided into two categories, and the investment objectives and policies vary with the nature of the fund.

- Operating and Fiduciary — Funds - These funds are to provide for the ordinary annual operating expenses of MWDOC (General Fund, Water Fund) and Funds to provide for trustee functions and expenditures (WFC, with the exception of the Debt Service Reserve) and other specified reoccurring and non-reoccurring purposes where MWDOC serves in a fiduciary role. ~~Portfolio management shall have as a primary objective to preserve principal, second, to ensure that funds are available as needed due to the short-term nature of the inflows and outflows of the principal of the fund, and third, to generate a return as a supplementary source of income.~~ These funds are considered "short-term" for investment purposes and will be invested to provide the safety and liquidity to meet all anticipated expenditures.
- ~~Surplus funds (Reserves)~~ Reserve Funds — These funds are Funds that have ~~no immediate use but may be~~ designated ~~and set aside~~ for contingencies or emergencies ~~or and~~ may be used to supplement the other funds as necessary. ~~Portfolio management is designed primarily to preserve principal so that it will be available when needed and secondarily to generate income.~~ These funds may be invested "longer-term" as defined in this investment Policy.

§2105 INVESTMENT OBJECTIVES

When investing, reinvesting, purchasing, acquiring, exchanging, selling or managing MWDOC's funds, the primary objective is to safeguard the principal of the funds. The secondary objective is to meet the liquidity needs of the DistrictMWDOC. The third objective is to achieve a maximum return on invested funds (California Government Code Section 53600.5.). It is the policy of MWDOC to invest funds in a manner to obtain the highest yield possible while meeting the daily cash flow demands of the DistrictMWDOC as long as investments meet the criteria established by this investment policy for safety and liquidity and conform to all laws governing the investment of the DistrictMWDOC's funds.

Safety of Principal.

Safety of principal is the foremost objective of MWDOC. Each investment transaction shall seek to first ensure that capital losses are avoided, whether they arise from securities defaults, institution default, broker-dealer default, or erosion of market value of securities. MWDOC shall mitigate the risk to the principal of invested funds by limiting credit and interest rate risks. Credit Risk is the risk of loss due to the failure of a security's issuer or backer. Interest Rate Risk is the risk that the market value of the MWDOC's portfolio will change due to an increase/decrease in general interest rates.

1) Credit risk will be mitigated by:

- (a) Limiting investments to only the most creditworthy types of securities;
- (b) By pre-qualifying the financial institutions with which the Agency will do business; and
- (c) By diversifying the investment portfolio so that the potential failure of any one issue or issuer will not place an undue financial burden on the District.

2) Interest rate risk will be mitigated by:

- (a) Structuring the portfolio so that securities mature to meet the District's cash requirements for ongoing obligations, thereby reducing the possible need to sell securities on the open market at a loss prior to their maturity to meet those requirements; and
- (b) Investing primarily in shorter term securities.

Liquidity

Availability of sufficient cash to pay for current expenditures shall be maintained. An adequate percentage of the portfolio shall be maintained in liquid short-term securities which can be converted to cash as

necessary to meet disbursement requirements. Since cash requirements cannot always be anticipated, sufficient investments in securities with active secondary or resale markets shall be utilized.

Rates of Return

Yield on investments shall be considered only after the basic requirements of safety and liquidity have been met. The investment portfolio shall be designed to attain a market average rate of return throughout budgetary and economic cycles, taking into account the MWDOC's risk constraints, the composition and cash flow characteristics of the portfolio, and applicable laws.

The investment objectives of the two funds differ:

◦ Operating and Fiduciary Funds

- Objective – The primary objective of this fund is preservation of principal and liquidity; income is a secondary objective.
- Risk Tolerance – Because most of the principal of the fund will be paid out over the course of the current fiscal year, minimal volatility of principal is tolerated, but enough of the fund will be invested in non-volatile, liquid investment to ensure payments will be made. Moderate income volatility can be tolerated. Financial risk is not acceptable, and because of the short investment time horizon of the funds, exposure to interest rate risk and purchasing power risk will be minimal.
- Rate of Return – The annual time-weighted rate of return of this fund should equal or exceed the quoted rate at the State of California Local Agency Investment Fund as its benchmark goal.

◦ Surplus (Reserve) Funds

- Objective – The primary investment objective is to safeguard principal then to provide income for the operating fund, emergency requirements and future uses.
- Risk Tolerance – Minimal volatility of principal is acceptable in order to obtain additional income. Financial risk is unacceptable, and interest rate risk and purchasing power risk must be minimal.
- Rate of Return – The rate of return should equal or exceed the return on an index of government securities with an equal duration measured over a

~~complete market cycle.~~

§2106 INVESTMENT POLICY GUIDELINES

The MWDOC investment portfolio may include the following investments subject to Government Code Section 53601 (as periodically amended), and with the following exceptions noted below.

- Collective Investment (Pools) - Assets of any of the funds may be invested in collective investment pools run and managed by other public bodies and banks that are approved by the Board of Directors. However, no such investment shall be made in a pool where the investment objectives differ from the investment objectives listed in Section ~~6-2105~~ of this ~~statement of~~ investment policy, nor should any investment be made in a fund that engages in market timing or anticipating interest rate changes or that uses derivatives or other securities other than as a hedge against interest rate risk.
- Money Market Mutual Funds - Investment in shares of money market mutual ~~investment~~ funds may be made if the investments meet the same restrictions as those of collective investment pools described in Section ~~62105~~. In addition, purchase of these funds must not result in payment of a purchase premium or commission. These mutual funds must attain the highest ranking of two of the three largest ratings services and the investment adviser must be registered with the Securities and Exchange Commission (SEC) as an investment adviser ~~and must have had at least~~ with not less than five years experience with investment portfolios of \$500 million or greater.
- Cash Holdings - The portfolio will hold sufficient cash equivalent investments to ensure availability of sufficient funds to meet known obligations for the next three months. Idle cash will be invested to the fullest extent practicable in interest-bearing investments.
- Other Permissible investments for the Operating and Fiduciary funds are:
 - Bank checking accounts, time deposits or certificates of deposit not to exceed the \$250,000 Federal Deposit Insurance Corporation (FDIC) limit without being collateralized. (Negotiated certificates of deposit shall not exceed 20% of portfolio in effect immediately after such investment.)
 - U.S. Treasury obligations with maturities of ~~one two~~ years or less.
 - ~~U.S. Government obligations,~~ U.S. Government agency Agency obligations and, U.S. Government instrumentality obligations with ~~a~~ maturities of one two years or less.
 - Prime Commercial Paper rated A-1/P-1/F-1 by Moody's, Standard and Poor's or Fitch (shall not exceed 20% of portfolio in effect immediately after such investment and have a maximum maturity not greater than 90 days from the date of purchase ~~provided the dollar-weighted average maturity does not~~

- ~~exceed 31 days).~~
 - Prime ~~B~~banker's ~~A~~acceptances rated A-1/P-1/F-1 by Moody's, Standard and Poor's or Fitch with a maturity not greater than 180 days (shall not exceed 20% of portfolio in effect immediately after such investment).
 - Corporate Securities with a rating of "A" or better by a nationally recognized rating service with a maturity of two years or less.
 - ~~Money market mutual funds that restrict investments to short-term U.S. Treasury and Agency securities (shall not exceed 15% of portfolio in effect immediately after such investment).~~
 - ~~State and other government agency collective investment pools, where the investment policies are compatible with those of Municipal Water District of Orange County.~~
 - Loans with an agreement for the collateral to be repurchased by the borrower (Repurchase Agreements), with a maturity not to exceed six months; the amount of such instruments will not exceed 10 percent of the market value of the portfolio. U.S. Treasury and Agency securities are acceptable collateral with a market value of at least 102% of the value of the for a Repurchase Agreement. Prior to investment, a Master Repurchase Agreement will be signed with the qualified counterparty.
- Permissible investments for ~~Surplus (Reserve Funds)~~ are:
 - All investments permitted for the Operating and Fiduciary funds, except maturities may not exceed five years without Board approval ~~three months~~ prior to investment.
 - Corporate ~~securities~~ Securities with a rating of "A" or better by a nationally recognized rating service with a remaining term to maturity of five years or less, not to exceed 20% of portfolio.
- Prohibited Investments and Investment Practices - The following are prohibited:
 - Purchases on ~~the~~ margin or short sales.
 - "Derivative" securities of any type.
 - Lending securities with an agreement to buy them back after a stated period of time (Reverse Repurchase Agreements).
 - Futures, Options and Margin Trading
 - In no instance shall a swap be used in speculation. Losses are only acceptable if the proposed swap or trade can clearly enhance quality or yield (value) over the life of the new security on a total return basis.
 - Investments are limited to maturities of five years or less without express authorization of the Board ~~three months~~ prior to the investment.
- Diversification - The investment portfolio will be diversified to avoid undue concentration in securities of one type or securities of one financial institution, so

that no single investment or class of investments can have a disproportionate impact on the total portfolio. This restriction does not apply to U.S. Treasury securities.

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

§2107 EXECUTION

The responsibility for the execution of security transactions shall rest with such qualified members of the investment staff as designated by the Board. The selection of the broker-dealer for a specific transaction shall be based on price and yield quotations. Every effort shall be made to obtain appropriate discounts on individual orders.

Security orders shall be placed on the basis of accepted investment practices. All security transactions, including for repurchase agreements, entered into by MWDOC shall be on a delivery-vs.-payment (DVP) basis, i.e. payment will be made upon receipt of the securities to the safekeeping or trust account or custodial facility. All securities shall be held in MWDOC's name pursuant to an agreement and all financial institutions are instructed to mail confirmation and safekeeping receipts directly to MWDOC within three business days after the trade.

Receipts for the confirmation of trades of authorized securities will include information on trade date, par value, maturity, interest rate, price, yield, settlement date, description of securities purchased, agency's name, amount due, and third party custodial information.

§2108 PERSONAL CONDUCT

The Board of Directors of Municipal Water District of Orange County is acutely aware of the responsibilities the staff has in administering the investment assets of MWDOC. Therefore, the integrity of the staff and all others involved in making investment decisions must be unquestioned.

Members of the Board of Directors, the Treasurer, Deputy Treasurers and members of the investment staff may not have a direct or indirect interest in the gains or profits of any investment made by MWDOC and may not receive any pay or emolument (profit arising from office or employment usually in the form of compensation or perquisites) for services other than as designated by MWDOC for compensation and authorized expenses.

All persons responsible for investment decisions or who are involved in the management of MWDOC assets shall be governed in their personal investment activities by the codes of conduct established by the applicable state statutes, the ~~National Association of Securities Dealers~~Financial Industry Regulatory Authority (FINRA), ~~and~~ the Securities and Exchange Commission, and the Code of Ethics and

Standards of Professional Conduct of the Association for Investment Management and Research.

All persons responsible for investment decisions or who are involved in the management of MWDOC assets shall refrain from any personal business activity that could conflict with the proper execution and management of the MWDOC investment program, or that could impair their ability to make impartial investment decisions.

§2109 REPORTING

The Treasurer shall prepare an investment report monthly, including a management summary that provides the status of the current investment portfolio and transactions made over the last month. The Report shall be submitted within thirty (30) days following the quarter ended. The report should be provided to and reviewed by the General Manager, the Administration & Finance Committee and provided to the Board of Directors. The report will include the following:

- A listing of individual securities held at the end of the reporting period;
- Average weighted yield to maturity of portfolio on MWDOC investments;
- Listing of investments by maturity date;
- Market values of current investments;
- Percentage of the total portfolio which each type of investment represents.

This investment policy shall be reviewed by the Administration and Finance Committee annually on an annual basis and as frequently as necessary, to enable the investment program Treasurer to respond to changing economic and market conditions.

GLOSSARY

~~Volatility of Principal – caused by changes in the market value or the prices of the securities.~~

~~Financial Risk – risk that the debtor will fail to make timely payments of principal or interest when due or that the company will fail.~~

~~Interest Rate Risk – interest rate change that may cause the market price or the yield to decline; includes reinvestment risk.~~

Cash Equivalents - instruments or investments of such high liquidity and safety that they are virtually as good as cash. Examples are a Money Market Fund and a Treasury Bill.

Broker/Dealer- individual or firm acting as a principal in a securities transaction. Principals trade for their own account and risk. When buying from a broker acting as a dealer, a customer receives securities from the firm's inventory; the confirmation must disclose this. When specialists trade for their own account, as they must as a part of their responsibility for maintaining an orderly market, they act as dealers. Since most brokerage firms operate both as brokers and as principals, the term broker-dealer is commonly used.

~~The investment policy shall be reviewed by the Administration & Finance Committee annually, and as frequently as necessary, to enable the Treasurer to respond to changing market conditions.~~

R1166 - 3/23/83; R1277 - 12/18/85; R1345 - 3/2/88; R1398 - 11/1/89; R1429 - 1/16/91; R1434 - 4/3/91; R1460 - 4/1/92; R1483 - 3/17/93; R1503 - 2/16/94; R1508 - 3/16/94; R1538 - 4/19/95; R1541 - 5/17/95; R1560 - 5/15/96; R1566; - 10/16/96; Motion - 11/25/96; R1584 – 5/21/97; R1694 – 4/17/02; R1718 – 6/18/03; R1736 – 5/19/04; R1880 – 5/19/10