

Short Term Investment Policies

1. Funds Subject to Short Term Investment Policies

The list of the funds of the State for which short-term investments are purchased and which are subject to this investment policy are maintained by the investment staff and is updated as needed.

2. Investment Objectives

- Maintenance of Appropriate Liquidity

In order to provide sufficient liquidity to cover all disbursements of the State, investments will be structured in a manner which will insure the funding of the State's expenditures and match the cash flow requirements of the account groups for which the State Investment Commission invests.

- Safety

All short-term investments will be purchased with the intent of preserving capital. Preservation of capital is enhanced through the use of high quality investment instruments. Investments will be made to minimize the volatility of principal value, liquidity risk and credit risk, and not on the basis of return alone. Furthermore, whenever possible, the short term investment portfolio will be structured to minimize interest rate (reinvestment) risk, by matching the maturities of investments with the requirements for funds disbursement.

- Legal Conformance

Consistent with the preceding section, no investments will be made in direct or indirect violation of the State statutes dealing with the investment of State funds.

- Rate of Return

The State Investment Commission seeks to maximize rates of return on purchased investments subject to credit quality, issuer, diversification, investment type restrictions and preferences as set forth herein, while controlling the investment risk. The rate of return on the short-term investment portfolio will be compared to the 30-day U. S. Treasury security benchmark for purposes of quantifying relative performance over time. However, investments will not be made on the basis of return alone.

3. Operations

- Monitoring the Portfolio

The State Investment Commission (SIC) will monitor the investment transactions on a monthly basis by reports prepared by the General Treasurer's Office. These reports will outline the structure of the portfolio and any variances to the provisions outlined in the policies. In addition, the reports will present the market value of the portfolio.

- Ethics and Conflicts of Interest

Employees of the General Treasurer's Office involved in the investment process shall refrain from personal activity that could conflict with the proper execution and management of the short-term investment program, or that could impair their ability to make impartial decisions.

- Internal Controls

In administering the short-term investment policies of the State, the General Treasurer's Office will implement an appropriate system of internal control to prevent any loss of public funds due to fraud, error, misrepresentation or imprudent actions. This system of internal controls will be subject to review annually as part of the audit process performed by the Auditor General.

- Collateralization

In 2010 the Office of the General Treasurer strengthened the collateralization requirements outlined in Chapter 10.1 of Title 35 of the General Laws entitled "Collateralization of Public Deposits" to state that *all* deposits held by financial institutions on behalf of the State must be fully collateralized at no less than 102% of principal. The only current exceptions are amounts covered by federal deposit insurance (either banks' Federal Deposit Insurance Corporation or thrifts' National Credit Union Administration) or held in the Ocean State Investment Pool, which has its own investment mandate determined by the Legislature.

There are two acceptable types of collateral. Debt instruments issued by the United States Treasury or by the following agencies of the US Government: Federal Home Loan Bank, Federal Farm Credit Banks, Government National Mortgage Association, Federal Home Loan Mortgage Corporation, and Federal National Mortgage Association can serve as pledged collateral at the 102% of principal threshold. Such collateral shall be held in custody in one of the following three ways, listed in order of the

State's preference: a) in the custody of an independent third-party institution and evidenced by a written agreement, b) in the custody of the Federal Reserve Bank in an account held in the State's name and evidenced by a written agreement, or c) in a separate account at the financial institution and evidenced by a written agreement. The State's custodian at present is BNY Mellon. The value of collateral shall be marked to market on a weekly basis by the custodian, and each depository institution will provide a quarterly report certifying compliance with this requirement, including a detailed listing of the amount and type of collateral held.

Alternatively, the Office of the General Treasurer may place investments with institutions that have obtained a letter of credit for the benefit of the State of Rhode Island from one of the Federal Home Loan Banks. The letter(s) of credit must represent 100% of the value of the state's investments they are supporting. Letters of credit must be submitted to the Office of the General Treasurer for custody.

- Acceptable Investments

The State may only invest funds in the following instruments in accordance with this policy:

- (i) U.S. Treasury Bills, short-term obligations issued by the United States Government with maturities of one year or less.
- (ii) Near-Maturity U.S. Treasury Notes or Bonds, obligations issued by the United States Government with a remaining maturity of 397 days or less.
- (iii) U.S. Agency Obligations, short-term obligations of U.S. Government Agencies or Instrumentalities with maturities of 397 days or less. However, investments in U.S. Agency obligations that have been securitized in a collateralized mortgage trust are prohibited.
- (iv) Certificates of Deposit (CDs), obligations issued by financial institutions for specific maturities at a stated rate of interest. Maturities of CDs must be 397 days or less.
- (v) Repurchase Agreements (Repo), a contractual obligation between the State and a seller. In a Repo, the seller receives cash and delivers U.S. Treasury or U.S. Agency securities with maturities of no longer than 3 years as collateral, which is custodied at a third party. The collateral value is to be marked to market weekly. The Repo seller agrees to repurchase the securities at predetermined dates and rates. Repos may only be purchased from financial institutions or broker/dealers who have signed a master repurchase agreement acceptable to the State Investment Commission. The

approved form of Master Repurchase Agreement is the current form used by Bond Market Association (formerly the Public Securities Association). Reverse Repurchase Agreements are prohibited.

- (vi) Commercial Paper (CP), a promissory note issued by a corporation for a specific maturity at a stated rate of interest. To be eligible for purchase, the rating on the commercial paper must be rated at least A2 by Standard & Poor's Corporation ("S & P"), or P2 by Moody's Investors Service ("Moody's"), or an equivalent short-term rating from another nationally recognized statistical rating organization (NRSRO). Maturity of commercial paper investments should not exceed 90 days, except under special circumstances. Furthermore, no issuer can represent more than 40% of the total CP investment portfolio or 10% of the overall short-term portfolio.
- (vii) Eurodollar Time Deposits, an offshore deposit in a domestic bank with a foreign branch. These deposits are the obligations of the domestic bank, but are subject to the banking regulations of a foreign country. As such, Eurodollar Time Deposits can enjoy more flexible bank reserve requirements and do not carry federal deposit insurance. For this reason, Eurodollar Time Deposits can offer a premium yield over domestic bank time deposits. To be eligible for purchase, the Eurodollar Time Deposit must be a deposit of a domestic commercial bank. The maximum maturity of a Eurodollar Time Deposit is limited to sixty days.
- (viii) Money Market Mutual Funds, a mutual fund that holds investments in short-term obligations with maturities of 397 days or less. State funds may be invested in Government or Treasury money market mutual funds. Per Securities and Exchange Commission (SEC) regulations, such portfolios consist only of U.S. Treasury Securities, U.S. Agency obligations and repurchase agreements fully collateralized by such securities. Money market mutual funds must be registered with the SEC under the Investment Company Act of 1940 and subject to Rule 2a-7 to qualify for investment.
- (ix) Ocean State Investment Pool (OSIP), an advisor-managed cash portfolio approved through legislation in June of 2011. Assets in OSIP may only be invested in securities that would constitute "Eligible Securities" under and as defined in Rule 2a-7 of the Investment Company Act of 1940. Additionally OSIP must be managed to meet the criteria for amortized cost measurement as defined by the Government Accounting Standards Board (GASB) Statement Number 79. The maximum maturity of any security

value in the pool will also be limited to the guidelines of Rule 2a-7 and Statement Number 79.

- (x) Collateralized Deposit Account. State funds can be invested into deposit accounts with agreed rates of return and guaranteed availability of funds. Funds on deposit within the account are collateralized in accordance with the requirements noted above and are adjusted daily as needed.
- (xi) Overnight Sweep Account, an interest-earning account into which funds may be automatically transferred. The State's excess funds in one bank account may be automatically swept into an interest-earning account with the same bank and invested overnight, as long as funds on deposit are collateralized in accordance with the requirements noted above for Collateralized Deposit Accounts and are adjusted daily as needed.
- (xii) Insured Cash Sweep Municipal Checking Money Market Account (ICS), investments distributed by a promontory network to multiple banks to qualify for federal deposit insurance, in return for an agreed-upon interest rate. The bank or dealer is responsible for distributing funds and ensuring compliance with current federal deposit insurance coverage guidelines, and must provide evidence of coverage on a monthly basis. These investments do not require collateralization as they are fully covered by federal deposit insurance.
- (xiii) Certificate of Deposit Account Registry Service (CDARS), investments distributed by a promontory network into CDs at various financial institutions in amounts that qualify for federal deposit insurance coverage, earning an agreed-upon interest rate. CDARS are fixed-term deposits, of which the maximum maturity will be limited to 397 days.
- (xiv) Other short-term instruments. State funds may be invested in other short-term instruments if approved by the Commission.

- Safekeeping of Securities

All securities will be held by the State's custodian or by its sub-custodian agent, unless otherwise directed to another custodian by the SIC. Securities lending by the safekeeping agent is not permitted. The State's current custodian is BNY Mellon. However, custody of pledged collateral shall be governed in accordance with the 'Collateralization' section of this investment policy statement.

- Delivery vs. Payment

In utilizing the delivery versus payment (“DVP”) process, the State will not release funds to the selling institution until the security has been received by the State’s custodian.

- **Competitive Pricing**

Investment instruments shall be purchased with consideration of returns, security, diversification and other benefits to the state, subject to restrictions set forth herein. If a specific maturity date is known, Treasury staff will seek multiple quotes for similar instruments of similar maturity.

4. Portfolio Diversification

State funds held in short-term instruments will be diversified sufficiently to reduce overall portfolio risk. Proper diversification will include diversification by maturity, by instrument, and by institution as set forth below.

- **By Maturity**

Whenever possible, maturities of investments purchased shall be scheduled to coincide with projected cash flow requirements. However, the maturity characteristics of the portfolio must comply with the following schedule:

<u>Total Portfolio Investments Maturing</u>	<u>Required Minimum Percentage of Total Portfolio</u>
397 Days or Under	100%
270 Days or Under	50%
90 Days or Under	25%
30 Days or Under	10%

- **By Investment Instrument**

The following schedule will be utilized as maximum percentages of the State’s total short-term portfolio.

U.S. Treasury Bills, Notes or Bonds	100% of portfolio
U.S. Agency Obligations	75% of portfolio
Certificates of Deposit	50% of portfolio
Repurchase Agreements	100% of portfolio
Commercial Paper	25% of portfolio
Eurodollar Time Deposits	15% of portfolio
Money Market Mutual Funds	75% of portfolio

Ocean State Investment Pool	50% of portfolio
Collateralized Deposits	75% of portfolio
Insured Cash Sweep Accounts	50% of portfolio
CDARS	50% of portfolio

The total amount invested in Collateralized Deposits and Certificates of Deposit combined may not exceed 75% of portfolio.

- By Financial Institution or Corporate Entity

The following schedule will be utilized as maximum percentages of investments to be purchased from any one issuer as a percentage of the State's total short-term portfolio.

U.S. Treasury Bills, Notes or Bonds	100% of portfolio
U.S. Agency Obligations	35% of portfolio
Certificates of Deposit	20% of portfolio
Repurchase Agreements	20% of portfolio
Commercial Paper	10% of portfolio
Eurodollar Time Deposits	15% of portfolio
Money Market Mutual Funds	35% of portfolio
Ocean State Investment Pool	50% of portfolio
Collateralized Deposits	35% of portfolio
Insured Cash Sweep Accounts	20% of portfolio
CDARS	20% of portfolio

Note: Total exposure by one single issuer is limited to 35% of the total short-term portfolio. Further, any combination of CDs, Commercial Paper and Eurodollar Time Deposits of one underlying financial institution must not exceed 15% of the total portfolio. Staff will also consider the size of the of the issuing or depository institution.

5. Vendor Selection Criteria

All financial institutions and broker/ dealers desiring to become qualified bidders for investment transactions must supply the following, if available:

- Current audited financial report.
- Proof of National Association of Securities Dealers registration.
- Latest published credit ratings by Standard & Poor's and Moody's.
- Certification of having read this investment policy.
- A letter from an officer of the financial institution or broker/ dealer, which details the securities to be sold to the State.
- Most recent Community Reinvestment Act rating.

Any financial institution or broker/dealer is eligible to make a written formal application to the General Treasurer's Office and if the institution meets or exceeds the guidelines outlined below, it may be considered for addition to the list. The General Treasurer's Office shall analyze institutions' latest published financial statements and consult with credit research reports prepared by nationally recognized rating agencies, to determine suitability for investment. Approval by the SIC is necessary for any financial institution or broker/dealer to be authorized for investment.

The General Treasurer's Office shall maintain a listing of all authorized financial institutions and broker/dealers, and make selection from those institutions when investing the State's funds. The General Treasurer's Office will keep credit ratings on file and comment to the SIC on any changes in ratings. Institutions that later fail to meet the minimum criteria may be removed from the authorized list.

Notwithstanding any of the foregoing, the General Treasurer's Office reserves the right, in its sole discretion, to withdraw its approval of any financial institution or broker/dealer at any time, without notice. Furthermore, the criteria for vendor selection and investment consideration are separate and distinct.

Only financial institutions meeting or exceeding the following criteria may be included in the list.

- Banks and Credit Unions

- (i) The financial institution must be covered by federal deposit insurance from either the FDIC or National Credit Union Administration (NCUA).
- (ii) The financial institution must meet or exceed the following:
 - Three years of operating history
 - An investment-grade short-term rating from a nationally recognized statistical ratings organization (NRSRO), or a minimum grade of Satisfactory from a bank rating service, e.g. Veribanc
 - Positive return on assets in four of the last six quarters
 - Federal Reserve risk-based capital ratio of at least 8%
 - Non-performing assets as a percentage of total assets less than 3%.

Any banking institution that does not meet these minimum criteria may be approved by exception only through a unanimous vote by the State Investment Commission.

- **Broker/Dealers**

Only approved broker/dealers will be used by the State. Broker/dealers must be regulated by the Securities and Exchange Commission and be members in good standing of the National Association of Securities Dealers. In addition, the broker/dealers must meet or exceed the following criteria:

- a. Three years of operating history
- b. \$250 million in capital
- c. Positive return on assets in four of the last six quarters

Any broker/dealer that does not meet these minimum criteria may be approved by exception through a unanimous vote by the State Investment Commission.

6. Preference for Banks with Outstanding Community Reinvestment Act Ratings

The State's Linked Deposit Policy is set forth in Rhode Island General Laws Sections 35-4-4.1 through 35-4-4.7. The policy aims to increase the availability of capital and banking services in low- and moderate-income neighborhoods in Rhode Island. The law requires the State to give preference when investing to institutions achieving an "outstanding" Community Reinvestment Act rating.

7. Preference for Participants in the Community Deposit Program

Without sacrificing the safety, security and liquidity of State deposits, the State Investment Commission permits up to \$30 million of the state's excess cash balances to be invested at banks and credit unions that put this capital to work supporting Rhode Island-based small businesses through the Community Deposit Investment Program.

To qualify for the Community Deposit Investment preference, banks and credit unions must meet the requirements set forth in this Short-Term Investment Policy and pay a market-acceptable rate on investments. Treasury will allocate investments to these institutions according to the criteria listed below:

- a) Banks and credit unions making loans of \$250,000 or less, including lines of credit, to small businesses, [defined as businesses with up to 100 employees at the time of application] may receive deposits of equal value to the principal of each loan

- b) Banks and credit unions making loans of \$250,000 or less, including lines of credit, to women- or minority-owned businesses, or businesses owned by first-time entrepreneurs may receive deposits of up to double the value of the principal of each loan

Institutions will be eligible for matching deposits for the terms of the associated loans. However, at no time will the State's liquidity needs be sacrificed for the maintenance of the Community Deposit Investment program.