

# **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. 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 rate of return on purchased investments subject to credit quality, issuer, diversification, and investment type restrictions 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.

### 3. Operations

- Monitoring the Portfolio

The State Investment Commission 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.

- Acceptable Investments

The State Investment Commission may only invest 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 less than 1 year.
- (ii) U.S. Treasury notes or Bonds issued by the United States Government with a remaining maturity of less than 1 year.
- (iii) U.S. Agency obligations, short term obligations of U.S. Government Agencies or Instrumentalities, with maturities of less than 1 year. However, investments in U.S. Agency obligations that have been securitized in a collateralized mortgage trust are prohibited.

- (iv) Certificates of Deposit, (“CD’s”) issued by financial institutions for specific maturities at a stated rate of interest. Financial institutions seeking to participate in issuing CDs to the State must meet or exceed standards established within Section 2.5.1 of these policies, listed as “Selection Criteria – Financial Institutions”. Furthermore, any CD or other term deposit investment with a maturity over 60 days must be fully collateralized.
  
- (v) Repurchase Agreements. A repurchase agreement is a contractual obligation between the State and the seller (“Repo”). 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 to a third party custodian designated by the State Investment Commission. The collateral value will be maintained at a minimum value of 102% of principal, and will be marked to market weekly by the custodian. 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”). Commercial paper is 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 at least A1/P1 by Moody’s Investors Service (“Moody’s”) and Standard & Poor’s Corporation (“S & P”). Exceptions may be granted by the Commission regarding the credit rating restriction if a sufficient credit enhancement (Letter of Credit, insurance etc.) exists to collateralize the commercial paper. Direct purchase is subject to Commission approval. Maturity of commercial paper investments should not exceed 60 days, except under special circumstances. Furthermore, a CP issuer participation is limited to 40% of the total CP investment portfolio, or 10% of the overall short-term portfolio.

- (vii) Eurodollar Time Deposits. A Eurodollar Time Deposit is 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 enjoy more flexible bank reserve requirements and do not carry federal deposit insurance. For this reason, Eurodollar Time Deposits typically 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 will be limited to sixty days.
- (viii) Money Market Mutual Funds. State funds may be invested in money market mutual funds whose portfolios consist of U.S. Treasury Securities, U.S. Agency obligations and repurchase agreements fully collateralized by such securities. A money market mutual fund must be registered with the Securities and Exchange Commission under the Investment Company Act of 1940 and subject to Rule 2a-7 to qualify for investment.
- (ix) Overnight Sweep Account. A passive investment strategy whereby excess funds in one bank account are automatically transferred into an interest-earning account with the same bank and invested overnight.
- (x) Other short-term instruments. State funds may be invested in other short-term instruments as they may be developed, subject to the approval of 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 Commission. Securities lending by the safekeeping agent is not permitted.

- 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.

- Collateralization

Beginning October 1, 1991 Chapter 10.1 of Title 35 of the General Laws entitled “Collateralization of Public Deposits” went into effect. All investments shall be made in accordance with that law. Treasuries and U.S. Agency Obligations not otherwise securitized in a collateralized mortgage trust are the only instruments acceptable as collateral. Also, any term deposit investment with a maturity over 60 days must be fully collateralized.

- Competitive Bid Pricing

At all times, investment instruments must be purchased utilizing a competitive bid process, subject to restrictions as set forth herein. If a specific maturity date is known, bids must be requested for instruments meeting that 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 investment 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>
1 Year 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
U.S. Government Money Market Mutual Fund	50% of portfolio
Certificates of Deposit	25% of portfolio
Repurchase Agreements	100% of portfolio
Commercial Paper	25% of portfolio
Eurodollar Time Deposits	15% 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
U.S. Government Money Market Mutual Fund	35% of portfolio
Certificates of Deposit	10% of portfolio
Repurchase Agreements	20% of portfolio
Commercial Paper	10% of portfolio
Eurodollar Time Deposits	15% of portfolio

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

## **5. Vendor Selection Criteria**

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

- 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.

The General Treasurer's Office shall maintain a listing of all authorized financial institutions and broker/dealers. 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. Institutions which subsequently fail to meet the minimum criteria will be removed.

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.

The General Treasurer's Office will make selection of financial institutions in which the State invests funds by consulting with credit research reports prepared by nationally recognized rating agencies. At a minimum, the General Treasurer's Office will keep these ratings on file and comment to the Commission quarterly on any changes in ratings. Selection of financial institutions is also made after a thorough analysis of the institution's latest published financial statements and reports, e.g. annual report, 10K, call report, etc.

As a result of the analysis, only those financial institutions meeting or exceeding the following criteria may be included in the list.

- Commercial Banks

- (i) The financial institution must be covered by Federal Deposit Insurance.
- (ii) The financial institution must meet or exceed the following:
  - Exist and operate for at least 3 years,
  - Moody's and S & P minimum investment grade credit of Aa2 and AA, respectively.
  - Return on assets within a six quarter period must be positive for at least four out of six consecutive quarters,
  - The Federal Reserve risk-based minimum capital ratio must be at least 8% ( a 8% ratio signals an adequately capitalized institution, 10% a well capitalized firm), and
  - Non performing assets as a percentage of total assets may not exceed 3%.

Any banking institution that does not meet these minimum criteria may be approved by exception 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. Exist and operate for at least 3 years,
- b. Maintain at least \$2.5 million in capital, and
- c. Return on assets within a six-quarter period must be positive for at least four quarters on a calendar quarter basis.

Any broker/dealer that does not meet these minimum criteria may be approved by exception 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 that the State give preference by investing in institutions achieving an "outstanding" Community Reinvestment Act rating.

The Guidelines for determining the preference are set forth in the "Guidelines For Determining Preference For Banks With Outstanding Community Reinvestment Act ("CRA") Ratings."