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Center For Public Investment Management

A PROGRAM BROUGHT TO YOU BY:

Josh Mandel

Treasurer of Ohio

INV 105:

Basics of Investing

2016

Eileen Stanic

- Eileen Stanic
  Senior Public Funds Advisor
  Meeder Investment Management

- 614-791-2580
- 440-213-4416

- estanic@meederinvestment.com

AGENDA

- HISTORY OF OHIO INVESTMENT LAW
- DEVELOPING AN INVESTMENT POLICY
- INVESTMENT OPTIONS
- ROLE OF INVESTMENT PROVIDERS

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History of Ohio Investment Law

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HISTORY OF OHIO INVESTMENT LAW

3 MAJOR EVENTS

- 1985-1986 OHIO SAVINGS & LOAN CRISIS
- 1990-1994 DERIVATIVES
- 1994 SAFE PROGRAM

SENATE BILL 81 effective 9/27/96

OHIO SAVINGS & LOAN CRISIS

70 Ohio Savings & Loans closed

- State of Ohio realized $151 million loss
  - Lack of proper supervision of the State's private deposit insurance fund
- How did this happen?
  - Multiple pledges of REPO collateral by ESM Government Securities

DERIVATIVES

20 Ohio public entities invested in derivative securities that resulted in loss of principal

- What is a derivative?
  - a financial instrument or contract or obligation whose value or return is based upon or linked to another asset or index, or both, separate from the financial instrument, contract, or obligation itself
- How did this happen?
  - Misrepresentation of investment by broker/dealer

SAFE PROGRAM

$115 Million loss to Cuyahoga County as local governments were made whole

- What was the SAFE program?
  - Secured Asset Fund Earnings (SAFE)
  - Local government investment pool managed by the Cuyahoga County Treasurer's office
- How did this happen?
  - Investments included long-term securities which were leveraged in an effort to enhance returns

SENATE BILL 81

Landmark legislation effective 9/27/96

- Prohibited investment in derivatives, reverse REPOs, strips and local investment pools other than STAR Ohio
- Prohibited the use of leverage or purchasing an investment that do not reasonably expect can be held to maturity
- Required investment in any federal agency or instrumentality security to be a direct issuance of the federal agency or instrumentality
- Mandated investment training
- Required filing of investment policy with Auditor of State
- Established maximum maturity of 5 years
- Expanded list of permissible investments to include commercial paper and bankers acceptances
- Established criteria for entering into a repurchase agreement (REPO)

CURRENT OHIO INVESTMENT LAWS

- **ORC 135.14**: Schools, Townships, Cities, etc.
- **ORC 135.35**: Mainly Counties or other agencies
- **Charter City**: May not follow state guidelines

Image courtesy of Stuart Miles/FreeDigitalPhotos.net

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Developing an Investment Policy

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WHAT IS AN INVESTMENT POLICY?

- An Investment Policy (IP) is an entity's **plan** for investment-related decision making.
- An IP should *consider the laws, rules, guidelines and regulations* applicable to the accounts, funds, plans or programs that are managed.
- An IP should *summarize the principles, goals and strategies* for the investment program.

INVESTMENT POLICY

- Requirements
  - Create, adopt and file with Auditor of State
  - Not required if annual average portfolio of investments is $100,000 or less
  - Service providers sign-off
- Best Practice
  - Review annually
    - Stay current with changes in Ohio law

COMPONENTS OF AN INVESTMENT POLICY

1. Purpose & Scope
2. Objectives
3. Delegation of Authority & Authorized Investments
4. Diversification Guidelines
5. Maturity & Duration Limits
6. Portfolio Management
7. Key Metrics
8. Internal Controls & Reporting
9. Selection of Counterparties

OBJECTIVES

- Safety
- Liquidity
- Return

INTERNAL CONTROLS & DUE DILIGENCE

- Proper Administrative Systems
  - Identify potential weaknesses in investment functions
- Written Procedures to Select Financial Institutions
- Organizational Structures
  - Who performs specific investment functions?
- Training Programs
  - Does each employee receive annual training?
- Periodic Internal Audits
  - Check procedures of outside investment professionals

Sound internal controls safeguard against theft and poor decision making.

SIMPLE INVESTMENT POLICY EXAMPLE

This document, in conjunction with the Ohio Revised Code, as amended, will govern the investment activities of XXX.

The purpose of the investment account is to generate income consistent with market rates of return while maintaining the safety of the portfolio's principal value and liquidity necessary for ongoing operations.

The Treasurer or other designated person will conduct all investment activities. A current list of individuals authorized to transact securities trades for the county will be maintained with this policy.

XXX will be permitted to invest in any security specifically authorized by the Ohio Revised Code, Section 135.XX, as amended, or other relevant sections.

The Treasurer or designee should normally seek to diversify its holdings of investments by avoiding concentrations of specific issuers.

Under the guidelines of this policy, no security will be purchased that has a remaining term to final maturity of more than five (5) years unless matched against a specific liability as per the Ohio Revised Code.

A copy of this policy will be filed with the Auditor of State.

The effective date of this policy is _____ , 2016.

Approved:

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Permissible Investments

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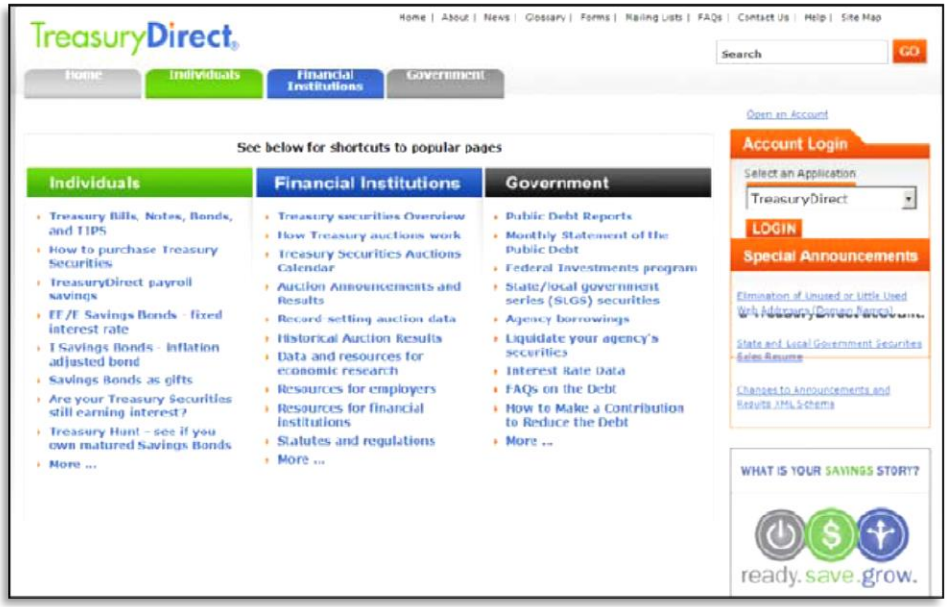
TREASURY SECURITIES

- Full faith and credit of the U.S. government
- Very liquid type of security
- Purchase directly from U.S. Treasury or through a broker/dealer



GOVERNMENT SECURITIES

- Full faith and credit or implied backing by U.S. government
- Customized structures – call types and steps
- Things to Consider
  - Compare bond with other dealers
  - Know the difference between the yield and coupon rate!

BANK DEPOSITS

- Savings and money market savings accounts
- CDs
- Know the requirements for protection
  - FDIC insurance
  - Collateral

CERTIFICATES OF DEPOSIT

135.144 Investment of interim moneys in federally insured certificates of deposit.

(A) In addition to the authority provided in section 135.14 or 135.143 of the Revised Code, the treasurer of state or the treasurer or governing board of a political subdivision may invest interim moneys in certificates of deposit in accordance with all of the following:

(1) The interim moneys initially are deposited with an eligible public depository described in section 135.03 of the Revised Code and selected, pursuant to section 135.12 of the Revised Code, by the treasurer of state or the treasurer or governing board of a political subdivision, for interim moneys of the state or of the political subdivision.

(2) For the treasurer of state or the treasurer or governing board of the political subdivision depositing the interim moneys pursuant to division (A)(1) of this section, the eligible public depository selected pursuant to that division invests the interim moneys in certificates of deposit of one or more federally insured banks, savings banks, or savings and loan associations, wherever located. The full amount of principal and any accrued interest of each certificate of deposit invested in pursuant to division (A)(2) of this section shall be insured by federal deposit insurance.

(3) For the treasurer of state or the treasurer or governing board of the political subdivision depositing the interim moneys pursuant to division (A)(1) of this section, the eligible public depository selected pursuant to that division acts as custodian of the certificates of deposit described in division (A)(2) of this section.

(4) On the same date the public moneys are redeposited by the public depository, the public depository may, in its sole discretion, choose whether to receive deposits, in any amount, from other banks, savings banks, or savings and loan associations.

(5) The public depository provides to the treasurer of state or the treasurer or governing board of a political subdivision a monthly account statement that includes the amount of its funds deposited and held at each bank, savings bank, or savings and loan association for which the public depository acts as a custodian pursuant to this section.

(B) Interim moneys deposited or invested in accordance with division (A) of this section are not subject to any pledging requirements described in section 135.18 or 135.181 of the Revised Code.

Amended by 129th General AssemblyFile No.67, HB 209, §1, eff. 3/22/2012.

Effective Date: 07-04-2006

CERTIFICATES OF DEPOSIT

Ohio Compliance Supplement

Any CD's purchased by a broker must be held in the name of the government. Also, the broker cannot be in possession of cash at any time. If we believe a broker has held cash for any length of time, AOS auditors should refer the matter to the Center for Audit Excellence and AOS Legal division for further evaluation. A way to verify compliance is to request monthly statements provided by the public depository located in Ohio. Ohio Rev. Code §135.144(A)(5) requires the initial public depository to provide public offices with a monthly account statement that includes the amount of its funds deposited and held at each bank, savings bank, or savings and loan association for which the public depository acts as a custodian pursuant to Ohio Rev. Code §135.144. If a public office does not have these statements, it may indicate that the money is being held by a broker-dealer in violation of Ohio Rev. Code §135.144.

COMMERCIAL PAPER

- Need additional training approved by TOS
- Max of 25% (ORC 135.35) or 40% (ORC 135.14) portfolio allocation
- Max maturity restriction of 270 days
- Highest rating category from two rating agencies (Moody's, S&P, Fitch)
- Maximum of 5% of total portfolio in any issuer at time of purchase (ORC 135.14)

CORPORATE SECURITIES

- ORC 135.35 permits up to 15% of interim funds in corporate securities
- Must be rated AA or better and have a two year maximum maturity
- Know what you are buying and the risk associated
  - Credit risk
  - Liquidity risk

MUNICIPAL SECURITIES

- Permits entities to purchase general obligations of the State or political subdivisions of the State (20% max under ORC 135.14)
- Must be rated in three highest categories (ORC 135.14)
- Cannot be the sole owner of an entire issue (ORC 135.14)
- Charter Cities could have specific language for purchasing municipals
- Must complete training with TOS (ORC 135.14)

REPURCHASE AGREEMENTS

- Term loan with collateral in the form of securities
- Master Repurchase Agreement outlines procedures
- Reverse repo enables investment officer to leverage the portfolio – **PROHIBITED**

BANKERS ACCEPTANCES

- Need additional training approved by TOS
- Max of 25% (ORC 135.35) or 40% (ORC 135.14) portfolio allocation
- Maturity restriction of 180 days

STAR Ohio

- AAAm rated by Standard and Poor's (highest)
- Similar to money market fund
- Daily interest income
- Daily liquidity (within guidelines)
- State administered

STAR Plus

- Convenience of one account and one statement
- All deposits are demand deposits and are 100% FDIC-insured
- Up to $50 million in deposits per legal entity
- Twice weekly withdrawal and daily deposit capability
- Daily transparency with 24/7 online access to account information

STAR Plus
Federally Insured Cash Account℠

MUTUAL FUNDS

- No-load money market funds invested in:
  - Government securities
  - Repurchase agreements collateralized by government securities
- Registered Investment Company
- Sponsored by mutual fund company and regulated by SEC

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Role of Investment Providers

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KNOW THE RISKS OF INVESTING

Market Risk	• Decline in market value
Credit Risk	• Securities, dealers, banks, CDs
Liquidity Risk	• Ability to sell
Reinvestment Rate Risk	• Reinvesting maturities in lower interest rates
Political Risk	• Risk to your career

WHO WILL HELP YOU INVEST?

Know the Types of Service Providers

STAR Ohio/Plus	*Banks*	*Investment Advisors*	*Brokers*

• **STAR Ohio**
  • Know the investments of STAR Ohio
  • Look over the annual report
• **Plus**
  • Understand how program works
  • Monitor deposit Banks
	• Make sure they understand nuances of public entities
	• Work with banks you know and trust
		• Acts as a fiduciary in the client's best interest
		• Who do they work with?
		• What are their credentials?
		• Check them out: **www.investor.gov**
			• Recommends suitable investments
			• Who do they work with?
			• What do they do and how much do they charge?
			• Check them out: **www.finra.org**

Perform the Due Diligence Before Investing

EXTERNAL MANAGERS – ADVISOR

- Provides investment advice
- Fiduciary responsibility
- May or may not have direct control (discretionary vs. non-discretionary)
- Executes purchases/sales
- Manages or provides advice on overall portfolio
- May coordinate safekeeping (3rd party custodian)

Definition of "Fiduciary" - fi·du·cia·ry - noun

- In law, a person in a position of authority whom the law obligates to act solely on behalf of the person he or she represents and in good faith.

Source: Merriam-Webster

EXTERNAL MANAGERS – BROKER/DEALER

- Provides investment advice
- No fiduciary responsibility
- Does not have direct control
- Acts as a broker when executing orders on behalf of clients
- Acts as a dealer when trading from its own account
- May provide safekeeping

BENEFITS OF USING EXTERNAL MANAGERS

- Professional manager – that is their business
- Greater access to investment markets/information
- Broker network – potentially more sources to receive best price execution of trades
- Enhanced credit research available for unsecured investments (i.e., commercial paper)
- Can complement internal resources or personnel
- Could increase internal control and "separation of duties"
- Be careful and know what role the provider is playing

SUMMARY

- Ask questions
- Know the details
- Protect yourself – follow the law
- Seek help when appropriate

- ULTIMATELY IT IS YOUR RESPONSIBILITY!

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Questions?

Thank you.

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