



Agenda Item No. 5

To: Rules, Policy and Industrial Relations Committee/Committee of the Whole
Meeting of February 27, 2009

From: Joseph M. Wire, Auditor-Controller
Celia G. Kupersmith, General Manager

Subject: **APPROVE AN AMENDMENT TO RULE XI, INVESTMENT POLICY, OF
THE RULES OF THE BOARD**

Recommendation

The Rules, Policy and Industrial Relations Committee recommends that the Board of Directors approve an amendment to **RULE XI, INVESTMENT POLICY**, of the *Rules of the Board*, as set forth below.

Summary

The District's investments are guided by the District's Investment Policy. In addition to the requirement that the District's investments be made with the "prudent person" standard of prudence, the District's investments are required to conform to all pertinent existing laws of the State of California. Of particular importance is California Government Code Section 53601 which sets forth the investments that public agencies such as the District are permitted to make.

The District's current Investment Policy (attached as Attachment 1) lists the District's permitted investment instruments under Section I. of RULE XI of the *Rules of the Board*. The District has been advised by its investment advisor, Public Finance Management, Inc. ("PFM") that there is only one investment instrument permitted by Government Code Section 53601 that is not included in the District's Investment Policy. Additionally, PFM has advised that while most of the District's permitted investments, credit criteria and maximum maturities are aligned with the California Code, there are some investments on which the District has chosen to impose additional restrictions. PFM's advice and analysis is included as Attachment 2.

Because the District's Investment Policy lists the District's permitted investment instruments and those permitted investment instruments are, for the most part, aligned with Section 53601, each time Section 53601 is amended to include new types of permissible investments or impose or remove restrictions on permissible investments, the District must determine whether its Investment Policy must be similarly amended to reflect those changes. The purpose of this rule change is to streamline this process so that the need to amend the *Rules of the Board* for future changes that may occur in the California Government Code in regards to permitted investments will be eliminated.

In order to achieve this purpose, Staff recommends that Section I. of RULE XI of the *Rules of the Board*, be replaced with the language stated below, indicating that the District will conform to California Government Code Section 53601 for permitted investment instruments except for certain additional restrictions as outlined. The result of this action is that the District's Investment Policy will no longer list the District's permitted investment instruments and will instead state that the District may invest in any investment instrument set forth in Government Code Section 53601, as that Section may be amended from time to time. The additional restrictions that the District imposes on the permissible investment instruments, now or in the future, would continue to be stated in the Investment Policy.

Replacing Section I. of RULE XI of the *Rules of the Board*, with the proposed language will also give the District's investment advisor the discretion to invest in any investment instrument permitted by Section 53601 of the Government Code, if it is prudent to do so, without first seeking Board approval. However, the Board will continue to receive periodic investment reports from the District's investment advisor so that it is fully informed about the District's investment portfolio. Though no longer required by law, the Auditor-Controller will continue to bring to the Board for review the District's Investment Policy, and any legislative changes that may be enacted that affect it, on a periodic basis.

Consequently, it is recommended that Rule XI, Investment Policy, of the *Rules of the Board* be amended and replaced in its entirety with the following:

I. *Permitted Investment Instruments*

California Government Code Section 53601 sets forth the securities that public agencies, such as the District, are permitted to invest in. The Board of Directors authorizes the investment of District funds in the categories of securities authorized by Section 53601, as it may be amended from time to time, subject to the following additional restrictions:

1. *Repurchase Agreements:*

Repurchase agreements may be used solely as short-term investments not to exceed 90 days.

Only U.S. Treasury securities or Federal Agency securities, as defined in the subdivisions of Government Code Section 53601, will be acceptable collateral.

Market value must be calculated each time there is a substitution of collateral.

The District or its trustee shall have a perfected first security interest under the Uniform Commercial Code in all securities subject to repurchase agreement.

The District may enter into repurchase agreements only with primary dealers of the Federal Reserve Bank of New York.

The District will have specific written agreements with each firm with which it enters into repurchase agreements.

The District may enter into reverse repurchase agreements only with primary dealers of the Federal Reserve Bank of New York.

2. *Bankers' Acceptances:* *The District may invest in bankers' acceptances issued by domestic or foreign banks, which are eligible for purchase by the Federal Reserve System, the short-term paper of which is rated in the highest category by Moody's Investors Services or by Standard & Poor's Corporation.*

Purchases of bankers' acceptances may not exceed 180 days maturity or 40 percent of the District's surplus money. However, no more than 15 percent of the District's surplus funds may be invested in the bankers' acceptance of any one commercial bank.

3. *Negotiable Certificates of Deposit:* *The District may invest in negotiable certificates of deposit or deposit notes issued by a nationally or state chartered bank or a state or federal savings and loan association or by a state-licensed branch of a foreign bank; provided that the senior debt obligations of the issuing institution are rated "AA" or better by Moody's or Standard & Poor's.*

4. *Shares of Beneficial Interest:* *The purchase price of shares of beneficial interest issued by diversified management companies, as defined in Section 23701m of the Revenue and Taxation Code, investing in the securities and obligations authorized by the subdivisions of Government Code Section 53601, shall not exceed 15 percent of the District's surplus money.*

Fiscal Impact

There is no fiscal impact associated with this report.

Attachments

As of April 2008

RULE XI. INVESTMENT POLICY

A. Introduction

The purpose of this Rule is to identify various policies and procedures that enhance opportunities for a prudent and systematic investment policy and to organize and formalize investment-related activities.

The investment policies and practices of the Golden Gate Bridge, Highway & Transportation District are based on state law and prudent money management. All general funds will be invested in accordance with the District's Investment Policy and Article 2 of Chapter 4 of the California Government Code (commencing with Section 53600). The investment of bond or note proceeds will be governed by the provisions of the relevant bond documents. (Res. 01-148, 9/14/01.)

B. Scope

It is intended that this policy cover all funds (except retirement funds) and investment activities under the direction of the District.

C. Prudence

Investments shall be made with judgment and care—under circumstances then prevailing—which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

The standard of prudence to be used by investment officials shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio. All persons investing, reinvesting, purchasing, acquiring, exchanging, selling and managing public funds shall act with care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the District.

D. Objectives

The primary objectives, in priority order, of the District's investment activities shall be:

1. Safety. Safety of principal is the foremost objective of the investment program. The District's investments shall be undertaken in a manner that seeks to ensure preservation of capital in the portfolio.
2. Liquidity. The District's investment portfolio will remain sufficiently liquid to enable the District to meet its cash flow requirements.
3. Return On Investment. The District's investment portfolio shall be designed with the objective of attaining a market rate of return on its investments consistent with the constraints imposed by its safety objective and cash flow considerations.

As of April 2008

E. Delegation of Authority

The management and oversight responsibility for the investment program is hereby delegated to the Auditor-Controller who shall monitor and review all investments for consistency with this investment policy. No person may engage in an investment transaction except as provided under the limits of this policy. The Board may delegate the day-to-day investment decision making and execution authority to an investment advisor. The advisor shall follow the policy and such other written instructions as are provided.

F. Ethics and Conflict of Interest

Officers and employees involved in the investment process shall refrain from personal business activities that could conflict with proper execution of the investment program, or which could impair their ability to make impartial decisions. Officers and employees involved in the investment process shall abide by the District's Conflict of Interest Code, California Government Code Section 1090 *et seq.* and the California Political Reform Act (California Government Code Section 81000 *et seq.*)

G. Internal Controls

The Auditor-Controller shall establish a set of internal controls. The internal controls will be reviewed with the independent auditor. The controls shall be designed to prevent employee error, misrepresentations by third parties, unanticipated changes in financial markets or imprudent actions by employees or officers of the District.

H. Selection of Financial Institutions and Broker/Dealers

To provide for the optimum yield in the District's portfolio, the District's procedures shall be designed to encourage multiple bids and offers on investment transactions from an approved list of broker/dealers. The Auditor-Controller, or the District's investment advisor, shall maintain a list of authorized broker/dealers and financial institutions which are approved for investment purposes, and it shall be the policy of the District to purchase securities only from those authorized institutions or firms.

I. Permitted Investment Instruments

1. Government obligations for which the full faith and credit of the United States are pledged for the payment of principal and interest.

2. Federal agency or United States government-sponsored enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises. (Res. 02-027, 2/8/02.)

3. Bonds, notes, warrants, or other evidences of indebtedness issued by California or any local agency in California, including evidences of indebtedness, payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency or by a department, board, agency or authority of the local agency or by the State of California; (b) registered treasury notes or bonds of any of the other 49 United States in addition to

As of April 2008

California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the other 49 United States, in addition to California.

4. Repurchase Agreements used solely as short-term investments not to exceed 90 days.

The following collateral restrictions will be observed: Only U.S. Treasury securities or Federal Agency securities, as described in subsections 1 and 2 above, will be acceptable collateral. All securities underlying Repurchase Agreements must be delivered to the District's custodian bank versus payment or be handled under a tri-party repurchase agreement. The market value of securities that underlay a Repurchase Agreement shall be valued at 102 percent or greater of the funds borrowed against those securities and the value shall be reviewed on a regular basis and adjusted no less than quarterly.

Market value must be calculated each time there is a substitution of collateral.

The District or its trustee shall have a perfected first security interest under the Uniform Commercial Code in all securities subject to Repurchase Agreement.

The District may enter into Repurchase Agreements only with primary dealers of the Federal Reserve Bank of New York.

The District will have specific written agreements with each firm with which it enters into Repurchase Agreements.

Reverse repurchase agreements will not be offered without the prior specific consent of the District's Board of Directors. If a reverse repurchase agreement is authorized, it may be utilized only if the security to be sold on reverse repurchase agreement has been owned and fully paid for by the District for a minimum of 30 days prior to the sale; the total of all reverse repurchase agreements on investments owned by the District does not exceed 20 percent of the base value of the portfolio; and the agreement does not exceed a term of 92 days, unless the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of the security using a reverse repurchase agreement and the final maturity date of the same security.

The District may enter into Reverse Repurchase Agreements only with primary dealers of the Federal Reserve Bank of New York.

5. Bankers' Acceptances issued by domestic or foreign banks, which are eligible for purchase by the Federal Reserve System, the short-term paper of which is rated in the highest category by Moody's Investors Services or by Standard & Poor's Corporation.

Purchases of Banker's Acceptances may not exceed 180 days maturity or 40 percent of the District's surplus money. However, no more than 15 percent of the District's surplus funds may be invested in the Banker's Acceptance of any one commercial bank. (Res. 01-036, 2/23/01.)

6. Commercial paper of "prime" quality of the highest ranking or of the highest letter and number rating, as provided for by a nationally recognized statistical-rating

As of April 2008

organization (NRSRO). The entity that issues the commercial paper shall meet all of the following conditions in either paragraph (a) or paragraph (b):

a. The entity meets the following criteria: (1) is organized and operating in the United States as a general corporation; (2) has total assets in excess of five hundred million dollars (\$500,000,000); and, (3) has debt other than commercial paper, if any, that is rated "A" or higher by a nationally recognized statistical-rating organization (NRSRO).

b. The entity meets the following criteria: (1) is organized within the United States as a special purpose corporation, trust, or limited liability company; (2) has program-wide credit enhancements including, but not limited to, over-collateralization, letters of credit, or surety bond; and, (3) has commercial paper that is rated "A-1" or higher, or the equivalent, by a nationally recognized statistical-rating organization (NRSRO).

Eligible commercial paper shall have a maximum maturity of 270 days or less. Local agencies, other than counties or a city and county, may invest no more than 25 percent of their money in eligible commercial paper. Local agencies, other than counties or a city and county, may purchase no more than 10 percent of the outstanding commercial paper of any single issuer. Counties or a city and county may invest in commercial paper pursuant to the concentration limits in subdivision (a) of Section 53635. (Res. 02-027, 2/8/02; Res. 04-023, 3/12/04.; Res. 05-016, 3/11/05)

7. Medium-term notes are defined as all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state operating within the United States. Medium-term corporate notes shall be rated in a rating category "A" or its equivalent or better by a nationally recognized rating service.

Purchase of medium-term notes may not exceed 30 percent of the District's surplus money. (Res. 00-041, 2/25/00.)

8. FDIC-insured or fully collateralized time certificates of deposit in financial institutions located in California, including U.S. branches of foreign banks licensed to do business in California. All time deposits must be collateralized in accordance with California Government Code Section 53651, either at 150 percent by promissory notes secured by first mortgages and first trust deeds upon improved residential property in California eligible under section (m) or at 110% by eligible marketable securities listed in subsections (a) through (l) and (n) and (o). The District, at its discretion and by majority vote of the Board of Directors, on a quarterly basis, may waive the collateralization requirements for any portion of the deposit that is covered by federal insurance. (Res. 03-035, 4/11/03)

Purchase of FDIC insured of fully collateralized time certificates shall not exceed a total of \$2 million.

9. Negotiable certificates of deposit or deposit notes issued by a nationally or state chartered bank or a state or federal savings and loan association or by a state-licensed branch of a foreign bank; provided that the senior debt obligations of the issuing institution are rated "AA" or better by Moody's or Standard & Poor's.

As of April 2008

Purchase of negotiable certificates of deposit may not exceed 30 percent of the District's surplus money.

10. Any mortgage pass-through security, collateralized mortgage obligation, mortgage-backed or any other pay-through bond, equipment lease-back certificate, consumer receivable pass-through certificate, or consumer receivable-backed bond of a maximum of five years maturity. Securities eligible for investment under this subdivision shall be issued by an issuer having an "A" or higher rating for the issuer's debt as provided by a nationally recognized rating service and rated in a rating category of "AA" or its equivalent or better by a nationally recognized rating service. Purchase of securities authorized by this subsection may not exceed 20 percent of the District's surplus money that may be invested pursuant to this section.

11. State of California's Local Agency Investment Fund. Investment in LAIF may not exceed \$40 million. (Res. 01-054, 3/23/01; Res. 02-027, 2/8/02.)

12. Shares of beneficial interest issued by diversified management companies, as defined in Section 23701m of the Revenue and Taxation Code, investing in the securities and obligations authorized by sections a through l of Government Code section 53601. To be eligible for investment pursuant to this subdivision these companies shall either: (1) attain the highest ranking letter or numerical rating provided by not less than two of the three largest nationally recognized rating services; or, (2) have an investment advisor registered with the Securities and Exchange Commission with not less than five years experience investing in securities and obligations authorized by Government Code Section 53601 and with assets under management in excess of \$500,000,000.

The purchase price of shares shall not exceed 15 percent of the District's surplus money.

Credit criteria listed to in this section refer to the credit of the issuing organization at the time the security is purchased. If a credit rating falls below the criteria stated, the Auditor-Controller shall notify the General Manager. In the event a rating drops below "A," the Auditor-Controller shall notify the General Manager, the Finance and Auditing Committee, and the Board along with a recommendation of whether to hold or sell the particular security.

J. Diversification

The District shall attempt to limit the District's investments in any one bank or corporation to no more than 15 percent of the District's total investments at the time of purchase.

K. Maximum Maturity

Investment maturities shall be based on a review of cash flow forecasts. Maturities will be scheduled so as to permit the District to meet all projected obligations.

Unless otherwise specified in this section, no investment shall be made in any security, other than a security underlying a repurchase or reverse repurchase agreement as authorized by this section, that at the time of the investment has a term remaining to maturity in excess of five years.

As of April 2008

Generally, not less than 20 percent of the District's portfolio, or a sufficient amount to enable the District to meet its cash flow requirements, whichever amount is greater, shall be placed in investments with maturity dates that do not exceed one year, with the understanding that the Chair of the Finance-Auditing Committee and the Auditor-Controller may approve jointly a lesser percentage on an investment by investment basis. (Res. 96-151; Res. 00-155, 7/28/00.)

L. Ineligible Investments

Any security type or structure not specifically approved by this policy is hereby specifically prohibited. Security types which are thereby prohibited include, but are not limited to,

1. "Complex" derivative structures such as range notes, dual index notes, inverse floaters, leveraged or deleveraged floating-rate notes, or any other complex variable-rate or structured note.
2. Interest-only strips that are derived from a pool of mortgages, or any security that could result in zero interest accrual if held to maturity.

M. Sales Prior to Maturity

Sales prior to maturity are permitted. Certain investment opportunities may involve the recognition of value losses. Book value trading losses are permitted. Any trading loss greater than 1 percent of principal value of any investment holding requires the following: (1) explanation of source of loss; (2) rationale for transactions resulting in recognition of loss; and, (3) estimation of time necessary to recoup the loss.

N. Reporting Requirements

The Auditor-Controller shall provide to the General Manager, the Finance-Auditing Committee and the Board a monthly investment report, which shall include, at a minimum, the following information for each individual investment:

- Type of investment instrument;
- Issuer name;
- Maturity date;
- Par value;
- Purchase price; and,
- Current market value and the source of the valuation. (Res. 03-035, 4/11/03)

The monthly report also shall: (1) state compliance of the portfolio to the statement of investment policy, or manner in which the portfolio is not in compliance; (2) include a description of any of the District's funds, investments or programs that are under the management of contracted parties, including lending programs; and, (3) include a statement denoting the ability of the District to meet its expenditure requirements for the next six months, or provide an explanation as to why sufficient money shall, or may, not be available.

This monthly report shall be submitted within 30 days following the end of the month.

As of April 2008

The Auditor-Controller shall annually render to the Board a statement of investment policy, which the Board shall consider at a public meeting.

O. Safekeeping and Custody

All securities, whether negotiable, bearer, registered, or nonregistered, whether purchased for the District by financial advisors, consultants or managers, shall be delivered, either by book entry or physical delivery, to the District's third party custodian.

P. Investment Sub-Committee

An Investment Sub-Committee shall be established that will include the Chair of the Finance-Auditing Committee, plus two other Directors and the Auditor-Controller, to periodically (at least quarterly) review the District's investment strategy and investment policy. (Res. 81-197, 5/29/81.)



The PFM Group

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January 30, 2009

Memorandum

To: Joe Wire, Auditor-Controller
Alice Ng, Financial Management and Business Process Manager
Golden Gate Bridge, Highway and Transportation District

From: Nancy Jones, Managing Director
Paulina Woo, Consultant
PFM Asset Management LLC

Re: Analysis of District's Permitted Investments versus California Government Code

During our January 13 meeting, you asked us to evaluate the differences between the permitted investments listed in California Government Code, §53601, and the District's Investment Policy. While most of District's permitted investments, credit criteria and maximum maturities are aligned with the California Government Code, there are some investments on which the District has chosen to impose additional restrictions. We have listed the differences between the District's Investment Policy and California Government Code below.

Permitted Investment Instruments

I.4. Repurchase Agreements

The District currently requires several conditions, which are not listed in California Government Code §53601(j), to be met when entering into a Repurchase Agreement. These conditions are:

- A 90-day maturity limit for Repurchase Agreements. The Government Code allows a maturity of up to one year.
- Only U.S. Treasuries and Federal Agencies as collateral. The Government Code does not place a restriction on the securities that can be used as collateral.
- A market value calculation each time there is a substitution of collateral. The Government Code does not require a market value calculation if collateral is substituted.
- A perfected first security interest under the Uniform Commercial Code in all securities subject to Repurchase Agreement. The California Government Code does not have this requirement when entering into a Repurchase Agreement.
- Repurchase Agreements only with primary dealers of the Federal Reserve Bank of New York. The Government Code does not place a limitation on the dealers for Repurchase Agreements.

- Written agreements with each firm with which the District enters into Repurchase Agreements. The Government Code does not have a written agreement requirement.

I.5. Bankers' Acceptances

The District requires that Bankers' Acceptances be rated in the highest category by Moody's or S&P. The California Government Code does not have credit rating criteria for these instruments. In addition, the District's Policy places a 15% portfolio allocation limit on Bankers' Acceptances, which is lower than the 40% total/30% per issuer limitations specified by the Code.

I.9. Negotiable Certificates of Deposit

The District requires a Moody's or S&P minimum credit rating of "AA" on the senior debt of the institutions issuing Negotiable Certificates of Deposit. The Government Code has no credit criteria.

I.12. Shares of Beneficial Interest Issued by Diversified Management Companies

The Policy limits investments in mutual funds to 15% of the portfolio. The California Government Code allows 20% of the portfolio to be invested in mutual funds.

Investments Permitted by California Government Code But Not Included in the District's Policy

Government Code §53601(p) was added to the Code a few years ago. This section allows public agencies to invest in shares of beneficial interest issued by joint powers authorities organized pursuant to Section 6509.7 that invest in the securities and obligations authorized in California Government Code §53601, subsections (a) to (o), inclusive. An example of a JPA in which the District could invest is the California Asset Management Program. This investment has not been added to the District's Investment Policy.

K. Maximum Maturity

The District mandates that the greater of 20% of the total portfolio or a sufficient amount of funds needed to meet District's cash flow needs be placed in investments with a maturity of one year or less. The California Government Code does require a certain percentage of the portfolio to have a maturity less than one year.

We will call you this week to see if you would like any additional information.