California Government Code: An In-Depth Discussion

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Important Codes Related to Investments

- California Government Code (CGC or Code)
  - Investment of Surplus (53600-53610)
  - Deposit of Funds (53630-53686)

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History of Changes Since 2001

January 1, 2001

- SB 68 designated money in the Local Agency Investment Fund (LAIF) as non-state money.

January 1, 2002

- AB 609:
  - Clarified which agencies fall under 53601 (all local agencies that are not counties) and 53635 (applies only to counties and certain pools).
  - Simplified definition of Federal Agencies by eliminating references to specific Agencies.
  - Changed sliding scale of permitted commercial paper allocation to static 25%.
  - Added Fitch to the list of rating agencies providing ratings for commercial paper.
  - Eliminated distinction between pre- and post-December 1994 investments for repurchase and reverse repurchase agreements and securities lending.
  - Added Community Redevelopment Act rating of satisfactory for depositories to be eligible to receive funds.
  - LAIF's deposit limit goes from $30 million to $40 million.

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History of Changes Since 2001

January 1, 2004	• SB 787 replaced references to specific rating agencies with "nationally recognized statistical-rating organization (NRSRO)".
September 30, 2004	• AB 2853 made the submission of investment policies and quarterly reports optional and therefore not a reimbursable mandate.
January 1, 2005	• AB 969 added 2 new sections, 6509.7 and 53601(p), that provide specific criteria and authorization for the formation and use of joint powers authorities for pooling funds for investment purposes.
January 1, 2007	• AB 2011 added 2 new Code sections, 53601.8 and 53635.8, allowing use of CD placement services through January 1, 2012.
January 1, 2008	• AB 1745 added 53601(d), which allows municipal bonds from any of the other 49 states.
November 16, 2009	• LAIF's deposit limit raised from $40 million to $50 million.
January 1, 2011	• SB 1344 removed January 1, 2012 sunset date for eligibility of CD placement services.
January 1, 2012	• SB 194 added federally-licensed branch of a foreign bank to list of eligible issuers for negotiable CDs.

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Who Does It Apply To?

- 53600 defines a “local agency” as any:
  - County
  - City
  - City and County
  - School District
  - Community College District
  - County Board of Education
  - County Superintendent of Schools
  - Public District
  - Public or Municipal Corporation

Typically required to invest through County Treasury

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Standard of Prudence (53600.3)

- Code defines the standard of prudence for public funds to be the **Prudent Investor Standard**, which states that:

> "When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, 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 agency."

- Members of Board and anyone authorized to make investment decisions are considered trustees and fiduciaries subject to this standard of prudence.
- Permits investments to be acquired.
- Considers investments as part of overall strategy/portfolio.

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Standard of Prudence (53600.3)

Prudent Investor Rule:

"When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, **a trustee** shall act with **care, skill, prudence, and diligence** under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, 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 agency. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law."

Prudent Person Rule:

"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."

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Objectives (53600.5)

1. Safeguard principal of funds under control

2. Meet liquidity needs of depositor

3. Achieve a return on the funds under control

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Application of 53601

- Agency types: Cities, districts, local agencies who do not pool money in deposits or investments with other local agencies with different governing bodies.
  - Directs local agencies pooling money with other local agencies to 53635, which directs local agencies back to 53601 with a few caveats.
- Fund types: Sinking funds or moneys in treasury not immediately required.
- Delivery of securities: Must be in agency's name and delivered to the agency or a third-party custodian.
- Application of percentage limits: Date of purchase.
- Maximum maturity: Five years unless otherwise stated or council/board has approved longer-term investments at least 90-days in advance.

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Summary of Investments Permitted by 53601

		Overnight	180 Days	270 Days	1 Year	5 Years	Beyond 5 Years
"Conventional" Fixed-Income	U.S. Treasuries	Permitted	Permitted	Permitted	Permitted	Permitted	Requires Approval
	Federal Agencies	Permitted	Permitted	Permitted	Permitted	Permitted	Requires Approval
	Municipal Securities	Permitted	Permitted	Permitted	Permitted	Permitted	Requires Approval
	Negotiable Certificates of Deposit	Permitted	Permitted	Permitted	Permitted	Permitted	Requires Approval
	Commercial Paper	Permitted	Permitted	Permitted	Prohibited	Prohibited	Prohibited
	Bankers' Acceptances	Permitted	Permitted	Prohibited	Prohibited	Prohibited	Prohibited
	Medium-Term Corporate Bonds ("A" or Better)	Permitted	Permitted	Permitted	Permitted	Permitted	Prohibited
	Asset-Backed Securities (ABS)	Permitted	Permitted	Permitted	Permitted	Permitted	Prohibited
	Repurchase Agreements	Permitted	Permitted	Permitted	Permitted	Prohibited	Prohibited
	Mutual Funds/Money Market Funds	Permitted	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Local Government Investment Pools	Permitted	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
Broader Fixed-Income	Foreign Sovereign/Supranationals	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Commercial MBS	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	High-Yield	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Private Placements	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Convertibles	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Non-U.S. Dollar Investment Grade	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Emerging Markets Debt	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
Equities	Domestic Small/Mid Cap	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Domestic Large Cap	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Domestic Value/Growth	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	International Small/Mid Cap	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	International Large Cap	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Emerging Markets	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
Alternatives	Commodities	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Real Estate	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Hedge Funds	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Private Equity	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Venture Capital	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited
	Tangible Assets	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited	Prohibited

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Permitted Investments – Government Issuer

- U.S. Treasuries (b)
- Federal Agencies (f)
  - Including up to 20% mortgage-backed securities
- Local agency's own bonds (a)
- State of California bonds (c)
- California local agency bonds (e)
- Bonds issued by 49 other states (d)

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Permitted Investments – Non-Government Issuer

- Bankers' acceptances (g)
  - 40% of portfolio
  - 180 day maximum maturity
- Commercial paper (h)
  - 25% (40% by 53635 (a)(1)) of portfolio
  - 270 day maximum maturity
  - Credit criteria
- Negotiable CDs (i)
  - Issued by nationally or state-chartered bank, savings association, federal association, state or federal credit union, or by a federally- or state-licensed bank branch of a foreign bank
  - 30% of portfolio
  - Conflict of interest limitation

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Permitted Investments – Non-Government Issuer

- Repurchase and reverse repurchase agreements (j)
  - 1 year/92 day maximum maturity
  - Counterparty, collateral, and other requirements
- Medium-term notes (k)
  - 30% of portfolio
  - 5 year maximum maturity
  - Issued by corporations organized and operating in U.S. or depository institutions licensed by U.S. or any state and operating in U.S.
  - A or better
- Mortgage- or asset-backed securities (o)
  - 20% of portfolio
  - 5 year maximum maturity
  - Issuer rating of A or better, issue rating of AA or better

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Permitted Investments – Pooled

- Shares of beneficial interest issued by a diversified management company (I)
  - Money market mutual funds
    - 20% of portfolio
    - AAA by two or more NRSROs or Advisor requirements
    - Stable net asset value (NAV)
  - Mutual funds
    - 20% of portfolio, no more than 10% in any one fund
    - AAA by two or more NRSROs or Advisor requirements
    - Variable net asset value (NAV)
    - Underlying investments must be same as CGC

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Permitted Investments – Pooled

- Shares of beneficial interest issued by a joint powers authority (p)
  - Local government investment pools (LGIPs)
  - Adviser requirements
- State of California's Local Agency Investment Fund (LAIF) (16429.1)
- County Treasurers' pools (53684)

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Permitted Investments (53635)

- For agencies that pool money with other local agencies that have different governing bodies.

- Difference from 53601
  - 40% of portfolio in commercial paper
  - 10% of portfolio in commercial paper of any one issuer

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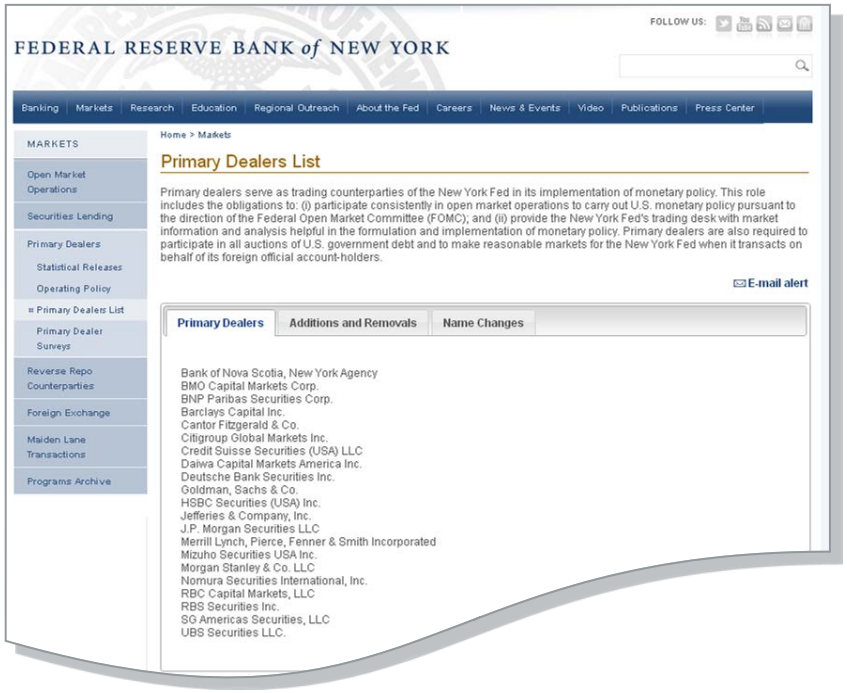
Authorized Securities Dealers (53601.5)

- Direct issuers
- Broker-dealer registered with California
- Member of a federally regulated securities exchange (i.e., FINRA)
- National or state-chartered bank
- Savings or federal association
- Primary dealers



Source: http://www.newyorkfed.org/markets/pridealers_current.html

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Prohibited Investments (53601.6)

- Inverse floaters
- Range notes
- Mortgage-derived, interest-only strips
- Security that could result in zero interest accrual if held to maturity
  - Exempts mutual funds

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Deposit Placement Services (53601.8)

- 30% of portfolio
- Depository institution must have branch in California and be one of these types of financial institutions:
  - Nationally or state chartered commercial bank
  - Savings bank
  - Savings and loan association
  - Credit union
- Must be FDIC or NCUA insured

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Other Permissions

- Can purchase investments through primary or secondary markets (53603)
- May sell or exchange investments prior to maturity (53604)
- May sell to raise cash for agency's expenditures (53605)

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Delegation of Authority (53607)

- Board may delegate to Treasurer for one-year period
- Must be renewed annually
- Must make monthly report of transactions when authority is delegated**

****Commonly missed reporting requirement**

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Reporting Requirements (53646)

- Quarterly reporting requirements are optional.
- If providing quarterly reports, they must:
  - Be submitted within 30 days after quarter end.
  - Include: Investment type, issuer, maturity date, par amount, purchase price, description of funds being managed by an outside party, market value and source for any securities managed by an outside party that is not a local agency or LAIF.
  - State that the portfolio is in compliance with the Policy or manner in which it is out of compliance.
  - State the ability of the agency to meet its pool's expenditure requirements for the next 6 months or explain why it cannot.

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Reporting Requirements (53646) Continued

Investment Type

Issuer

Maturity Date

Par Amount

Purchase Price

Market Value

PFM

Managed Account Detail of Securities Held

For the Month Ending **September 30, 2012**

Security Type/Description Dated Date/Coupon/Maturity	CUSIP	Par	S&P Rating	Moody's Rating	Trade Date	Settle Date	Original Cost	YTM at Cost	Accrued Interest	Amortized Cost	Market Value
Security Type Sub-Total		**840,000.00**					**895,084.00**	**1.21**	**6,694.26**	**882,253.79**	**890,024.80**
Federal Agency Bond / Note											
FNMA NOTES DTD 11/01/2010 0.750% 12/18/2013	31398A5W8	295,000.00	AA+	Aaa	06/28/11	06/29/11	294,985.25	0.75	633.02	294,992.78	296,958.51
FHLMC NOTES DTD 12/18/2011 0.625% 12/23/2013	3134G3BF6	435,000.00	AA+	Aaa	12/20/11	12/21/11	436,257.59	0.48	740.10	435,771.22	436,951.41
FHLMC GLOBAL NOTES DTD 06/19/2009 3.000% 07/28/2014	3137EACD9	1,150,000.00	AA+	Aaa	02/01/11	02/04/11	1,208,006.00	1.51	6,037.50	1,180,763.12	1,205,398.95
FHLMC NOTES DTD 06/02/2011 1.000% 07/30/2014	3137EACU1	445,000.00	AA+	Aaa	12/13/11	12/14/11	449,481.15	0.61	754.03	448,129.42	450,762.75
FHLMC NOTES DTD 07/05/2011 1.000% 08/27/2014	3137EACV9	500,000.00	AA+	Aaa	08/15/11	08/15/11	507,140.00	0.52	472.22	504,498.33	507,035.00
FNMA GLOBAL BENCHMARK NOTES DTD 03/30/2005 5.000% 04/15/2015	31359MA45	350,000.00	AA+	Aaa	08/29/11	08/29/11	403,147.50	0.75	8,069.44	387,347.45	390,878.91
FANNIE MAE GLOBAL NOTES DTD 04/19/2012 0.500% 05/27/2015	3135G0KM4	485,000.00	AA+	Aaa	04/17/12	04/19/12	483,598.35	0.59	835.28	483,799.67	486,501.56
FNMA NOTES DTD 06/14/2010 2.375% 07/28/2015	31398AU34	610,000.00	AA+	Aaa	09/01/10	09/07/10	629,678.60	1.69	2,535.31	621,562.37	643,873.30
FNMA NOTES (CALLABLE) DTD 08/07/2012 0.500% 08/07/2015	3135G0NG4	800,000.00	AA+	Aaa	08/02/12	08/07/12	799,920.00	0.50	600.00	799,923.98	799,498.40
FNMA NOTES DTD 09/27/2010 1.625% 10/26/2015	31398A4M1	700,000.00	AA+	Aaa	09/23/11	09/27/11	718,907.00	0.95	4,897.57	714,290.63	725,589.90
FNMA NOTES DTD 03/04/2011 2.375% 04/11/2016	3135G0BA0	410,000.00	AA+	Aaa	07/18/12	07/19/12	437,170.70	0.58	4,598.26	435,729.00	437,053.03
FANNIE MAE NOTES DTD 10/20/2011 1.375% 11/15/2016	3135G0ES8	295,000.00	AA+	Aaa	06/05/12	06/07/12	301,678.80	0.85	1,532.36	301,210.72	304,169.78
FANNIE MAE GLOBAL NOTES DTD 07/20/2012 0.875% 08/28/2017	3135G0MZ3	520,000.00	AA+	Aaa	09/06/12	09/10/12	521,289.60	0.82	417.08	521,274.76	522,618.72
Security Type Sub-Total		**6,995,000.00**					**7,191,260.54**	**0.90**	**32,122.17**	**7,129,293.45**	**7,207,290.22**

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Investment Policies (53646)

- Counties:
  - May annually render to the board of supervisors/oversight committee a statement of investment policy, which board shall review and approve at a public meeting.
  - Any change in the Policy shall be reviewed and approved by the board at a public meeting.

- Local Agencies:
  - May annually render a statement of investment policy to council/board/oversight committee, which shall be considered at a public meeting by the council/board.
  - Any change in the Policy shall be considered by the council/board at a public meeting.

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Resources

California

- California Government Code (http://www.leginfo.ca.gov/cgi-bin/calawquery?codesection=gov&codebody=&hits=20)
- California Municipal Treasurers Association (http://cmta.org/?page=39)

National

- Association of Public Treasurers (http://www.aptusc.org/certifications/investment-policy-certification)
- Government Finance Officers Association (www.gfoa.org/downloads/sampleinvestmentpolicy.pdf)
- CFA Institute (http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2010.n13.1)

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