Best Practices for Overseeing Your Investment Program

ICCCFO Spring 2018 Conference

April 18, 2018
This “fiduciary” thingy really complicates exploiting my job to get stinking rich.
Investing Public Funds: Recommended Procedures

- Develop adequate controls and oversight
- Adopt a written investment policy
- Match investment maturities with cash flow requirements
- Diversify investments
- Know what you are buying and get it in writing
Develop adequate controls and oversight
**Why Have Investment Internal Controls?**

- One of the weakest links in an investment program is often the management system and internal control procedures.

- Internal controls help prevent:
  - Fraud
  - Embezzlement
  - Malfeasance and repeated errors

- Internal controls can help to identify potential problem areas:
  - Embezzlement/conversion (cash, securities, deadline with outside parties)
  - Transaction errors (incorrect transaction amounts, wire failures, wrong payees)
  - Judgement errors (security selection, cash flow versus maturity selection)
  - Cover-ups (fraud, delaying bad news, changing numbers)

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**Independence**

**Separation of Duties**

**Reconciliation**

**Oversight**
Documented Investment Procedures

- Organizational Design
  - Separation of functions
  - Barriers to collusion
  - Checks and balances

- Supervisory Controls
  - Pre-employment screening
  - Documentation of transactions

- Custodial Safekeeping

- Staff and Management Training

- Reporting Requirements

- Internal Audit Review
Adopt a written investment policy
Investment Management: Investment Policy

“A written investment policy is the single most important element in a public funds investment program.”

– GFOA Best Practice: Creating an Investment Policy (2010)
An Investment Policy is Akin to a Permit
Why Develop a Formal Investment Policy?

Purpose of an Investment Policy

- Build a framework for investment practices
- Protect assets of the College and the liability of the College’s staff
- Communicate the College’s investment objectives
- Establish limits
- Delineate staff roles

Target Audience

- Internal finance staff
- College Board of Trustees
- Members of the public
- Investment providers
Define Investment Objectives

For general operating, reserves, and bond proceeds:

- Protect principal
- To meet ongoing and uncertain needs
- Maximize earnings, while simultaneously providing safety and liquidity
Investment Policy Statement Components

- Objectives
- Standard of Prudence
- Ethics & Conflicts
- Delegation of Authority
- Selection of Brokers / Dealers
- Competitive Selection
- Safekeeping and Custody
- Internal Controls
- Authorized Investments
  - Specifically define
- Belts and Suspenders
  - Diversification
    - Sector
    - Issuer
  - Maximum Maturity
  - Security downgrades
    - What to do?
- Performance and Reporting Standards
Match investment maturities with cash flow requirements
Cash Flow is Key

- Identifies “core” versus liquid funds
- Helps ensure adequate liquidity and seeks to enhance cash management techniques
- Identifies trends in cash balances
- Can increase investment income
  - Amounts available for investment
  - Period of time to hold the investment
  - Assists with investment strategies
- Helps forecast potential deficits
Cash Flow Analysis and Forecasting

Liquidity and Operating Funds
- Daily liquidity
- Funds to cover specific, predictable cash flows
- Investment horizon less than twelve months

Bond Proceeds
- Funds dedicated for a specific use
- Investments matched to a particular draw schedule

“Core” Reserves
- Funds with stable balances
- Investment horizon of more than one year

For illustrative purposes only.
Why Prepare a Cash Flow Analysis?

- There are advantages to keeping money liquid
  - Money is available for unexpected expenses
  - Funds usually earn interest in fully-liquid accounts

- There are also costs to keeping cash on hand
  - Lost investment income
  - Market risk
  - Potentially bad press

- Time is Money
  - Many priorities competing for staff time
  - Finding the right mix of investments takes time, continually monitoring of changing market conditions
Diversify investments
Permitted Investments – Operating Funds

- Define general universe

- Bound by the Illinois Public Funds Investment Act (30 ILCS 235)

- Set diversification limits
  - Term
  - Sector
  - Credit Quality

- Restrictive clauses

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>Allowed?</th>
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<tbody>
<tr>
<td>U.S. Treasuries</td>
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<td>Mutual Funds (Equity)</td>
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Permitted Investments – Foundation Funds

- Define general universe

- *Not* bound by the Illinois Public Funds Investment Act (30 ILCS 235)

- Set diversification limits
  - Term
  - Sector
  - Credit Quality

- Restrictive clauses

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Risk Tolerances

"We’ve considered every potential risk except the risks of avoiding all risks."

VS.

‘NOTHING VENTURED NOTHING GAINED’
Know what you are buying and get it in writing
Custodial Reporting

- Frequency
  - Monthly
  - Quarterly
  - Annual

- Content
  - Securities listing
  - Allocation by sector
  - Book value
  - Market value
  - Yield and/or return
  - Income earned
Best Practice: Document Everything

**WHY?**

- If a dispute arises, the College may need to defend itself

- Old lawyer adage: if it was not documented, it does not exist

- College should document *everything* they do to fulfill their fiduciary duties to monitor and oversee investments
Summary

- Be proactive with your internal controls
- Follow your investment policy and review it periodically
- Devote the time to develop an investment strategy
- Do not expect higher returns without higher risks
- Engage your program partners / vendors for support
- Look to GFOA for best practices and sample documents
Questions???
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