

● **Board of Directors**  
**Audit, Budget and Finance Committee**

June 12, 2001 Board Meeting

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**9-4**

**Subject**

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Approve Metropolitan's Annual Statement of Investment Policy and delegation of authority to the Treasurer to make investments on behalf of Metropolitan

**Description**

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Metropolitan's investment policy ([Attachment 1](#) and [Attachment 2](#)) is guided by, in priority order, the three guiding principles of public funds management:

- (1) Safety - The foremost objective of Metropolitan. Each investment is entered into seeking quality of the issuer, the underlying security or collateral, and diversification of the portfolio.
- (2) Liquidity - In an effort to ensure Metropolitan's portfolio is sufficiently liquid to meet current and anticipated operating requirements, a cash flow analysis is prepared and updated on a regular basis.
- (3) Return - Investments are undertaken to produce an acceptable rate of return after first considering safety of principal, liquidity and the prudent standard principle. This principle is a standard of conduct where a person acts with care, skill and diligence when purchasing, selling, exchanging and managing funds.

Delegation of Authority to Invest

In accordance with Section 53600 et seq. of the Government Code of the State of California, the authority to invest public funds is expressly delegated to the Board of Directors for subsequent re-delegation to the Treasurer. The Board is required each year to renew the delegation to the Treasurer.

Change to Investment Policy

It is recommended that the credit requirement for Bankers Acceptances, Negotiable Certificates of Deposit, and Time Deposits be changed from Thompson Bank Watch rating of TWB-1 to Fitch rating of F1. This change is necessary, as Thompson ratings have been discontinued due to Fitch's purchase of Thompson Bank Watch late last year.

Changes to Investment Operations and Strategy

Staff is working with the Subcommittee on Investments and Bond Financing on certain changes to investment operations and strategy. This may result in the potential need for changes to the investment policy. Examples of changes related to investment operations and strategy are:

- The consolidation of funds into one investment pool - completed May 1, 2001
- Implementation of new Investment Management software - Request For Proposal issued May 8, 2001
- The segmenting of the pool into short-and long-term portfolios
- Actively managing the longer-term portfolio to an appropriate benchmark

As appropriate, staff will bring any recommendations for changes to the Statement of Investment Policy to the Audit, Budget and Finance Committee for approval at a later date.

**Policy**

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Per Section 5114 of the Metropolitan Water District Administrative Code, not less than annually, the Treasurer is required to render a Statement of Investment Policy to the Board and to obtain the Board’s approval for annual delegation of authority to the Treasurer to make investments on behalf of Metropolitan. Metropolitan’s Statement of Investment Policy is included as **Attachment 1** and **Attachment 2**. Changes to the policy are described in the detailed report.

**CEQA**

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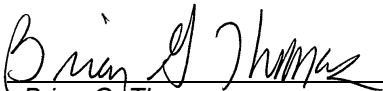
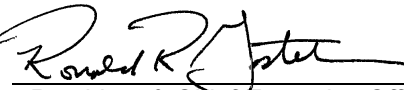
The proposed action is not defined as a project under the California Environmental Quality Act (CEQA), because the proposed action involves the creation of government funding mechanisms or other government fiscal activities, which do not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment (Section 15378(b)(4) of the State CEQA Guidelines).

The CEQA determination is: Determine that the proposed action is not subject to CEQA per Section 15378(b)(4) of the State CEQA Guidelines.

**Staff Recommendation**

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Adopt the CEQA determination, approve the re-delegation of authority to the Treasurer to make investments on behalf of Metropolitan and approve the Statement of Investment Policy with changes as indicated.

	5/21/2001
_____ Brian G. Thomas Chief Financial Officer	Date
	5/22/2001
_____ Ronald R. Foster President & Chief Executive Officer	Date

**Attachment 1 – Statement of Investment Policy**  
**Attachment 2 – Comparison of California Government Code and Statement of Investment Policy Authorized Investments**

# THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

## STATEMENT OF INVESTMENT POLICY\* June 12, 2001

### I INVESTMENT AUTHORITY

In accordance with Section 53600 et seq. of the Government Code of the State of California, the authority to invest public funds is expressly delegated to the Board of Directors for subsequent re-delegation to the Treasurer. Investments by the Treasurer pursuant to the delegation hereby made by this Statement of Investment Policy are limited to those instruments specified by the Board in Section 5101 of the MWD Administrative Code, and as further defined in this Statement of Investment Policy.

### II STATEMENT OF OBJECTIVES

In order of priority, three fundamental criteria shall be followed in the investment program:

1. Safety of Principal - Investments shall be undertaken in a manner which first seeks to ensure the preservation of principal in the portfolio. Each investment transaction shall be entered into after taking into consideration the quality of the issuer, the underlying security or collateral, and diversification of the portfolio. Market risk shall be reduced by limiting the average maturity of the portfolio, the maximum maturity of any one security, and by performing continuous cash flow analysis to avoid the need to sell securities prior to maturity.
2. Liquidity - In an effort to ensure that Metropolitan's portfolio will be sufficiently liquid to meet current and anticipated operating requirements, a cash flow analysis will be performed on an ongoing basis. Investments shall be made so that the maturity date is compatible with cash flow needs and safety of principal.

\* Supersedes Statement of Investment Policy dated June 13, 2000.

3. Return on Investment - Investments shall be undertaken to produce an acceptable rate of return after first considering safety of principal and liquidity and the prudent investor standard.

All investment activity shall be consistent with the prudent investor standard.

### **III PRUDENT INVESTOR STANDARD**

As applicable to Metropolitan and its fiduciaries, the prudent investor standard is a standard of conduct whereby any person authorized to make investment decisions on behalf of Metropolitan acts 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 Metropolitan, that a prudent person acting in 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 meet the liquidity needs of Metropolitan.

### **IV PORTFOLIO**

Any reference to the portfolio shall mean the total of Metropolitan's cash and securities under management by the Treasurer, excluding cash and securities held in escrow or trust on behalf of Metropolitan. The Treasurer may invest in any security authorized for investment under the State law, subject to the limitations described below:

#### 1. Maturity Limitations

- a. The Treasurer is authorized to invest Metropolitan's fund balances up to a maximum term of five years. Special trust funds shall not be subject to the five-year maximum maturity. The Treasurer is therefore authorized to invest special trust funds in excess of five years. These funds include, but are not limited to the following:

Employees' Deferred Compensation Fund  
Water Revenue Bond Reserve Funds  
Iron Mountain Landfill Closure/  
Postclosure Maintenance Fund  
Lake Mathews Conservancy

- b. For certain instruments, the term of the investment is limited by market convention or as otherwise prescribed herein.
- c. Not more than 20 percent of the portfolio shall consist of securities with a term to maturity in excess of three years, after deducting those Funds noted in 1a.

2. Investment Transactions

- a. Information concerning investment opportunities and market developments will be gained by maintaining contact with the financial community.
- b. The purchase of any investment other than those purchased directly from the issuer shall be, to the extent possible, from a firm designated as a Primary Dealer by the Federal Reserve Bank of New York. Investments in reverse repurchase agreements may be made only with Primary Dealers of the Federal Reserve Bank of New York.
- c. All dealers will be required to provide confirmations of all purchases or sales directly to the Controller for audit.
- d. Annually the Treasurer shall transmit a copy of the current Statement of Investment Policy to all approved dealers. Each dealer is required to return a signed statement indicating receipt and understanding of Metropolitan's investment policies.
- e. When practicable, the Treasurer shall solicit more than one quotation on each trade. All investment trades will be awarded on a competitive bid basis.
- f. Each day's listing of market indices and quotations shall be transmitted by the Treasurer to the Controller for filing.
- g. Prohibited investments include inverse floaters, range notes, interest only strips derived from a pool of mortgages (Collateralized Mortgage Obligations), and any security that could result in zero interest accrual if held to maturity. (Zero interest accrual means the security has the potential to realize zero earnings depending upon the structure of the security. Zero coupon bonds and similar investments that start at a level below the face value are legal because their value does increase).
- h. Metropolitan will actively encourage participation of minority-owned and women-owned firms in its investment activities. These firms will be provided opportunities to sell fixed income securities and provide investment advisory services to Metropolitan.

3. Exchange of Securities

An exchange of securities is a shift of assets from one instrument to another and may be done for a variety of reasons, such as to increase yield, lengthen or shorten maturities, to realize a profit, or to increase investment quality. In no instance shall an exchange be used for speculative purposes. Any such exchange shall be simultaneous (same day execution of sale and purchase), and shall require the approval of the Chief Financial Officer.

4. Portfolio Adjustments

- a. Should an investment percentage of portfolio limitation be exceeded due to an incident such as a fluctuation in portfolio size, the affected securities may be held to maturity to avoid losses.
- b. When no loss is indicated, the Treasurer shall consider reconstructing the portfolio basing his decision in part on the expected length of time the portfolio will be imbalanced.
- c. Should a security held in the portfolio be downgraded below the minimum criteria included in this Statement of Investment Policy, the Treasurer shall sell such security in such a manner to minimize losses on the sale of such security. If the security is downgraded to a level that is less than investment grade and the term to maturity is greater than one year, the Treasurer shall sell such affected security within sixty days of the rating change.

5. Safekeeping

- a. All securities transactions, including collateral for repurchase agreements entered into by Metropolitan shall be conducted on a delivery versus payment (DVP) basis.
- b. Securities will be held by an independent custodian designated by the Treasurer and held in safekeeping pursuant to a safekeeping agreement.
- c. All financial institutions which provide safekeeping services for Metropolitan shall be required to provide reports or safekeeping receipts directly to the Controller to verify securities taken into their possession.

**V AUTHORIZED INVESTMENTS**

1. U.S. Government and Agencies

- a. Investments in U.S. Treasury obligations shall not be subject to any limitations.
- b. Investments in direct obligations of Federal Agencies guaranteed by the U.S. Government shall not be subject to any limitations. (Please refer to Appendix)

- c. Investments in Federal Agency obligations shall not exceed 50 percent of all investments in effect immediately after any such investment is made.

2. Bankers' Acceptances

Restrictions are as follows:

- a. Investments in prime bankers' acceptances shall not exceed 40 percent of the portfolio in effect immediately after any such investment is made.
- b. No more than 25 percent of this category of investments may be invested in any one commercial bank's acceptances.
- c. Eligibility shall be limited to those financial institutions which maintain ratings equivalent to F1 by Fitch or better.
- d. The maximum maturity shall be limited to 270 days.

3. Negotiable Certificates of Deposit

Restrictions are as follows:

- a. Investments in negotiable certificates of deposit shall not exceed 30 percent of the total portfolio in effect immediately after any such investment is made.
- b. The total investment in an eligible financial institution shall not exceed 25 percent of the total portfolio available for investment in this investment category.
- c. To be eligible, a certificate of deposit must be issued by a nationally or state-chartered bank, a state or federal savings and loan association or savings bank, or by a state-licensed branch of a foreign bank.
- d. Eligibility shall be limited to those financial institutions which maintain ratings equivalent to F1 by Fitch or better.
- e. The investment shall not exceed the shareholders' equity of any depository bank. For the purpose of this constraint, shareholders' equity shall be deemed to include capital notes and debentures.
- f. The investment shall not exceed the total of the net worth of any depository savings and loan association, except that investments up to a total of five hundred thousand dollars may be made to a savings and loan association without regard to the net worth of that depository, if such investments are insured or secured as required by law.
- g. The maximum maturity shall be limited to one year.

4. Commercial Paper

Restrictions are as follows:

- a. Only commercial paper of prime quality of the highest ranking or of the highest letter and numerical rating as provided by Moody's Investors Service, Inc., or Standard and Poor's Corporation may be purchased.
- b. Eligible paper is further limited to issuing corporations that are organized and operating within the United States and having total assets in excess of \$500,000,000.
- c. Eligible issuer's debt must carry Moody's or Standard and Poor's rating of at least an "A".
- d. Investments in commercial paper shall not exceed 30 percent of the portfolio in effect immediately after any such investment is made, providing that the dollar-weighted average maturity of the entire amount does not exceed 31 days. "Dollar-weighted average maturity" means the sum of the amount of each investment multiplied by the number of days to maturity, divided by the total amount of outstanding commercial paper.
- e. Investments in commercial paper totaling 15 percent or less of the portfolio in effect immediately after any such investment is made shall not be subject to the dollar-weighted average maturity limitation.
- f. Each investment shall not exceed 180 days maturity. The total investment in the commercial paper of an issuer shall not exceed 25 percent of the total portfolio available for investment in this investment category.
- g. No more than 10 percent of the outstanding commercial paper of an issuing corporation may be purchased.



5. Repurchase Agreements

A repurchase agreement is a purchase of authorized securities (other than commercial paper) with terms including a written agreement by the seller to repurchase the securities on a later specified date for a specified amount. Restrictions are as follows:

- a. The percentage limit for investment in repurchase agreements shall be 50 percent of the total portfolio.
- b. Purchases of repurchase agreements will be limited to a maximum maturity of one year.
- c. Repurchase agreements shall be made only with primary dealers in government securities or financial institutions with a Moody's Investors Service, Inc., or equivalent, rating of A or better.
- d. Such investments shall provide for purchased securities with a market value at least 102 percent of the amount of the invested funds. Value shall be adjusted not less than quarterly.
- e. Purchased securities are limited to Treasury bills, bonds and notes, or other investments that are direct obligations of or fully guaranteed as to principal and interest by the United States or any agency thereof; negotiable certificates of deposit; and bankers' acceptances eligible for acceptance under Federal Reserve rules. Zero coupon and stripped coupon instruments are not acceptable.
- f. Such investments shall provide for transfer of ownership and possession of the purchased securities either to Metropolitan directly or to a custodian depository institution which shall take record title and shall establish and maintain a sub-account in its financial records for the securities in Metropolitan's name, and such custodian shall not be the dealer from which the securities were purchased.
- g. Each repurchase agreement shall provide a contractual right to liquidation of the purchased securities upon the bankruptcy, insolvency or other default of the counterparty.
- h. Purchased securities shall have maturities within sixty months of the date of investment.

6. Reverse Repurchase Agreements

A reverse repurchase agreement is a sale by the Treasurer of securities in the portfolio with terms including a written agreement to repurchase the securities on or before a specified date for a specified amount.

- a. Subject to the approval of the Board of Directors, the Treasurer may enter into a reverse repurchase agreement provided that the proceeds are invested solely to supplement the income normally received from the securities involved in the agreement. These agreements may only be performed with primary dealers of the Federal Reserve Bank of New York.
- b. Limit investments in reverse repurchase agreements to the lesser of 10 percent of the portfolio, or 25 percent of the United States Treasury and Agency securities held in Metropolitan's portfolio at cost.
- c. Match or closely approximate the maturity of the investment purchased with the proceeds of a reverse repurchase agreement with the maturity of the reverse repurchase agreement(s).
- d. Purchases of securities with proceeds from reverse repurchase agreements may not be subject to a reverse repurchase agreement.
- e. Reverse repurchase agreements will be limited to a maximum maturity of 92 days.
- f. Securities used to make reverse repurchase agreements must be made for and held for a minimum of 30 days prior to the transaction.

7. Time Deposits

For purposes of this policy, collateralized time deposits shall be considered investments.

The following criteria will be used in evaluating financial institutions and form of collateral to determine eligibility for deposits:

- a. The financial institution must have been in existence for at least five years.
- b. Eligibility for deposits shall be limited to those financial institutions which maintain rating equivalent to F1 by Fitch or better. Credit requirements may be waived for a \$100,000 time deposit that is federally insured.
- c. The deposit shall not exceed the shareholders' equity of any depository bank. For the purposes of this constraint, shareholders' equity shall be deemed to include capital notes and debentures.

- d. The deposit shall not exceed the total of the net worth of any depository savings and loan association, except that deposits not exceeding a total of five hundred thousand dollars (\$500,000) may be made to a savings and loan association without regard to the net worth of that depository, if such deposits are insured or secured as required by law.
  - e. The total deposits shall not exceed the Shareholders' equity of any depository bank.
  - f. In order to secure such deposits, the financial institution shall maintain in the collateral pool, securities having a market value of at least 10 percent in excess of the total amount deposited.
  - g. Promissory notes secured by real estate mortgages or deeds of trust may not be accepted as collateral.
  - h. When other factors are equal, appropriate consideration will be given to a financial institution that either individually or as a member of a syndicate bids on or makes a substantial investment in Metropolitan's bonds; contributes service to Metropolitan or a member public agency; offers significant assistance to Metropolitan, so as to provide for distribution of total deposits among eligible financial institutions.
  - i. Purchased time deposits will be limited to a maximum maturity of one year.
8. Medium Term Notes

Restrictions are as follows:

- a. Investment in medium-term notes are limited to corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States.
- b. Notes eligible for investment under this subdivision shall be rated in a rating category of at least "A" or its equivalent or better by a nationally recognized rating service. Maturities greater than two years must be rated "AA" or better.
- c. Purchases of medium-term notes may not exceed 30 percent of the portfolio.
- d. Purchases of medium-term notes will be limited to a maximum maturity of five years .

9. Mortgage Obligations and Asset Backed Securities

Any mortgage pass-through security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable pass-through certificate, or consumer receivable-backed bond.

Restrictions are as follows:

- a. A maximum of five years maturity.
  - b. Securities eligible for investment 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 "AAA" by a nationally recognized rating service.
  - c. Purchase of securities authorized by this subdivision may not exceed 10 percent of the portfolio.
10. Local Agency Investment Fund Deposits

Deposits for the purpose of investment in the Local Agency Investment Fund of the State Treasury may be made up to the maximum amount permitted by State Treasury policy.

11. Metropolitan Water District Federal Credit Union Deposits

Deposits for the purpose of investment of funds held pursuant to Metropolitan's deferred compensation plans in the Metropolitan Water District Federal Credit Union shall be limited to the maximum amount insured by the National Credit Union Share Insurance Fund.

12. Securities Related to the State Water Project

Investments in State of California securities shall be limited to one registered bond or note, in the minimum denomination available, of any series of bonds or notes issued for purposes related to the State Water Project.

13. Shares of Beneficial Interest

The Treasurer may invest in shares of beneficial interest issued by eligible diversified management companies that (1) invest in authorized securities such as United States Treasury notes, bonds, bills; registered state warrants or treasury notes and bonds for the State of California, obligations of local agencies; commercial paper; negotiable certificates of deposit; repurchase agreements or reverse repurchase agreements and medium term notes or (2) are money market funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940. These companies must meet the following criteria:

Attain the highest ranking of the highest letter and numerical rating provided by not less than two nationally recognized statistical rating agencies.

Retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience investing in authorized securities and obligations listed above.

Assets under management shall be in excess of \$500 million.

The purchase price of the shares of beneficial interest purchased shall not include any commission, that the companies may charge and shall not exceed 20 percent of the agency's surplus money that may be invested. However, no more than 10 percent of the agency's surplus funds may be invested in shares of beneficial interest of any one mutual fund described above.

## **VI REPORTING**

In accordance with Administrative Code Section 5114, the Treasurer shall submit a monthly report to the Executive Secretary of the Board of Directors via the General Manager indicating the types of investment by fund and date of maturity, and shall provide the current market value of all securities, rates of interest, and expected yield to maturity. The Treasurer shall also submit a monthly summary report to the Board of Directors via the General Manager showing investment activity, including yield and earnings, and the status of cash by depository.

## **VII MONITORING SAFETY AND LIQUIDITY OF DISTRICT FUNDS**

The Treasurer shall monitor or cause to be monitored the extent to which financial institutions with which Metropolitan maintains deposits or investments are consistent with Metropolitan's policies regarding business activities within countries that may jeopardize the safety and liquidity of District funds or violate other Metropolitan policies. Such matters shall be reported to the Budget and Finance Committee as part of the Treasurer's monthly report.

## **VIII ADMINISTRATION**

The Treasurer may, at any time, further restrict the securities approved for investment as deemed appropriate.

**APPENDIX**Securities of Government-Sponsored Enterprises, Agencies and International Institutions

<u>Issuer</u>	<u>Explicit U.S. Gov't. Guarantee</u>	
Agency for Int'l. Dev.	(AID)	Yes
Farmer's Home Admin.	(FmHA)	Yes
Financ'l. Assist. Corp.	(FAC)	Yes
Gen'l. Svcs. Admin.	(GSA)	Yes
Gov't. Nat'l. Mtge. Assn.	(GNMA)	Yes
Private Export Funding	(PEFCO)	Yes
Small Busi. Admin.	(SBA)	Yes
Veteran's Admin.	(VA)	Yes
Washington Met. Area Transit		Yes
Fed'l. Farm Cr. Bank	(FFCB)	No
Fed'l. Home Loan Bank	(FHLB)	No
Fed'l. Home Loan Mtge. Corp.	(FHLMC)	No
Fed'l. Nat'l. Mtge. Assn.	(FNMA)	No
Financing Corp.	(FICO)	No
Resolution Funding Corp.	(Refcorp)	No
Student Loan Mktg. Assn.	(SLMA)	No
Tennessee Valley Authority	(TVA)	No
U.S. Postal Svc.		No
World Bank	(WB)(IBRD)	No

**COMPARISON OF CALIFORNIA GOVERNMENT CODE AND  
STATEMENT OF INVESTMENT POLICY AUTHORIZED INVESTMENTS**

<u>Cal. Govt. Code</u>	<u>Investment Category</u>	<u>Maximum Maturity</u>	<u>Government Code Authorized Percentage Limit</u>	<u>Quality S&amp;P/Moody's</u>	<u>Maximum Maturity</u>	<u>Metropolitan Authorized Percentage Limit</u>	<u>Quality S&amp;P/Moody's</u>
53601(b)	U. S. TREASURY	5 YEARS	100%		5 YEARS	100%	N/A
53601(d)	CALIFORNIA LOCAL AGENCY DEBT	5 YEARS	100%		5 YEARS	100%	N/A
53601(e)	FEDERAL AGENCIES	5 YEARS	100%		5 YEARS	50%	N/A
53601(f)	BANKERS ACCEPTANCES	270 DAYS	40%		270 DAYS	40%	"F1" (1)
53601(g)	COMMERCIAL PAPER	180 DAYS	30%(2)	"A1/P1"	180 DAYS	30%(2)	"A1/P1"
53601(h)	NEGOTIABLE CERTIFICATES OF DEPOSIT	5 YEARS	30%		1 YEAR	30%	"F1"
53601(h)	TIME DEPOSITS	5 YEARS	30%		1 YEAR	30%	"F1"
53601(i)	REPURCHASE AGREEMENTS	1 YEAR	100%		1 YEAR	50%	N/A
53601(i)	REVERSE REPURCHASE AGR	92 DAYS	20%		92 DAYS	10%	N/A
53601(j)	MEDIUM TERM NOTES	5 YEARS	30%	"A"	5 YEARS	30%	"A"/"Aa"(3)
53601(k)	SHARES OF BENEFICIAL INTEREST	5 YEARS	20%	"AAA"/"Aaa"	N/A	10%	"AAA"
53601(n)	MORTGAGE OBLIGATIONS AND ASSET BACKED SECURITIES	5 YEARS	20%	"AA"	5 YEARS	10%	"AAA"
	LOCAL AGENCY INVESTMENT FUNDS	N/A (4)	\$30 Million (4) (5)		N/A	N/A (4) (5)	

- (1) Fitch short term credit rating for banks.
- (2) 15% if the dollar weighted average maturity of commercial paper exceeds 31 days.
- (3) Securities that have maturities of 2 years or less must be rated "A" or better. Securities that have maturities greater than two years must be rated "AA" or better.
- (4) Investment in Local Agency investment funds are limited to \$30 million and there is no stated maturity for these investments.
- (5) Construction bond proceeds may be invested in Local Agency investment funds without regard to any dollar or percentage limitation.