

Investment Pools



**North Central Texas
Council of Governments**



What are Local Government Investment Pools? (LGIP)

- A Local Government Investment Pool is an investment product that combines the cash of participating local governments to purchase securities allowed under the state's laws. Participants share equity in the portfolio of securities and share proportional income and fees.
- May be government sponsored or privately sponsored.
- Are Not Guaranteed!
- Texas Government Code, Chapter 2256.016

Objectives

- Discussion of:
 - LGIP requirements in Texas
 - Types of LGIPs in Texas
 - LGIP Structures
 - LGIP Calculations and Ratings
 - LGIP Documentation

Public Funds Investment Act - 2256

§ 2256.016. AUTHORIZED INVESTMENTS: INVESTMENT POOLS.

- (a) An entity may invest its funds and funds under its control through an eligible investment pool if the governing body of the entity by rule, order, ordinance, or resolution, as appropriate, authorizes investment in the particular pool. An investment pool shall invest the funds it receives from entities in authorized investments permitted by this subchapter.

To Receive Funds, Pools Must Provide...

- (1) the types of investments in which money is allowed to be invested;
- (2) the maximum average dollar-weighted maturity allowed, based on the stated maturity date, of the pool;
- (3) the maximum stated maturity date any investment security within the portfolio has;
- (4) the objectives of the pool;
- (5) the size of the pool;
- (6) the names of the members of the advisory board of the pool and the dates their terms expire;
- (7) the custodian bank that will safekeep the pool's assets;
- (8) whether the intent of the pool is to maintain a net asset value of one dollar and the risk of market price fluctuation;
- (9) whether the only source of payment is the assets of the pool at market value or whether there is a secondary source of payment, such as insurance or guarantees, and a description of the secondary source of payment;
- (10) the name and address of the independent auditor of the pool;
- (11) the requirements to be satisfied for an entity to deposit funds in and withdraw funds from the pool and any deadlines or other operating policies required for the entity to invest funds in and withdraw funds from the pool; and
- (12) the performance history of the pool, including yield, average dollar-weighted maturities, and expense ratios.

Maintain Eligibility, Pools Must Provide...

- (1) investment transaction confirmations; and
- (2) a monthly report that contains, at a minimum, the following information:
 - (A) the types and percentage breakdown of securities in which the pool is invested;
 - (B) the current average dollar-weighted maturity, based on the stated maturity date, of the pool;
 - (C) the current percentage of the pool's portfolio in investments that have stated maturities of more than one year;
 - (D) the book value versus the market value of the pool's portfolio, using amortized cost valuation;
 - (E) the size of the pool;
 - (F) the number of participants in the pool;
 - (G) the custodian bank that is safekeeping the assets of the pool;
 - (H) a listing of daily transaction activity of the entity participating in the pool;
 - (I) the yield and expense ratio of the pool;
 - (J) the portfolio managers of the pool; and
 - (K) any changes or addenda to the offering circular.

Pool Investment Policy Certification (2256.005 (k))

- Pools are still required to provide an investment policy certification to the local government.
- Texas Legislature 85th Session 2017*
 - HB 1701 changes “person” to “business organization” and narrowly defines business organization as either an investment pool or an investment management firm under contract to manage the entity’s portfolio with discretionary authority. Very few investment management contracts for public funds grant such discretion, meaning investment pools will generally be the only organizations still required to sign this certification.

Pools – Government Portfolio Content

- Government Pools are Limited to securities/funds that are U.S. Governments, U.S. Agencies and related obligations
 - US Government
 - Treasury Bills/Notes/Bonds
 - US Agencies
 - FHLB, FNMA, FHLMC, FFCB, etc.
 - Repurchase Agreements
 - Collateralized with US Governments/Agencies
 - Government Money Market Mutual Funds
 - no load
 - SEC Regulated
 - containing only US Government /Agency positions
 - FDIC Insured Certificates of Deposit

Pools – Prime Portfolio Content

- Prime Pools may contain any instruments allowed by Texas Public Funds Investment Act, including Commercial Paper
 - Distinctions may include:
 - Domestic versus non-domestic commercial paper.
 - Commercial Paper with a maximum maturity of 365 days.
 - This maximum maturity extension also applies to commercial paper serving as repurchase agreement collateral.

Pools – Rating & Maturity

- Overnight Liquidity Pool (“Constant Dollar” or “Stable”):
 - “Seek to maintain \$1.00 Net Asset Value (NAV)”
 - Rating Agency Limits for Constant Dollar Pools:
 - 60-Day WAM to reset
 - 120-Day WAM to final
 - 13-month maximum limit for fixed rate security
 - 24-month maximum limit for variable rate security
 - PFIA Rule – must take action if NAV falls outside the band of \$0.995 and \$1.005
 - Rating of AAAM (Policies fall within SEC 2a7 Rule)

Pools – Rating & Maturity

- Floating Net Asset Value Pools:
 - Does not require a \$1.00 NAV statement
 - Rating Agency Limits for Floating Pools:
 - 90-Day WAM to reset
 - 120-Day WAM to final
 - 13-month maximum limit for fixed rate security
 - 24-month maximum limit for variable rate security
 - Rating of AA Af (Policies fall beyond SEC 2a7 Rule)

Pool Custody of Investments

- (d) An entity by contract may delegate to an investment pool the authority to hold legal title as custodian of investments purchased with its local funds.
- What are we saying.....
 - As a pool participant, you do not have a specific investment (CUSIP) assigned to your entity.
 - You get a “transaction” confirmation, but not a “trade ticket” confirmation.
 - You have a **pro-rata portion** of the total investments of the pool based on your percentage ownership of the total assets and liabilities of the pool.

Pool Yield Calculation

- (e) In this section, "yield" shall be calculated in accordance with regulations governing the registration of open-end management investment companies under the Investment Company Act of 1940, as promulgated from time to time by the federal Securities and Exchange Commission.

+ Investment Accretion/Amortization	\$ 1,000
+ Investment Interest Accrual	\$ 7,000
+/- Gains & Losses	\$ 100
- Expense Accrual (Inv. Mgr. Custodian, Audit, Legal)	<u>\$ (1,300)</u>
= Net Earnings	\$ 6,800
÷ Total Shares	÷ 1,000,000,000
= Dividend Factor	= 0.000006800
x Days in Year (366 for Leap Yr.)	x 365
= Daily Yield	0.2482%

Pool Yield Calculations

- **Daily Yield = (Allocation Factor x 365)** **0.2482%**
- **Seven Day Yield (Average of Prior Seven Days)**
 - Day 1 0.248%
 - Day 2 0.214%
 - Day 3 0.212%
 - Day 4 0.207%
 - Day 5 0.207%
 - Day 6 0.207%
 - Day 7 0.196%
 - 0.213%**
- **The 7 day SEC yield** is a measure of performance in the interest rates of money market funds offered by US mutual fund companies. The calculation is performed as follows:
 - Add the net interest income earned by the fund over the last 7 days and subtract the fund's expenses for that period. Divide that dollar amount by the average size of the fund's investments over the same 7 days. Multiply by 365/7 (366/7 if a leap year), to give the 7 day SEC yield.
 - This does not take compounding into effect.

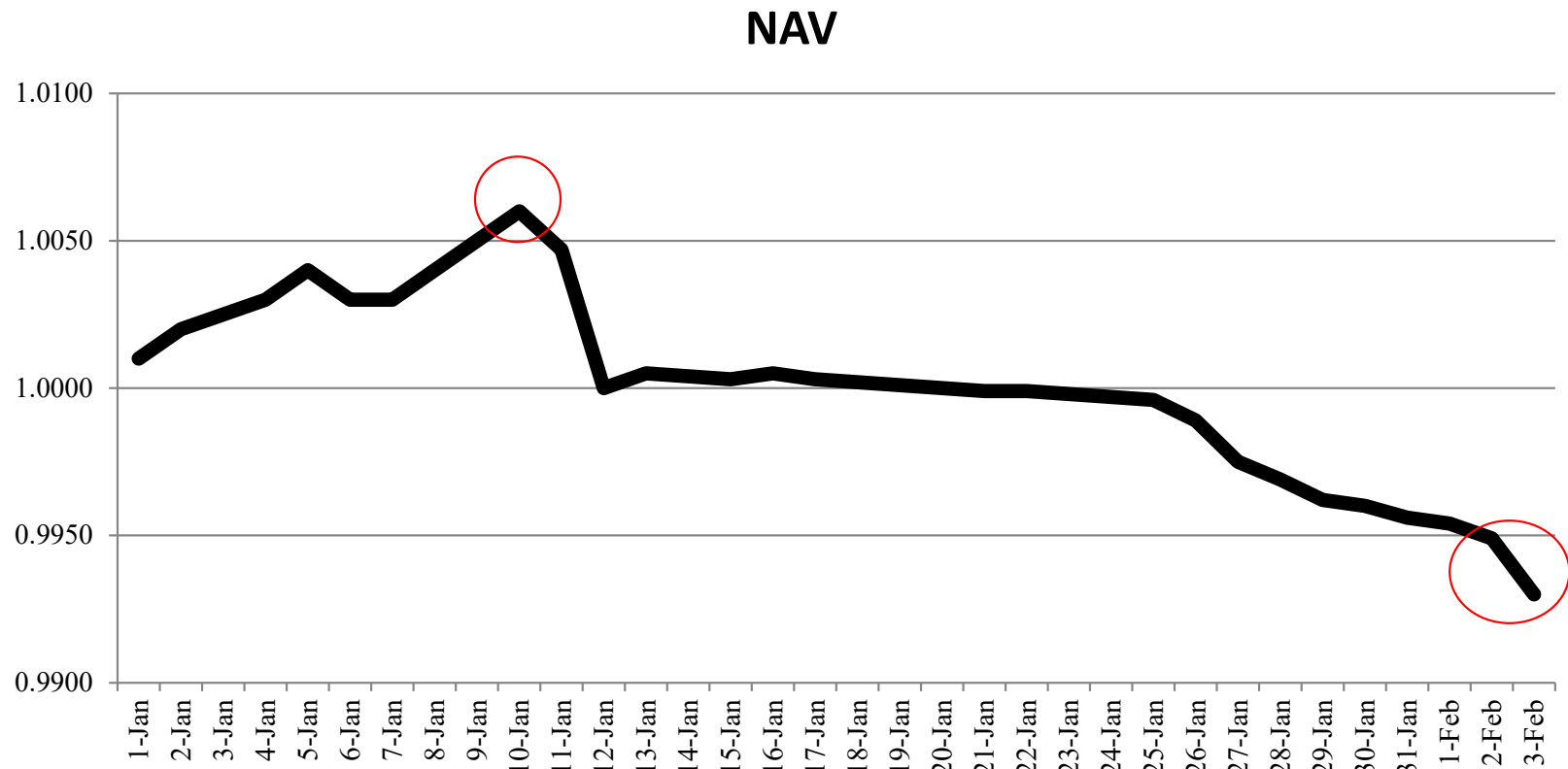
Pool Net Asset Value (NAV)

- (f) To be eligible to receive funds from and invest funds on behalf of an entity under this chapter, a public funds investment pool created to function as a money market mutual fund must mark its portfolio to market daily, and, to the extent reasonably possible, stabilize at a \$1 net asset value. If the ratio of the market value of the portfolio divided by the book value of the portfolio is less than 0.995 or greater than 1.005, portfolio holdings shall be sold as necessary to maintain the ratio between 0.995 and 1.005.

+	Market Value of Pool's Securities	\$ 1,000,000,000
+	Other Assets: Cash, Accrued Interest, etc.	\$ 100,000
-	Liabilities: Dividends Payable, Accrued Expenses, etc.	\$ <u>(200,000)</u>
		\$ 999,900,000
÷	Shares Outstanding (Book Value)	\$ 1,000,000,000
=	Net Asset Value Per Share	0.9999

Pool Net Asset Value (NAV)

- For a Constant Dollar Pool, the NAV must remain between 1.005 and 0.995.



Pool NAV Scenario

- The FED lowers rates by .25%
 - What happens?

- The Fed raises rates by .50%
 - What happens?

Ratings

- (h) To maintain eligibility to receive funds from and invest funds on behalf of an entity under this chapter, an investment pool must be continuously rated no lower than AAA or AAA-m or at an equivalent rating by at least one nationally recognized rating service.
 - **S&P** –
 - **AAAm – Money Market**
 - **AAAf – Bond Fund Rating (Non-dollar pools)**
 - With Volatility Ratings (S1+, S1, S2 etc...)
 - **Moody's – Aaa**
 - With Volatility Ratings (P1+, P1, P2 etc...)
 - **FITCH – AAA**
 - With Volatility Ratings (V1+, V1, V2 etc...)

Weighted Average Maturity (WAM)

<u>Security Description</u>	<u>Investment Amount</u>	<u>Maturity in</u>
Repurchase Agmt (Repo)	\$ 100,000,000	(1 day)
Discount Note	\$ 45,000,000	(79 days)
US Treasury Note	<u>\$ 5,000,000</u>	(237 days)
	\$ 150,000,000	

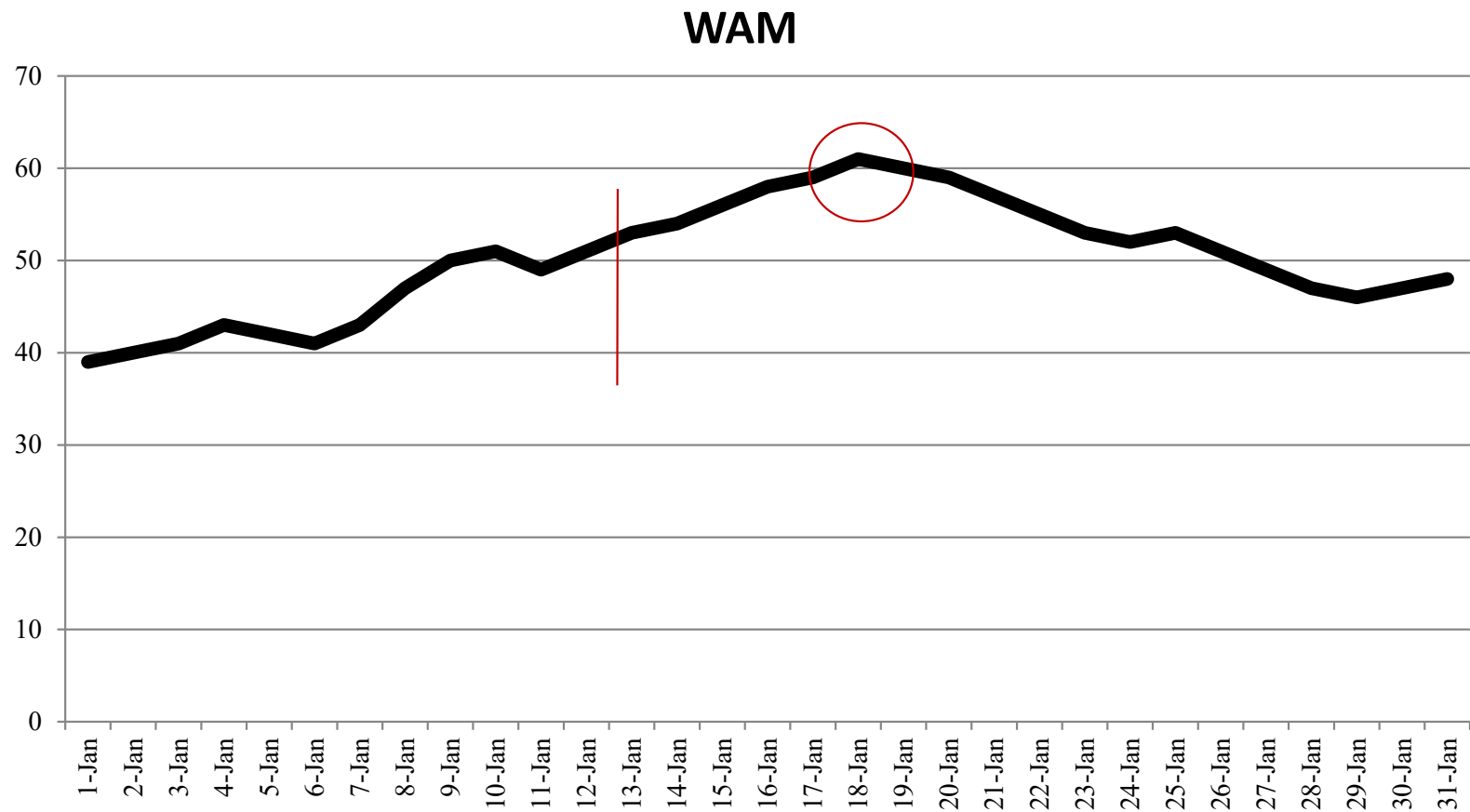
Using the Current Date and Maturity Date: Weighted Average Maturity (WAM) =

The overall sum of each security's par amount multiplied by its number of days to maturity, divided by the total of all investments.

$$\begin{aligned} & ((100,000,000 \times 1) + (45,000,000 \times 79) + (5,000,000 \times 237)) / 150,000,000 \\ & \quad = \mathbf{32 \text{ days}} \end{aligned}$$

- **WAM Calculations that are based on Floating Rate and Variable Rate securities use the reset date in the calculations.**

Weighted Average Maturity (WAM)



Pool WAM Scenario

- Participants deposit a large amount of the deposits in the pool.
 - What happens?
- Participants withdrawal a large amount of the deposits in the pool.
 - What happens?

Texas Pools

- Many Options Available:
 - Overnight Liquidity
 - Government Pools
 - Commercial Paper Pools
 - Longer-Term Pools
 - Targeted Maturity Pools

Typical Pool Documentation

- Information Statement
 - Contains all of the PFIA-required information and should be reviewed
 - Investment Policy/Strategy of the Pool(s)
 - Management Team – Board, Advisor, Administrator, Custodian, Legal, Auditor, Sponsor
 - Rating Agency and Rating Assigned
 - Disclosure of Risks
 - Disclosure of Fees & Expenses
 - Processes and Procedures
 - Enrollment Forms, Agreements and Instructions

Typical Pool Documentation

- Participant Documents
 - Pool Resolution
 - Participation Agreement
 - Application
 - Bank Information Forms
 - Vendor Forms

Rating Agency Pool Profile Report

- Go to Rating Agency Website to Research
- Example: Standard & Poors Ratings
 - <https://spglobal.com>
 - Search “Local Government Investment Pool”
 - Click “Profiles”
 - Click on Pool Name
- See Pool Profile Sample

S&P Global Ratings

Principal Stability Fund Ratings Definitions

AAA A fund rated 'AAA' demonstrates extremely strong capacity to maintain principal stability and to limit exposure to principal losses due to credit risk. 'AAA' is the highest principal stability fund rating assigned by S&P Global Ratings.

AA A fund rated 'AA' demonstrates very strong capacity to maintain principal stability and to limit exposure to principal losses due to credit risk. It differs from the highest-rated funds only to a small degree.

A A fund rated 'A' demonstrates strong capacity to maintain principal stability and to limit exposure to principal losses due to credit risk, but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than funds in higher-rated categories.

BBB A fund rated 'BBB' demonstrates adequate capacity to maintain principal stability and to limit exposure to principal losses due to credit risk. However, adverse economic conditions or changing circumstances are more likely to lead to a reduced capacity to maintain principal stability.

BB A fund rated 'BB' demonstrates speculative characteristics and uncertain capacity to maintain principal stability. It is vulnerable to principal losses due to credit risk. While such funds will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions.

B A fund rated 'B' has failed to maintain principal stability resulting in a realized or unrealized loss of principal.

Plus (+) or Minus (-)
The ratings may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the rating categories.

March 28, 2019

POOL PROFILE

TEXPOOL

About the Pool

Pool Rating	AAAm
Pool Type	Stable NAV Government Investment Pool
Investment Adviser	Federated Investment Management Co.
Portfolio Manager	Susan R. Hill, CFA (Since 2002)
Pool Rated Since	March 1995
Custodian	State Street Bank
Distributor	Federated Securities Corp.

Rationale
S&P Global rates TEXPOOL 'AAAm'. This is S&P Global's highest principal stability fund rating and is based on an analysis of the pool's investment portfolio and guidelines, market price exposure, and management. The rating signifies our forward-looking opinion about a fixed-income fund's ability to maintain principal value (i.e., stable net asset value, or 'NAV'). TEXPOOL has a very conservative investment policy, which is in line with Rule 2a-7 money-market practices. To ensure an accurate and current rating, S&P Global monitors pertinent pool information, including its portfolio holdings, on a weekly basis.

Overview
TEXPOOL is a local government investment pool. It offers a safe, efficient and liquid investment alternative to local governments in the state of Texas. The primary objectives of the pool are to preserve capital and protect principal, maintain sufficient liquidity, provide safety of funds and investments, diversify to avoid unreasonable or avoidable risks, and maximize the return on the pool. Cities, counties, school districts, institutions of higher education, special districts, and other public entities of Texas make up the investor base.

Management
TEXPOOL was originally rated in March 1995, but effective April 2002, the Texas comptroller contracted with Federated Investors, Inc. for the day-to-day operations of TEXPOOL. Federated Investors, Inc. performs the pool's investment management and custodial functions. It also provides the marketing function, working closely with participants. Federated Securities Corp. acts as the distributor for the portfolio. Oversight of TEXPOOL continues to be provided by the Texas comptroller of public accounts, as well as the TEXPOOL advisory board. In January 1995, the advisory board adopted and implemented long-term

Policy Changes
policy changes to provide for a stable net asset value (NAV) pool, which, in effect, operates like an SEC regulated Rule 2a-7 money-market fund. These changes were made to ensure a more conservative investment strategy and to provide a much higher level of investment safety for local government funds.

Portfolio Assets
The pool invests a majority of its assets in repurchase agreements contracted with highly-rated counterparties, with the remainder of the portfolio invested in fixed rate or floating rate U.S. agency securities. In order to meet the liquidity needs of the pool's shareholder base and to limit its exposure to significant market price fluctuations occurring during periods of volatile interest rate movements, the weighted average maturity to reset (WAM(R)) of the pool's assets is limited to 60 days or less.

Portfolio Composition as of March 28, 2019

Asset Class	Percentage
REPO	40.6%
GOV-AGCY	44.8%
TREAS	11.4%
MMF	3.4%

GOV-AGCY - Agency and Government, REPO - Repurchase Agreement, TREAS - Treasury, MMF - Money Market Fund

S&P Global Ratings Analyst: Peter Rizzo - (t) 212-438-5059 www.spratings.com

Participants should consider the investment objectives, risks and charges and expenses of the pool before investing. The investment guidelines which can be obtained from your broker-dealer, contain this and other information about the pool and should be read carefully before investing.

Pool Websites

- Will Contain All Documents
- Will Contain Contact Information
- Will Contain Current and Historical Rate Information
- Participant Board Members
- News Updates

HB 2706

- eligible collateral for repurchase agreements (Section 2256.011) is expanded from a combination of cash and obligations of the United States, its agencies or instrumentalities to include commercial paper and corporate bonds, if applicable. Any restrictions associated with the investment of public funds in either commercial paper or corporate bonds as authorized in Section 256.013 or Section 2256.0204, respectively, by the Act also apply to the use of these obligations as repurchase agreement collateral.
- extends the stated maximum maturity of commercial paper from 270 days or fewer to 365 days or fewer from the date of its issuance. This maximum maturity extension also applies to commercial paper serving as repurchase agreement collateral.

HB 2706

- Requires investment pools maintaining a \$1.00 net asset value to calculate and report yield to investors in the pool in accordance with federal regulations applicable to money market funds. An investment pool using amortized cost accounting, to the extent reasonably possible, must stabilize at a \$1.00 net asset value, when rounded and expressed to two decimal places. The governing body of an investment pool using amortized cost accounting must also take action to eliminate or reduce to the extent reasonably practicable any dilution or unfair result to existing pool participants, including a sale of portfolio holdings, to attempt to maintain the ratio of market value of the portfolio divided by the book value of the portfolio between 0.995 and 1.005.
- Repeals Section 2256.0204(g), which prohibited public funds investment pools from investing in corporate bonds.

Funds and Pool Comparisons

	No-Load Money Market Mutual Fund 2a-7	No-Load Mutual Fund	Constant Dollar Pool	Floating Net Asset Value Pool
Restricted to Public Funds Inv. Act Authorized Investment	N	Y	Y	Y
Rating Required	N	Y	Y	Y
Weighted Average Maturity (WAM) Limit	60 days	2 years	90 days	None
Stable Net Asset Value (NAV) at \$1	N	N	Y	N
Requires Advisory Board	N	N	Y	Y
Investment Amount Limits (maximum)	None	15% of operating funds, excluding bond reserve and debt service funds	None	None
Investment Bond Proceeds	Y	N	Y	Y
Weighted Average Maturity (WAM) calculation using stated or reset dates	Reset	Stated	Stated	Stated
Public Funds Investment Act Disclosure Requirements	Y	Y	Y	Y

Summary

- Confirm pool investment options.
- Stay within your risk comfort zone and tolerances.
- Consider appropriate risk/return.
- Transparency is golden.
- How many participants?
- What is fee and how does it compare?
- Diversify Liquidity Options.