

# Texas Public Funds Investment Act Compliance

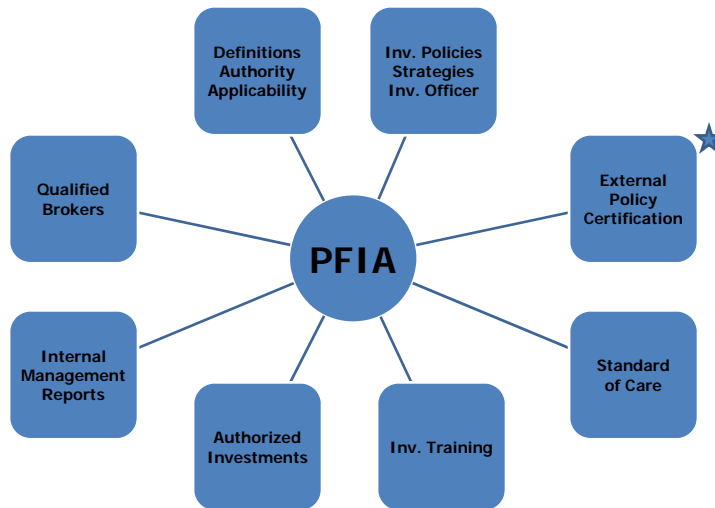


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## Objectives of this Session

- Understand the history of the PFIA
  - Originally approved in 1987
  - Amended every session of the legislature except 2013
  - Expanded authority until 1995
  - Expanded controls from 1995 to 1999
  - 1999 on, targeted points of change from specific interests
- Understand the requirements of the PFIA
- Determine whether or not your organization is in compliance with the PFIA
  - PFIA Compliance Checklist

## PFIA Components



## Chapter 2256, Government Code

- 001. Short Title – Public Funds Investment Act
- 002. Definitions
  - (1) Bond Proceeds
  - (2) Book Value
  - (3) Funds
  - (4) Institution of Higher Education
  - (5) Investing Entity
  - (6) Investment Pool
  - (7) Local Government
  - (8) Market Value
  - (9) Pooled Fund Group
  - (10) Qualified Representative
  - (11) School District
  - (12) Separately Invested Asset
  - (13) State Agency

## Chapter 2256, Government Code

- 003. Authority to Invest Funds
  - (1) Local Government
  - (2) State Agency
  - (3) Nonprofit Corporation acting on behalf of a local government
  - (4) Investment PoolInvestment Management Firm – 2 year maximum term with renewal options.

## Chapter 2256, Government Code

- 004. Applicability; Does Not Apply To:
  - (1) Public Retirement System Section 801.001
  - (2) State Funds Section 404.024
  - (3) Certain Institutions of Higher Ed. Total Endowments of at least \$150 Million in book value.
  - (4) Veterans' Land Board Chapters 161, 162, 164, Natural Res. Code
  - (5) County Registry Funds Chapter 117, Local Government Code
  - (6) Deferred Compensation Plan
  - (7) Donated Assets (ex.: gift of stock)
    - Terms of donation.

## Chapter 2256, Government Code

- 005. Investment Policies; Strategies; Investment Officer
  - (a) Adopt an investment policy
  - (b) The policies must:
    - (1) Be written
    - (2) Primarily emphasize safety of principal and liquidity
    - (3) Address investment diversification, yield, and maturity and the quality and capability of investment management

## Chapter 2256, Government Code

- 005. Investment Policies; Strategies; Investment Officer
  - (b) The policies must:
    - (4) Include:
      - (A) Authorized Investments
      - (B) Maximum allowable stated maturity
      - (C) Maximum dollar-weighted average stated maturity
      - (D) Methods to monitor market price
      - (E) Settlement of transactions by delivery vs. payment
      - (F) Procedures to monitor rating changes in investments

## Chapter 2256, Government Code

- 005. Investment Policies; Strategies; Investment Officer
  - (c) Certificate of deposit bid solicitation methods
    - (1) Orally, (2) in writing, (3) electronically or (4) in any combination
  - (d) Written investment strategy must address:
    - (1) Understanding of the suitability of the investment
    - (2) Preservation and safety of principal
    - (3) Liquidity
    - (4) Marketability if the need arises to liquidate
    - (5) Diversification of the portfolio
    - (6) Yield

## Chapter 2256, Government Code

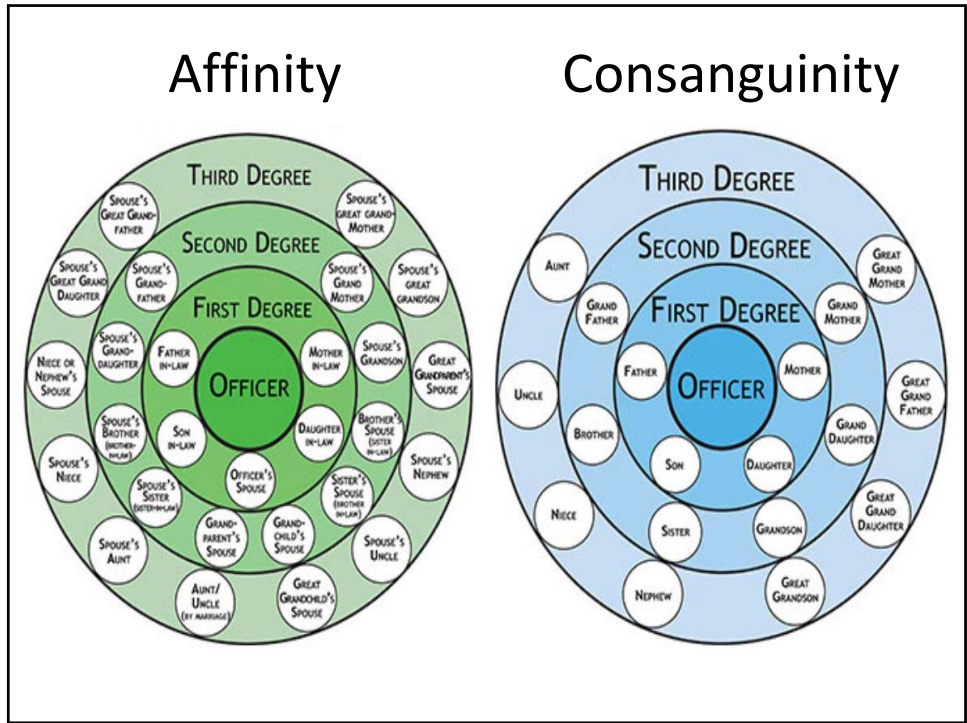
- 005. Investment Policies; Strategies; Investment Officer
  - (e) Governing body must annually review policy and strategies
  - (f) Governing body designates one or more investment officers but retains ultimate responsibility
  - (g) Previous section does not apply when investment officer is designated by state law
  - (h) An investment officer for a regional planning commission may not serve as an investment officer for another local government

## Chapter 2256, Government Code

- 005. Investment Policies; Strategies; Investment Officer
  - (i) Investment officer must file a statement of personal business relationship with a business organization and/or a statement of relationship by blood or by marriage within the second degree to a seller of investments with the governing body and the Texas Ethics Commission

## Personal Business Relationship

- Own 10% or more of the voting stock
- Own \$5,000 or more or more of the fair market value
- Receive funds in excess of 10% of gross income
- Acquire personal investments equal to \$2,500 or more



## Chapter 2256, Government Code

- 005. Investment Policies; Strategies; Investment Officer
  - (j) Governing body may specify in its policy that any investment authorized by this chapter is unsuitable.
  - (k) Present investment policy to a seller of investments.
    - Received and reviewed the policy.
    - Acknowledged the implementation of reasonable procedures and controls
    - ***An acknowledgement of receipt of the local investment policy is acceptable.***

## Chapter 2256, Government Code

- 005. Investment Policies; Strategies; Investment Officer
  - (m) Compliance audit of management controls on investments and adherence to approved investment policies performed in conjunction with annual financial audit
  - (n) State agency compliance audit performed at least once every two years
  - (o) Audit requirements do not apply to assets invested by the Comptroller

## Chapter 2256, Government Code

- 006. Standard of Care
  - (a) Investments shall be made with judgement and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived.



## Chapter 2256, Government Code

- 006. Standard of Care
  - (a) Investment of funds shall be governed by the following investment objectives, in order of priority:
    - (1) Preservation and safety of principal
    - (2) Liquidity
    - (3) Yield

## Chapter 2256, Government Code

- 006. Standard of Care
  - (b) In determining whether an investment officer has exercised prudence with respect to an investment decision, the determination shall be made taking into consideration:
    - (1) The investment of all funds, or funds under the entity's control, over which the officer had responsibility rather than a consideration as to the prudence of a single investment
    - (2) Whether the investment decision was consistent with the written investment policy of the entity

## Chapter 2256, Government Code

- 007. Investment Training; State Agency Board Members and Officers & Higher Education
  - (a) Initial training within 6 months
  - (b) Texas Higher Education Coordinating Board
  - (c) Investment controls, security risks, strategy risks, market risks, diversification of investment portfolio, and compliance
  - (d) Not less than once each state fiscal biennium from an independent source approved by the governing body (investment officer only)

## Chapter 2256, Government Code

- 008. Investment Training; Local Governments
  - (a) Treasurer, chief financial officer, and investment officer
    - (1) Initial training of 10 hours within 12 months from an independent source approved by the governing body or a designated investment committee
    - (2) 10 hours not less than once in a two-year period that begins on the first day of that local government's fiscal year and consists of the two consecutive fiscal years after that date (8 hours for schools and municipalities)
    - From an independent source approved by the governing body or a designated investment committee

## Chapter 2256, Government Code

- 008. Investment Training; Local Governments
  - (b) 4 hours of training for investment officers of some entities that begins on the first day of that local government’s fiscal year and consists of the two consecutive fiscal years after that date
  - (b-1) Housing Authorities to have 5 hours of training
  - (c) Investment controls, security risks, strategy risks, market risks, diversification of investment portfolio, and compliance
  - (d) Independent source annually reports names of entities trained to the Comptroller
  - (e) Does not apply to certain water districts
    - Chapters 36 or 49, Water Code

## Training Requirements

State Agency & Higher Education - **5** Hours  
Based on the State Fiscal Biennium

Municipality & School District (10 Hours Initial) - **8** Hours based on the Fiscal Year of the Entity

Housing Authorities – **5** Hours based on the Fiscal Year of the Entity

All Others – **10** Hours based on the Fiscal Year of the Entity

Water Entities - [Chp. 36 or 49]  
**6** Hours Initial  
**4** Hours Renewal  
Based on the Fiscal Year of the Entity

Municipality with no investments outside of Interest Bearing Accts and local CDs – Exempt at the discretion of the entity and the local auditor.

## Chapter 2256, Government Code

- 009. Authorized Investments: Obligations of, or Guaranteed by Governmental Entities
  - (1) Obligations, including letters of credit, of the United States or its agencies and instrumentalities
  - (2) Direct obligations of this state or its agencies and instrumentalities
  - (3) Collateralized mortgage obligations issued by a federal agency and guaranteed

## Chapter 2256, Government Code

- 009. Authorized Investments: Obligations of, or Guaranteed by Governmental Entities
  - (4) including obligations that are fully guaranteed or insured by the FDIC or by the explicit full faith and credit of the United States;
  - (5) Obligations of states, agencies, counties, cities, and other political subdivisions of any state rated not less than A or its equivalent
  - (6) Bonds issued, assumed, or guaranteed by the State of Israel
  - (7) interest bearing bank deposits insured by the FDIC or the National Credit Union Share Insurance Fund
  - (8) interest bearing bank deposits (brokered)

## Chapter 2256, Government Code

- 009. Authorized Investments: Obligations of, or Guaranteed by Governmental Entities
  
- The following are not authorized investments:
  - (1) Interest only mortgage-backed collateral securities
  - (2) Principal only mortgage-backed collateral securities
  - (3) Collateralized Mortgage Obligation with a stated maturity greater than 10 years
  - (4) Inverse floater (Indexed that adjust opposite to changes in a market index) Collateralized Mortgage Obligations

## Chapter 2256, Government Code

- 010. Authorized Investments: Certificates of Deposit and Share Certificates
  - (a) Main office or a branch office in this state and is:
    - (1) Guaranteed or insured by FDIC or NCUSIF or successors
    - (2) Collateralized by PFIA authorized investments (excluding the four listed in the prior slide), or
    - (3) Secured in any other manner provided by law
  - (b) CDARS program or a broker that has its main office or a branch office in this state and is selected from a list adopted by the investing entity as required by Section 2256.025

## Chapter 2256, Government Code

- 011. Authorized Investments: Repurchase Agreements
  - (a) A fully collateralized repurchase agreement with:
    - (1) Defined termination date
    - (2) Secured by obligations in Section 009(a)(1); and,
    - (3) Third-party safekeeping
    - (4) Primary dealer or financial institution doing business in this state

## Chapter 2256, Government Code

- 011. Authorized Investments: Repurchase Agreements
  - (b) Simultaneous agreement to buy, hold for a specified time, and sell back at a future date
  - (c) Reverse security repurchase agreement may not exceed 90 days
  - (d) Investments acquired must mature not later than the expiration in the reverse agreement

## Chapter 2256, Government Code

- 0115. Authorized Investments: Securities Lending Program
  - (a) Authorized
  - (b) To qualify:
    - (1) 100% collateralized, including accrued income
    - (2) Termination at any time
    - (3) Secured by:
      - (A) Securities described in Section 009
      - (B) Letters of credit
      - (C) Cash

## Chapter 2256, Government Code

- 0115. Authorized Investments: Securities Lending Program
  - (4) Collateral must be:
    - (A) Pledged
    - (B) Held in the entity's name
    - (C) Deposited with a third party
  - (5) Must be placed through:
    - (A) Primary dealer
    - (B) Financial institution doing business in this state
  - (6) Term of 1 year or less

## Chapter 2256, Government Code

- 012. Authorized Investments: Banker's Acceptances
  - (1) 270 days or fewer
  - (2) Liquidated in full at maturity
  - (3) Eligible Federal Reserve Bank collateral
  - (4) U.S. Bank rated not less than A-1 or P-1

## Chapter 2256, Government Code

- 013. Authorized Investments: Commercial Paper
  - (1) 270 days or fewer
  - (2) Rated not less than A-1 or P-1 by at least:
    - (A) Two credit rating agencies; or,
    - (B) One credit rating agency and an irrevocable bank letter of credit



## Chapter 2256, Government Code

- 014. Authorized Investments: Mutual Funds
  - (a) A no-load money market mutual fund
    - (1) Registered and regulated by the SEC
    - (2) Must provide a prospectus and other information required by federal law
    - (3) Investing entity may not own more than 10% of the fund's total assets
    - Must comply with SEC Rule 2a-7
    - prime money market funds are authorized investments.
      - Investors should bear in mind that these prime funds now come with a floating NAV as well as potential liquidity fees and redemption gates.

## Chapter 2256, Government Code

- 014. Authorized Investments: Mutual Funds
  - (b) A no-load mutual fund
    - (1) Registered with the SEC
    - (2) Must have a WAM of less than 2 years
    - (3) Limited to PFIA-authorized investments
    - (4) Must be rated not less than AAA or its equivalent by at least one rating agency
    - (5) Conforms to Section 016 (b) and (c)
    - Ultra-short Bond Funds that have a duration of less than one year and whose investments are limited to investment grade securities, excluding asset-backed securities.

## Chapter 2256, Government Code

- 014. Authorized Investments: Mutual Funds
  - (c) Not authorized
    - (1) An entity may not invest more than 15% of its monthly average fund balance, excluding bond proceeds, reserves, and debt service funds
    - (2) Ineligible for investment of bond proceeds, reserves, and debt service funds
    - (3) Investing entity may not own more than 10% of the fund's total assets

## Funds & Pools

	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	None	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	N	Y	Y	Y

## Chapter 2256, Government Code

- 015. Authorized Investments: Guaranteed Investment Contracts
  - (a) Authorized investment for bond proceeds
    - (1) Defined termination date
    - (2) Secured by Section 009(a)(1)
    - (3) Third party safekeeping
  - (b) Term may not exceed 5 years from date of bond issuance, excluding reserves and debt service funds

## Chapter 2256, Government Code

- 015. Authorized Investments: Guaranteed Investment Contracts
  - (c) To be eligible:
    - (1) Must specifically authorize when authorizing bonds
    - (2) Three bids
    - (3) Highest yield
    - (4) Drawdown schedule
    - (5) Reasonable administrative costs

## Chapter 2256, Government Code

- 016. Authorized Investments: Investment Pools
  - (a) Governing body must authorize investment in particular pool; can only invest in obligations approved in the Act.
  - (b) must furnish offering circular:
    - (1) Types of investments
    - (2) Maximum average dollar-weighted maturity
    - (3) Maximum stated maturity date

## Chapter 2256, Government Code

- 016. Authorized Investments: Investment Pools
  - (b) Must furnish offering circular:
    - (4) Objectives
    - (5) Size
    - (6) Advisory board
    - (7) Custodian
    - (8) \$1 objective or not
    - (9) Secondary source of payment, insurance or guarantee
    - (10) Independent auditor
    - (11) Requirements to deposit and withdraw funds
    - (12) Performance history and expense ratios

## Chapter 2256, Government Code

- 016. Authorized Investments: Investment Pools
  - (c) To maintain eligibility:
    - (1) Transaction confirmations
    - (2) Monthly report
      - (A) Types and breakdown of securities
      - (B) Average dollar-weighted maturity
      - (C) Investments of more than 1 year
      - (D) Book value vs. market value
      - (E) Size

## Chapter 2256, Government Code

- 016. Authorized Investments: Investment Pools
  - (c) To maintain eligibility
    - (2) Monthly report
      - (F) Number of participants
      - (G) Custodian bank
      - (H) Daily transaction activity
      - (I) Yield and expense ratio including a statement on how yield is calculated.
      - (J) Portfolio managers
      - (K) Changes to the offering circular

## Chapter 2256, Government Code

- 016. Authorized Investments: Investment Pools
  - (d) Delegate to pool authority to hold legal title as custodian of investments
  - (e) “Yield” in accordance with SEC regulations
  - (f) Pool created to function as a MMMF must mark its portfolio to market daily and stabilize at \$1 net asset value; (0.995 to 1.005) half-penny rule

## Chapter 2256, Government Code

- 016. Authorized Investments: Investment Pools
  - (g) Advisory board composed of:
    - (1) Equal number of participants and other qualified persons who do not have a business relationship with the pool (TexPool); or,
    - (2) Participants and at least one other qualified person who does not have a business relationship with the pool
  - (h) Rated not less than AAA, AAAm, or equivalent by at least one rating agency
  - (i) Specific information must be posted on their website (offering circular, newsletters and yield calculation).

## Chapter 2256, Government Code

- 017. Existing Investments
  - Not required to liquidate investments that were authorized when purchased
- 019. Rating of Certain Investment Pools
  - A public funds 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.

## Chapter 2256, Government Code

- 020. Authorized Investments: Institutions of Higher Education
  - (1) Cash management and fixed income funds
  - (2) Negotiable certificates of deposit
  - (3) Corporate bonds rated in two highest long-term rating categories

## Chapter 2256, Government Code

- 0201. Authorized Investments: Municipal Utility
  - (a) Municipal electric and/or natural gas utility may hedge
  - (b) Payment is fuel expense, and receipts credit against fuel expenses
  - (c) Governing body sets policy
  - (d) “Hedging” means the buying and selling of fuel oil, natural gas, coal, nuclear power, and electric energy futures or options or similar contracts on those commodities and related transportation costs as a protection against loss due to price fluctuation.

## Chapter 2256, Government Code

- 0202. Authorized Investments: Mineral Rights
  - (a) Municipality may invest funds from oil, gas, or mineral development in any investment authorized by Subtitle B, Title 9, Property Code (“Trusts”).
  - (b) Must segregate and account for separately.



## Chapter 2256, Government Code

- 0203. Ports and Navigation Districts
  - (b) Port or navigation district may purchase, sell, and invest its funds and funds under its control in negotiable certificates of deposit issued by a bank
    - that has a certificate of deposit rating of at least 1 or the equivalent by a nationally recognized credit rating agency or that is associated with a holding company having a commercial paper rating of at least A-1, P-1, or the equivalent by a nationally recognized credit rating agency.

## Chapter 2256, Government Code

- 0204. Independent School Districts
  - ADA of 50,000 - 1371(4)(L) or issuer of \$100 million in outstanding debt 1201.002 may invest in corporate bonds.
    - Senior secured debt obligation with a minimum rating of at least AA- or the equivalent.
    - Stated final maturity less than or equal to 3 years from the purchase date.
    - Limited to invest up to 15% of its monthly average fund balance, excluding bond proceeds, reserves and debt service funds.
    - Restricts investment of less than or equal to 25% of the corporate bond portion of the investment portfolio in any one issuer.
    - Requires timely liquidation if issuer is placed on negative credit watch or loses the minimum credit rating.
  - (g) Investment pools are not allowed to invest in corporate bonds.

## Chapter 2256, Government Code

- 0205. Authorized Investments:  
Decommissioning Trust
  - (a) Definitions of “decommissioning trust” and “funds”
  - (b) May invest funds held in a decommissioning trust in any investment authorized by Subtitle B, Title 9, Property Code (“Trusts”)
- 0206. Hedging Agreements
  - Requires at least \$250 million in outstanding debt.

## Chapter 2256, Government Code

- 021. Effect of Loss of Required Rating
  - Investment does not qualify when it does not have the minimum rating; take prudent measures to liquidate
- 022. Expansion of Investment Authority
  - Expansion requires a risk assessment by the State Auditor, subject to approval of the legislative audit committee

## Chapter 2256, Government Code

- 023. Internal Management Reports
  - (a) Quarterly written report
  - (b) Report includes:
    - (1) Investment position on the date of the report
    - (2) Prepared jointly by all investment officers
    - (3) Signed by all investment officers of the entity
    - (4) Summary statement:
      - (A) Beginning market value for the reporting period
      - (B) Ending market value for the period
      - (C) Fully accrued interest for the period

## Chapter 2256, Government Code

- 023. Internal Management Reports
  - (b) Report includes:
    - (5) Book value and market value of each separately invested asset by the type of asset and fund type
    - (6) Maturity date
    - (7) Account or fund
    - (8) Statement of compliance with investment strategy and the Act
  - (c) Not less than quarterly within a reasonable time after the period
  - (d) Formally reviewed at least annually by independent auditor

## Chapter 2256, Government Code

- 024. Subchapter Cumulative
- 025. Selection of Authorized Brokers
  - Governing body or designated investment committee must, at least annually, review, revise, and adopt a list of qualified brokers
- 026. Statutory Compliance
  - Comply with all federal, state, and local statutes, rules or regulations

## Chapter 2256, Government Code

- 051. Electronic Funds Transfer
- 052. Private Auditor
- 053. Payment for Securities Purchased by the State
  - Security purchase may not be made at a price exceeding the existing market value
- 054. Delivery of Securities Purchased by the State
- 055. Deposit of Securities Purchased by the State