MFABC
Municipal Finance Authority of BC

DEVELOPING A COMPREHENSIVE INVESTMENT POLICY

The foundation of any successful investment program is a comprehensive policy that reflects the organization's investment philosophy and tolerance for risk. All organizations have cash flow needs that must be carefully managed to ensure that there is sufficient cash to meet obligations and that idle cash is efficiently invested. A well-crafted investment policy is essential to guide cash managers as they make daily decisions about the allocation of public funds among allowable investment instruments.

For many organizations, developing policies and procedures is a time-consuming process that may be low on the list of priorities due to other commitments. However it is prudent that every Board or Council adopt a statement of the organization's investment policies and goals prior to investing in the prescribed securities. The investment policy should be much more than a simple list of authorized investment instruments. It should define the parameters of the investment program and indemnify investment officers from personal liability so long as they adhere to the tenets of their respective policies.

The Board or Council must consider investment risk tolerance, preservation of capital, and risk aversion through portfolio diversification when developing their policy.

The key sections that should be included within the policy are:

Element	Comments
Policy Statement	This identifies the key purpose(s) of the policy. Keep in mind the difference between a policy and a procedure. A policy sets out what you can do. A procedure spells out how you are going to do it. Some policies get bogged down in too much detail and become quickly out dated. Adopt investment policy as a resolution of Council. By adopting the policy through ordinance or a resolution, the policy becomes an official document.
Scope	Clearly describe which funds are covered by the policy and which funds are covered by a separate policy. The policy should be clear on which funds are covered by the policy since some funds may have different investment objectives or different investment horizons and would be better managed under a separate policy. This identifies and defines the financial assets that are included in the investment policy: · General funds · Operating funds · Special revenue funds · Reserve funds · Capital project funds · Trust and agency funds
Objectives	Include a clear and concise statement of objectives. Simply stating investment objectives as safety, liquidity, and yield will not help governments protect their funds. Statements describing how these objectives will be achieved offer better guidance. The objective should include explicit statements of objectives. This provides a prioritized list of objectives and a description including but not limited to the following: · Legality · Safety/preservation of capital · Maintenance of liquidity · Competitive Rate of Return (Yield)
Authority	This includes identification of Community Charter Section 183. In addition, this may include the internal municipal signing authorities.

Element	Comments
Standards of Care	This may include such items: · Prudence · Ethics and Conflict of Interest · Delegation of Authority · Competitive Selection - Require a formal process for selecting financial institutions and broker/dealers and describe this process in the policy. The point of this section is to specify what process governments will use to screen firms selling securities. This section should require a due diligence review of prospective firms, specify minimum credit criteria for financial institutions, and limit transactions to only those firms on the approved list. The list should be included as an appendix item. Require competitive quotes from at least three financial institutions and/or broker/dealers. Many municipalities obtain competitive quotes for their investment transactions but do not specifically require them in the investment policy. By not requiring competitive quotes, this practice could be lost over time. Adding this requirement to the investment policy ensures that the competitive quotation process is always used and the most efficient trade execution for investment transactions.
Safekeeping and Custody	This may include policy statements pertaining to how securities will be held.
Internal Controls	This may include statements pertaining to the frequency of independent review and maintenance of operating procedures for effective control and management of investment activities. Examples include formal signing officers to approve transactions and should address separation of duties such that no one person can independently execute an agreement for purchase/sale and cause it to be settled for the exchange of cash or securities.
Suitable and Authorized Investments	This typically includes statements as to which investment types the municipality will consider investing. While the Community Charter places restrictions on the type of the instruments, municipalities may place additional restrictions on the type of investment permitted. This requires knowledge of investment legislation and regulations and a determination if all of the allowable investment instruments are appropriate for your investment program. Caution should be exercised in copying other municipal investment policies, without fully understanding whether the instruments included in the policy are appropriate.

Element	Comments
Investment Parameters	It is recommended that the policy include clear, explicit language describing allowable investment instruments and the respective parameters. This leaves little room for interpretation and helps protect municipalities from imprudent investment decisions. This typically specifies the quality of investments, the quantity or range in percentage terms for various portfolio holdings by type of investment instrument and the maximum term of investments. There may be specific policy statements addressing such issues as: • Diversification/Portfolio Share - Avoid arbitrary percentages when discussing diversification requirements; instead, use guidelines such as “no more than 5 percent of the portfolio can be invested in the securities of a single issuer” or “no more than 20 percent of the portfolio may be invested beyond one year.” Many investment policies include specific diversification guidelines such as, “The portfolio must be invested in 50 percent Treasuries, 30 percent certificates of deposit, and 10 percent MFA Investment Pool.” Arbitrary percentages can restrict the ability of governments to implement effective investment strategies. The purpose of diversification is to reduce risk in the portfolio. This can be accomplished by investing in a variety of maturities and avoiding over-concentration in specific sectors • Maximum Maturity • Percentage weightings for class and type of investments • Minimum credit rating standards different from those in the regulations
Reporting	The policy should identify the frequency and type of reporting that will be provided.
Performance Standards	This establishes benchmarks upon which performance will be measured and may identify the frequency upon which performance will be evaluated and reported. Pick relevant benchmarks to gauge investment performance. Many investment policies specify the 90-day Treasury bill as the benchmark in one section and then state that the portfolio must maintain a one-year weighted average maturity in another section. The benchmark should mirror the weighted average maturity of the portfolio in order to provide a meaningful performance comparison. A list of benchmarks with varying weighted average maturities can be included in the policy to cover times when the portfolio's weighted average maturity changes. Watch out for benchmarking against MFA pooled funds as these are marked to market and contain investments not eligible for purchase by municipality.
Definitions	An investment policy may need to have a supporting glossary of key terms.