



School District Auditing: Investments

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June 8th & 9th, 2010



Prudent Man Rule

"Those with responsibility to invest money for others should act with prudence, discretion, intelligence, and regard for the safety of capital as well as income." – Rule originates from the 1830 ruling of the US judge Samuel Putnum.



Topics Covered

- Allowable Investments for Illinois School Districts
 - Descriptions
 - Limitations
 - Risk Categories

- Collateral
 - Types
 - Monitoring
 - Reporting



Investment Guideline

- What is allowable?
 - State Statute
 - District's Investment Policy
 - State law requires every district to have an investment policy
 - Can reference State Statute or be more conservative
 - District's Internal Policies & Procedures



30 ILCS 235:(Public Funds Investment Act) Illinois Statutes – Authorized Investments

- U.S. Treasury
- U.S. Agency
- U.S. Instrumentality (some)
- Certificates of Deposit
- Demand/Checking Accounts
- Commercial Paper/BAs
- Municipal Bonds
- Money Market Funds
- Repurchase Agreement
- Public Treasurers' Investment Pool
 - ISDLAF+ Multi-Class Series



Investment Descriptions

- **US Government Obligations**
 - Full faith and credit of the US Government
 - Treasury Bonds – Maturities greater than 10 years
 - Treasury Notes – Maturities 1-10 Years
 - Treasury Bills – Maturities less than 1 Year
- **Obligations of US Agencies & Instrumentalities**
 - Implied full faith and credit of the US Government
 - Debt obligations not equity
 - FNMA
 - Freddie Mac
 - FHLB



Investment Descriptions

- **Certificates of Deposit**
 - FDIC Insurance
 - \$250K (through 12/31/2013)
 - Will revert back to \$100K unless extended
 - Collateral
 - Third Party Insurance
 - Letter of Credit



Investment Descriptions

- **Commercial Paper (CP)**
 - Short-term unsecured promissory note issued by corporations
 - Maximum of 270 days
 - Assets greater than \$500MM
 - Tiered credit ratings: 3 highest classifications permitted
- **Bankers Acceptance (BA)**
 - Letter of Credit issued by a bank
- **Municipal Debt (Muni)**
 - Debt obligation of State or local govt.
 - Varying degrees of risk



Investment Descriptions

- **Liquid Balance Accounts**

- Liquid balance accounts

- Demand Deposit Accounts (DDA)
- Savings Deposit Accounts (SDA)
- Negotiable Order of Withdrawal (NOW)

- Transitional Account Guarantee (TAG) Program

- Non-interest bearing accounts (FDIC guaranteed through 06/30/10)
- “NOW” account earning 0.5% or less (FDIC Guaranteed through 06/30/10)
- Effective 7/1/10: “NOW” account earning 0.25% or less (FDIC Guaranteed through 12/31/10)
- Banks must opt in to participate in TAG program



Investment Descriptions

- **Money Market Funds (30 ILCS 235, Section 2a)**
 - Investments can be made in money market mutual funds registered under the Investment Company Act of 1940, provided that the portfolio of any such money market fund is limited to obligations described in paragraph (1) or (2) of this subsection and to agreements to repurchase such obligations.



Investment Descriptions

- **Public Treasurer's Investment Pool (30 ILCS 235, 2e)**
 - Created under Section 17 of the State Treasurer's Act
 - Illinois School District Liquid Asset Fund+
 - Illinois Funds (IPTIP)



Investment Descriptions

- **ISDLAF+**
 - Common law trust organized and existing under Illinois State Statute
 - Governed by a Board of Trustees elected from fund participants
 - AAA money market fund by S&P
 - Rating reaffirmed on a weekly basis
 - Maintains a \$1.00 per share Net Asset Value

FDIC Advisory Opinion (FDIC-93-10)

“Circumstances Under Which the FDIC as Receiver Will Not Seek to Avoid Security Interest or Collateral Pledge Under 12 U.S.C. 1823(e).”



Collateral

- **Public Funds Investment Act (30 ILCS 235, 6d)**
 - Whenever a public agency deposits any public funds in a financial institution, the public agency may enter into an agreement with the financial institution requiring any funds not insured by the FDIC or other approved share insurer to be collateralized by certain classes of securities such as: direct and general obligation bonds of the United States and/or any agency or instrumentality of the United States, securities, mortgages, letters of credit issued by a FHLB that are in an amount equal to at least market value of the amount of funds deposited exceeding the FDIC insurance.



The Collateral Agreement must be:

- In Writing
- Signed by the Proper Parties
- Approved by Bank’s Board of Directors

Security Agreement

- Depositor and Bank
 - Grants Pledgee a “Perfected Security Interest”
 - Describes: Types of acceptable collateral
- Amount of collateral (e.g. 100% of deposits)
- Should reference the Pledge Agreement



Pledge Agreement

Bank and Custodian

- Custodian agrees to hold pledged securities in a segregated account
- Custodian agrees to provide Pledgee with monthly collateral statements
- Control
 - Depositor (Pledgee) must approve all withdraws and substitutions of collateral
 - Pledgee can waive this right, but the agreement must state that in the event that the Pledgee notifies the Custodian that the Bank has defaulted on its obligations, the Custodian must follow only instructions of the Pledgee



Why is a Third Party Necessary?

- Oakwood Deposit Bank
 - Failed in 2004
 - Bank had pledged securities as collateral
 - The CEO was accused of posting the same assets for multiple accounts
 - Schools, villages and hospitals all lost money in the failure

Common Collateral Mistakes

- Board minutes not received
- Executed agreements not held by client
- Monthly collateral statement not received
- Collateral statement not reconciled to deposits
- Pledged collateral is not allowed per investment policy
- No third party custodian



Jumbo CDs

- Insured Certificate of Deposit: Amount above FDIC insurance secured by an insurance wrap placed with 3rd party surety company
 - Rating of Insurance Agency
- Letter Of Credit: binding document that guarantees the payment of an obligation.
 - Payable on demand
 - Usually written by an FHLB (Governmental Agency)

Deposit and Investment Risk

- Credit Risk
 - Discloser needed for external investment pools, money market funds, bond mutual funds, and pooled investments of fixed income securities.

Deposit and Investment Risk

- Custodial Credit Risk
 - Any deposits not covered by depository insurance and the deposits are uncollateralized should be disclosed
- Interest Rate Risk
 - If needed, discloser should be made regarding investment type and amount.



Documentation for Deposits & Investments

- Investment Holdings Report
 - Classification of Investments
 - How investments are secured
 - Accrued Interest
 - Original Cost, Par, Market Value
- Collateral Statement
 - 3rd Party Custodian
 - Market Value



Questions?



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