pfm

September 12, 2019

Memorandum

To: Sandie Arnott, Treasurer/Tax Collector

From: Nancy Jones
Lauren Brant, Managing Director
Richard Babbe, Senior Managing Consultant

RE: 2019 Investment Policy Review

We reviewed the County of San Mateo's (the "County") Investment Policy (the "Policy"). As written, the Policy is comprehensive and in compliance with the California Government Code (the "Code") sections that govern the investment of public funds. From our review, however, we identified various sections where Policy language should be updated to reflect recent Code revisions. In addition, there were several sections that should be updated to reflect the County's use of a professional investment advisor.

We have attached a marked-up version of the Policy that reflects our recommendations. Our recommendations are also summarized by Policy section below.

VII. Authorized Investments
SB-974, effective January 1, 2017, clarified the Code's rating requirements such that the required rating is for the entire "rating category" and not just for a specific rating (e.g., the requirement for an "A" rating would encompass securities rated "A+," "A," and "A-" and not just "A" rated securities). With this Code change, the reference to rating modifiers in this paragraph is no longer needed. As a result, we recommend deleting the reference to modifies in this section an update how credit requirements are specified in the Policy into all sections that mention rating requirements.

VII.C. Commercial Paper
We recommend the County revise how long-term ratings are referenced in this section to match Code requirements.

VII.D. Negotiable Certificates of Deposit
Negotiable certificates of deposit (NCDs) can be issued with either short-term or long-term credit ratings depending on the security's term at time of issuance. Accordingly, we recommend that the County incorporate both short- and long-term ratings as part of the Policy's credit requirements to avoid any compliance questions. The Code does not require a credit rating for the purchase of NCDs.

VII.E. Bankers Acceptances
As these are short-term securities, we recommend deleting the reference to long-term credit ratings in this section. The Code does not require a credit rating for the purchase of bankers' acceptances.

VII.G. Mortgage-Backed Securities and Asset-Backed Securities

AB 1770, effective January 1, 2019, clarified the Code's rating requirements for the purchase of mortgage-backed (MBS) and asset-backed securities (ABS). The primary change was that the Bill removed the requirement that, in addition to a security specific rating, the issuer also have a rating. Since MBS and ABS are typically issued by trusts that are created to hold the underlying collateral or loans, the trusts as the "issuers" do not typically have stand-alone ratings (only the security is rated). We recommend the County update the Policy to reflect the 2019 Code change. There is no change to the Policy's existing security rating requirements.

VII.H. Corporate Securities

To provide the County with additional investment flexibility and enhance portfolio risk management, we recommend revising the Policy's current requirement that 75% of the portfolio's 30% the portfolio's corporate allocation (22.5% of the overall funds) be invested in "AA" or better rated securities. As an alternative, we recommend allowing "A" rated corporate securities to comprise 27% of the overall portfolio (90% of the 30% corporate allocation). Any additional corporate securities would need to be rated "AA" or better. Since the universe of "AA" and "AAA" rated issuers is far smaller than it was a decade ago (note: approximately 21% of the eligible corporate universe is rated AA/AAA while 79% is rated "A"), increasing the allowable percentage of "A" rated securities would significantly enhance the County's ability to access the corporate sector. This would enable the County to increase the number of corporate issuers in the portfolio thereby significantly reducing the percentage invested in any one particular corporate issuer,

VII.M. Mutual Funds and VII.N. Local Government Investment Pools (LGIPs)

We recommend increasing the maximum portion of the portfolio that can be invested in Money Market Mutual Funds and LGIPs to 20%. This is consistent with the Code's limit for mutual funds, although there is no Code limit on LGIPs. Given the large size of seasonal inflows and outflows to/from the County's portfolio, larger limits will provide greater flexibility to manage short-term cash during periods of large balances. We also recommend establishing a 10% limit per fund for any money market fund or LGIP to provide diversification.

X. Diversification and Maturity Restrictions

We recommend the County update this table to incorporate the other recommendations.

XVII.F. External Investment Advisor/Compliance Review

As the County now has additional tools to provide regularly monitored portfolio compliance, the current requirement that requires the use of an outside advisor no longer makes sense. As a result, we recommend the County revise the Policy to provide greater flexibility to determine how compliance is monitored.

XVII.I. Approved Brokers

We recommend the County add a provision to this section to acknowledge that PFM will be using its own list of approved issuers, brokers/dealers and financial institutions to conduct transactions on the County's behalf. PFM employs a rigorous process to select firms for our approved list. This change will also allow the County to benefit from PFM extensive purchasing power.

Please let us know if you have any questions or if you would like to discuss our recommendations in more detail.