ITEM 9

GFOA Best Practice

Creating an Investment Policy

Background. A written investment policy is the single most important element in a public funds investment program. An investment policy should describe the most prudent primary objectives for a sound policy: safety, liquidity, and yield. It should also indicate the type of instruments eligible for purchase by a government entity, the investment process, and the management of a portfolio. Such a policy improves the quality of decisions and demonstrates a commitment to the fiduciary care of public funds, with emphasis on balancing safety of principal and liquidity with yield. Adherence to an investment policy signals to rating agencies, the capital markets and the public that a government entity is well managed and is earning interest income suitable to its situation and economic environment.

Recommendation. GFOA recommends that all governing bodies adopt a comprehensive written investment policy and review and update its policies, if necessary on an annual basis.

The process of creating an investment policy should include:

- **Examination of state public funds investment statutes.** Most states have some form of public funds investment statutes. A state's public funds statute defines the parameters of what a government entity may do and serves as a guideline to begin drafting an investment policy. A government entity's policy may be more restrictive than a statute (e.g., limiting the amount (usually a percentage) or prohibiting the purchase of commercial paper, even though state law allows it) but it may not be more expansive.
- **Examination of state public funds collateral statutes.** State collateral laws correlate with public funds investment statutes and define how the government entity's public funds must be protected against depository failure. Government entities should adopt a public funds collateral policy just as they do an investment policy or incorporate such language within its investment policy. Many times a collateral law or policy will reference state investment statutes in establishing what instruments or techniques are eligible for use as collateral.
- **Review of sample investment policies.** Rather than starting an investment policy from scratch, government entities should consider reviewing existing investment policies. The GFOA's sample investment policy provides a format and content that can be modified for an entity's needs. Policies from other jurisdictions or state associations can be similarly useful.
- **Drafting of an investment policy.** The most prudent primary objectives for drafting a sound investment policy should be: safety, liquidity, and yield, in that order. The investment policy should address certain key questions, including:
  - Who are the authorized investment officers?
  - What standard of care will be established?

   - What instruments will be eligible for investment?
   - How will diversification be ensured?
   - How will safekeeping be handled?
   - What is the maximum term for any given investment?
   - What type of internal controls should be in place?
   - Who will comprise the investment committee (internal/external members), if any?
   - What type of investment reports/performance reports will be produced?
   - What types of benchmarks will be used?
   - Will an investment advisor be used (and to what capacity)?
   - What are the criteria for beginning or ending an investment relationship?
- **Review by appropriate parties.** Once a draft policy is formulated, seek input from the government entity's proposed investment officer(s), its leadership, including the government entity's legal department or counsel and the proposed investment committee. Colleagues in other jurisdictions might also be willing to review and comment.
- **Adoption by formal action of governing body.** Many states require a government investment policy to be approved by the entity's governing body. The approval process can be by resolution or other official action in a public meeting. By presenting the policy for formal approval, the policy becomes an established part of the government entity's operations, rather than simply serving as an internal guideline.
- **Establishment of written investment procedures.** Just as the investment policy defines the boundaries of an entity's investing program, written procedures document who will do what on a day to day basis. Topics should include: procedures for taking competitive bids, delivering and paying for purchases, recording transactions, and obtaining approval before buying or selling decisions.
- **Annual review of investment policy.** The written investment policy should be a living document that is reviewed each year by a government entity's investment officials and modified as needed. The policy should be presented each year to the governing body for formal review and approval.

References.

Sample Investment Policy (GFOA) (2011)

Investing Public Funds by Girard Miller with M. Corinne Larson and W. Paul Zorn. 2nd edition. Chicago: GFOA, 1998

Approved by the GFOA's Executive Board, October, 2010.