



# Memorandum

**TO:** PUBLIC SAFETY, FINANCE AND  
STRATEGIC SUPPORT COMMITTEE

**FROM:** Scott P. Johnson

**SUBJECT:** PROPOSED CHANGES TO CITY  
OF SAN JOSE INVESTMENT  
POLICY

**DATE:** May 3, 2007

Approved

*Ray Wines*

Date

*5/4/07*

**COUNCIL DISTRICT:** City-Wide

## RECOMMENDATIONS

Review and approval of the proposed changes to the City of San Jose's Investment Policy including referral to the City Council with a recommendation to adopt a resolution approving the annual review of the City of San Jose Investment Policy, including certain revisions thereto.

## OUTCOME

City Council's annual approval of the City's Investment Policy (the "Policy") meets the requirements contained in the City's Investment Policy, the guidelines set forth in the California Government Code and allows for approval of modifications to the investment guidelines as set forth by the Investment Policy.

## BACKGROUND

The City of San Jose Investment Policy (Policy) requires an annual review of the Policy by the Finance Department. The Finance Department submits any proposed changes to the Policy to the City Council for consideration and approval. The review of the Policy this year was undertaken with the following objectives:

- Examine the feasibility of disbanding the Investment Committee and replacing the oversight function with the appropriate Council committee
- Incorporation of changes recommended by Macias Consulting as part of their review of the City's Investment Program

- Clarification of ambiguous language and conformance with current practices and procedures
- Clarification of means of reporting and information included in the Investment Reports

## **ANALYSIS**

In accordance with Section 17, (which is Section 16.0 of the Revised Policy), Finance Department staff has completed its annual review of the Policy. The proposed changes incorporated into the Policy with respect to disbanding the Investment Committee were reviewed with the Investment Committee on March 5, 2007. Committee members concurred with the proposed disbanding of the Investment Committee subject to provisions outlined to the Committee:

- Continue to provide the complete monthly and quarterly investment reports electronically on the City's web site for public access and have a hard copy available to the public in the City Clerk's Office.
- Continue to provide quarterly investment reports to the Council Committee responsible for finance related matters and change the responsibilities of this Council committee, (currently Public Safety, Finance & Strategic Support Committee (PSF&SSC)); to include a full presentation from staff of the Quarterly Investment Reports for quarters ending December 31 and June 30.
- Request that the City Internal Auditor add to his workplan a review of the City's investment program for compliance and internal controls, no less than semi-annually.

This proposal was also conceptually presented to the PSF&SS Committee at the February 15, 2007 meeting with direction to staff to return to the Committee with the revised changes to the Policy to disband the Investment Committee.

Proposed revisions and enhancements are outlined below for the Committee's consideration and approval. Please refer to the Policy attached with this memorandum for recommended changes (the proposed new wording is in blue underlined font, while the deleted wording is indicated by strikeouts in red). The summary below provides a description of the proposed change and rationale for the change. Small word edits and clarifications are not specifically discussed in the staff report.

**Section 3.0 -- Prudent Investor Standard** – This language has been revised to more closely mirror the language in the California Government Code. The Prudent Investor standard is a commonly used concept for both public and private investors and provides guidance to professional staff in conducting their day-to-day work in investing and managing the City's investment portfolio.

**Section 5.0 – Delegation of Authority** – There are two significant amendments to the Policy recommended in this section connected to the recommendation to eliminate the Investment Committee and designate new oversight responsibilities to the City Auditor and the City Council.

The Investment Committee's responsibility as described in the Current Investment Policy (Section 5.0(F)) is to provide external review of investment activity, investment strategy, investment and banking procedures, significant investment-related work projects being undertaken in the Finance Department, and new types of debt financings being contemplated by the City. The Investment Committee currently meets quarterly and its meetings are summarized in minutes which are distributed to the City Council. Per the City's Investment Policy, the Investment Committee shall consist of the City Manager (or his/her designee), the Director of Finance, three Deputy Directors of Finance, as appointed by the Director of Finance and three private sector investment experts. Private sector members of the Committee must be professionals who operate in the San Jose area and have a background in finance, investments, economics, accounting, banking, or are educators in a related area.

Due to the difficulty in recruiting public members (only one public member currently resides on the Committee), staff's recommendation for the elimination of the Investment Committee will be with the following safeguards being added or maintained:

- Continue to provide the complete monthly and quarterly investment reports electronically on the City's web site for public access and have a hard copy available to the public in the City Clerk's Office. (Section 15.0 of the Revised Policy)
- Continue to provide quarterly investment reports to the Council Committee responsible for finance related matters and change the responsibilities of this Council committee, (currently Public Safety, Finance & Strategic Support Committee (PSF&SS)), by adding the requirement to include a full presentation from staff of the Quarterly Investment Reports no less than semi-annually for quarters ending December 31 and June 30. (Section 5.0(E) of the Revised Policy)
- Expand the responsibilities of the City Internal Auditor to include "*no less than semi-annually each year, ... to conduct or cause to be conducted a compliance audit of the investment program, which is to be limited to compliance with the Investment Policy, departmental procedures, and internal controls with respect to investment of funds.*" (Section 5.0 (D) of the Revised Policy).

**Section 6.0 – Ethics and Conflicts of Interest** – This proposed change adds the reference to Government Code Section 1090 as an area which needs to be examined with respect to potential conflicts of interest in addition to the California Political Reform Act.

**Section 7.0 – Authorized Financial Dealers and Institutions** – The proposed amendments in this section accomplish several objectives:

- Clarification of the City's ability to file copies of audited financial statements of the financial institutions electronically or in paper and clarification that the gathering of financial statements is completed annually as part of the annual review process and not part of an ongoing updating review process. The ability to store the financial statements electronically reduces physical filing requirements, creates ease of access by multiple staff and reduces the time involved in compiling the documentation.

- Clarification that the City will enter into Agreements with Financial Institutions (including broker/dealer firms) to the extent they are providing services other than broker/dealer services to the City. The City will conduct business only with the broker/dealers meeting the Standards for Financial Institutions as described in this section for the purpose of buying and selling securities. All other work must be evaluated by the Director of Finance for the determination of whether a written Agreement is necessary to conduct other investment related activities, such as investment advisory services and investment custodial services.
- Clarification on the timing of distribution of the Investment Policy to Financial Institutions and broker/dealers. The distribution will occur after City Council's approval of any revisions to the Policy or subsequent to the annual approval process.

**Section 8.0 – Authorized Investments** – There are several changes in the authorized investment section which are recommended to bring our Policy more in alignment with the Government Code. These proposed changes are summarized below:

- Commercial Paper (Section 8.0 (5)), increasing the allowable maturity from 180 days to 270 days. This change conforms to the Government Code and matches the maximum maturity date in which commercial paper can be issued.
- Local Agency Investment Fund (“LAIF”) (Section 8.0 (9)), adding the requirement to conduct an annual review of LAIF's Pool Money Investment Board's (“PMIB”) Annual Report. Adding this requirement here, allows for the elimination of Section 9.0 of the Policy, which is duplicative of other sections.
- Money Market Mutual Fund (Section 8.0 (10)), recommended change allows for the credit criteria to be one of two standards (rating or investment advisor management) rather than requiring both. This change is consistent with the Government Code provisions.

**Section 9.0 – Investment Pools/Mutual Funds** – These requirements are included in Section 7.0 (B), Section 8.0 (9) and Section 8.0 (10) of the Revised Policy. Deleting this section of the Policy ensures that the Policy remains internally consistent and eliminates any duplication.

**Section 11.0 – Diversification** – The recommended change clarifies that portfolio diversification is undertaken with maintaining consistency with the primary objectives of safety, liquidity and yield.

**Section 14.1 – Market Yield (Benchmark)** – The Macias Audit includes two recommendations regarding benchmarking of the portfolio yields. Recommendation #1 suggests elimination of the 6-month rolling average of the one-year T-Bill since the City's portfolio historically has an average days to maturity greater than 180 days. Recommendation #2 suggests selecting specific targets to meet or exceed as benchmarks for yield performance.

Based on these recommendations, staff is revising this section of the policy to eliminate the specific benchmark targets and that the Director of Finance determine whether market yields are being achieved by identifying benchmark(s) comparable to the weighted average maturity of the

investment portfolio. The recommended change reiterates the primary objective in the design of the City's Investment Portfolio of attaining a market rate of return throughout budgetary and economic cycles, taking into consideration the investment risk tolerance and liquidity needs of the City. Yield on the City's investment portfolio is of secondary importance to the safety and liquidity objectives.

**Section 15.0 – Reporting and Distribution** – The proposed changes in this section of the policy clarify the electronic means of distribution of the monthly and quarterly investment reports.

- **Section 15.1 – Quarterly Investment Reports** – the list of items to be included in the Quarterly Investment Report has been rearranged to group the information into the following major categories of reporting: Portfolio Statistics, Portfolio Performance, Compliance Reporting Requirements, Investment Trading Activity, and Investment Strategy. This grouping assists in preparing the quarterly reports.
- **Section 15.2 – Monthly Investment Reports** – the list of items has also been rearranged to group the information into the following major categories of reporting: Portfolio Statistics, Portfolio Performance, Compliance Reporting Requirements, and adding a section on Investment Strategy.

**Section 16.0 – Investment Policy Review/Adoption** – The proposed change recommends that the Council Committee responsible for reviewing the quarterly reports also reviews any recommended changes to the Investment Policy prior to submission to the entire City Council for consideration and approval.

**Exhibit A -- Primary Dealer Name Changes** -- Primary government securities dealers report weekly to the Government Securities Dealers Statistics Unit of the Federal Reserve Bank of New York. The proposed revisions to Exhibit A in the attached Investment Policy reflect the most recent changes to the Federal Reserve Bank's Primary Dealer List which was last updated February 8, 2007. Two dealers have been removed from the list, ABN AMRO Bank N.V., New York Branch and CIBC World Markets Corp. and one firm has been added to the list Cantor Fitzgerald & Co.

## **PUBLIC OUTREACH**

The proposed changes regarding disbandment of the Investment Committee were discussed at the March 5, 2007 Investment Committee meeting.

## **COORDINATION**

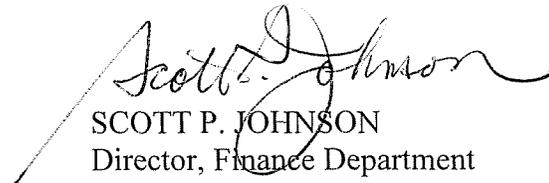
This memorandum was coordinated with the offices of the City Manager and City Attorney.

**COST SUMMARY/IMPLICATIONS**

Not applicable.

**CEQA**

Not a project.

  
SCOTT P. JOHNSON  
Director, Finance Department

Attachment

For questions, please contact Julia H. Cooper, Deputy Director, Treasury at (408) 535-7011.