CAJPA SPRING WORKSHOP

TECH SAVVY, HR WISE & FISCALLY READY

Investment Fiduciary Responsibilities:

Avoiding Issues & Oversights When Searching for Guidance

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CAJPA SUMMIT SERIES POOL PROFESSIONALS

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Why Investments Are Important for JPAs

A JPA's Investment Portfolio

Purpose: Investment Income

- Maximizing Investment Income Can Mean:

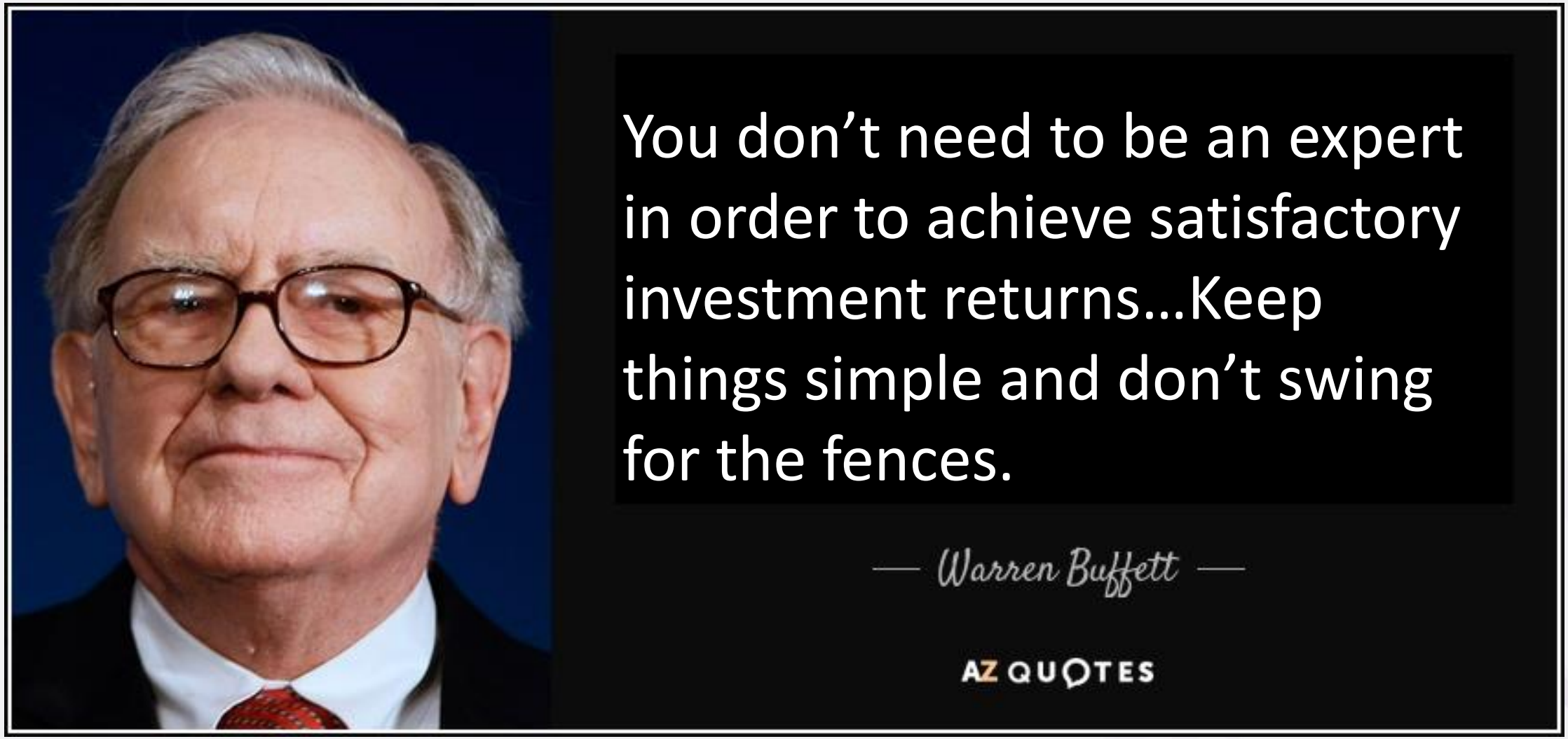
Competitive Pricing and Member Retention

or

Member Attrition Due to 'Hard Market' Pricing

Investments Are Important,

But Remember…


You don’t need to be an expert in order to achieve satisfactory investment returns…Keep things simple and don’t swing for the fences.
— Warren Buffett —
AZ QUOTES

Seeking Outside Guidance:

Balancing Internal & External Perspectives is Key to a JPA's Success

Investment Fiduciary:

Advice In Your JPA's Best Interest

What is a Fiduciary?

- A Person/Organization Providing Investment Services

- Legally and Ethically Bound to Acting In Your Best Interests

Two Types of Fiduciaries

Investment Managers

- ❑ Buy and Sell Securities to Match Desired Portfolio Structure
- ❑ Discretionary Authority
- ❑ Can Offer Ancillary Services, Like Schedule D Accounting

Investment Consultants

- ❑ Provide Independent Oversight & Recommendations
- ❑ Non-Discretionary Authority / Do Not Manage Assets
- ❑ Monitors Investment Managers & Overall Performance

Brokers/Dealers are NOT Fiduciaries

B/D's Can Buy a Bond for Their Inventory, Then Sell It to You, ***Potentially Benefiting Twice****.*

Why Do JPA's Use Fiduciaries?

Investment Managers

- ❑ Outsource Portfolio Management Duties & Expertise
- ❑ Standard Fee Schedules Based on Portfolio Size

Investment Consultants

- ❑ Outsource "Chief Investment Officer' Role & Duties
- ❑ Cost-Effective Alternative to Full-Time Staff

Is Our Investment Partner A Fiduciary?

Fiduciary: How to Check

1. **Are they registered with a federal or state regulatory body?**
   If "Yes," then they are likely a fiduciary.

2. **Are they a broker/dealer responsible for determining investments?**
   If "Yes," then they are NOT a fiduciary.

3. **Are they an internal investment professional?**
   If "Yes," then probably not as they are held to standards of employment, but some regulations may redefine this.

Unsure?

Ask and Get Assurances in Writing.

Red Flags for Any Investment Partner

1) **Conflicts of Interest;**
   i.e. revenue sources or partnerships

2) **Violations & Litigation**
   i.e. regulatory censure or investigations

3) **Unfamiliar with JPA Constraints;**
   their approach for JPAs does not differ from other clients

Not Working w/ a Fiduciary?

Common Issues:

SWOT Analysis: Utilizing a Broker/Dealer *(Example - Compilation)*

STRENGTHS | WEAKNESSES | OPPORTUNITIES | THREATS

- ‘All-In’ Service Provides Appropriate Value-Add but May Change with Growth.
- Recommendations **Lack an Explicit Connection** to the Board/Trustee’s Goals
- Fee structures not clearly outlined, with **profits hidden within transactions**
- No performance attribution to help explain under/over performance
- Performance returns, if and when available, are not GIPS compliant.
- Potential Conflicts of Interest with B/D’s Selected Partners and Recommendations

Common Issues: Opportunity Costs

Reduced Investment Income Often Comes From:

1) Not **considering all allowable asset classes available to your JPA**

2) Not considering the **impacts (both risks and benefits) of more diversification**

3) Foregoing **periodic reviews** of any part of the investment process

4) Lacking consistent reviews for any **investment-related fees**

Opportunity Cost: Example

- **CA JPAs Must Adhere to the 'Government Code':**
- **Restrictive is an Understatement**

Allowed & Prohibited Investments Under the CA Government Code							
		Overnight	180 Days	270 Days	1 Year	5 Years	Beyond 5 Years
Traditional Investment-Grade Fixed Income	*Asset-Backed Securities*	Allowed					Prohibited
	Bankers' Acceptances	Allowed			Prohibited		
	Commercial Paper	Allowed				Prohibited	
	Federal Agencies	Allowed					Subject to Approval
	Local Government Investment Pools	Allowed	Prohibited				
	Medium-Term Corporate Notes ('A' or higher)	Allowed					Prohibited
	Money Market Funds / Bond Mutual Funds	Allowed	Prohibited				
	Municipal Securities	Allowed					Subject to Approval
	Negotiable Certificates of Deposit	Allowed					Subject to Approval
	Repurchase Agreements	Allowed				Prohibited	
	Supranationals ('AA' or Higher)	Allowed					Prohibited
	U.S. Treasuries	Allowed					Subject to Approval
Additional Fixed Income Vehicles	*Bank Loans*	Allowed					Prohibited
	Convertibles	Prohibited					
	Emerging Market Debt	Prohibited					
	Fixed Income ETFs	Prohibited					
	Foreign Sovereign	Prohibited					
	High-Yield Bonds	Prohibited					
	Non-U.S. Dollar Investment Grade	Prohibited					
	Private Placements	Prohibited					
Equities (Common Stock)	*Domestic - Large Cap*	Prohibited					
	Domestic - Mid-Cap	Prohibited					
	Domestic - Small Cap	Prohibited					
	Emerging Markets	Prohibited					
	Equity Mutual Funds and ETFs	Prohibited					
	International - Large Cap	Prohibited					
	International - Mid Cap	Prohibited					
	International - Small Cap	Prohibited					
	Preferred Stock	Prohibited					
Alternative Investments	*Commodities*	Prohibited					
	Derivatives, Futures, and Options	Prohibited					
	Hedge Funds	Prohibited					
	Other Tangible Assets	Prohibited					
	Private Equity	Prohibited					
	Real Estate	Prohibited					
	Venture Capital	Prohibited					

Source: PFM Asset Management

Opportunity Cost: Example

- **However, Potential Flexibility to Find Improvement Still Exists**

Recommendation	Reasoning
Increase Duration	Increases Investment Grade Yields Better Alignment with Reserves Duration
Increase Maturity of US Treasury, Municipal, Federal Agency, and Negotiable CD Securities	Government Code allows for increase in maturity limits, which allows Board/Trustees with more flexibility
Add Limits & Specify Prohibited Investments	Ensures compliance and governance over the investment portfolio and reflects Board/Trustee's investment perspectives
Focus on Duration Limits Instead of Maturity Limits	Provides a better measure of interest rate risk and more investment flexibility

Knowing When Advice is Appropriate

Even If You Don't Agree with the Recommendation –

Investment Advice Can Still Be Provided With Your Best Interest in Mind.

A Fiduciary Should Provide Guidance That Is:

1) **Independent | Free of Potential Conflicts;**

2) **Tailored to JPAs/Risk Pools;**
   i.e. time horizons, CA Code, etc.

3) **Always Considering Enterprise Risk & Surplus Impacts**

What Next?

Potential Next Steps

1) Confirm All Investment-Related Fees

a. For Internal Clarity

b. Partners Should Have Clear Answers

2) Assess Staff's Comfort with Investment Duties

Potential Next Steps

3) Verify Investment Flexibility with Partners

- Avoid Potential Opportunity Costs

4) Discuss a Potential Education Program/Plan

- Improve Understanding & Communication

Potential Next Steps

5) Consider a Fiduciary Search (Consultant or Manager)

- Ensure Proper Due Diligence

6) Most Importantly: Keep Asking Questions

Thank You For Your Time!

Questions?

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