

MISSOURI DEPARTMENT OF TRANSPORTATION INVESTMENT POLICY

Scope

This policy applies to the investment of Missouri Department of Transportation (MoDOT) funds held outside of the State Treasurer's Office.

Investments through external programs, facilities and professionals operating in a manner consistent with this policy will constitute compliance.

The purpose of the Investment Policy shall be to establish the investment objectives of MoDOT and provide a set of investment parameters to govern the type, quality, diversification and term of investments in order to realize those objectives. To assist in accomplishing investment objectives, MoDOT shall employ an Investment Advisor to act in a fiduciary capacity as custodian for the interest and benefit of MoDOT and to, among other responsibilities, develop, implement and execute an investment strategy consistent with this Investment Policy.

The Investment Advisor and MoDOT shall have in place an agreement that will determine the duties expected of them as MoDOT's Investment Advisor. In developing and implementing any investment strategy for the custodial assets, the Investment Advisor shall comply with the investment parameters set forth herein.

General Objectives

The primary objectives, in priority order, of investment activities shall be safety, liquidity and yield:

1. **Safety.** Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate credit risk and interest rate risk.
 - a. **Credit Risk.** MoDOT will minimize credit risk, the risk of loss due to the failure of the security issuer or backer, by:
 - Limiting investments to the safest types of securities, as defined in Section V; and
 - Diversifying the investment portfolio so that potential losses on individual securities will be minimized.
 - b. **Interest Rate Risk.** MoDOT will minimize the risk that the market value of securities in the portfolio will fall due to changes in general interest rates, by:
 - Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity.

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2. **Liquidity.** The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands (static liquidity). Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity). A portion of the portfolio also may be placed in money market mutual funds or local government investment pools that offer same-day liquidity for short-term funds.
3. **Yield.** The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The core investments are limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall not be sold prior to maturity with the following exceptions:
 - A security with declining credit may be sold early to minimize loss of principal;
 - A security exchange would improve the quality, yield, or target duration in the portfolio; or
 - Liquidity needs of the portfolio require that the security be sold.

Standards of Care

1. **Prudence.** The standard of prudence to be used by MoDOT investment officers shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio. The standard of prudence to be used by MoDOT financial advisors shall be the "prudent expert" standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and the liquidity and the sale of securities are carried out in accordance with the terms of this policy.

Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

2. **Ethics and Conflicts of Interest.** Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees and investment officers shall disclose any material interests in financial institutions with which they conduct business. They shall further

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disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with which business is conducted on behalf of MoDOT.

- 3. Delegation of Authority.** Authority to manage the investment program is granted to the Resource Management division within MoDOT. Responsibility for the operation of the investment program is hereby delegated to the Resource Management Director and his or her delegate, hereinafter referred to as investment officers, who shall act in accordance with established written procedures and internal controls for the operation of the investment program consistent with this investment policy. Procedures should include references to: safekeeping, delivery vs. payment, investment accounting, repurchase agreements, wire transfer agreements, and collateral/depository agreements. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the investment officers. The investment officers shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officers.

Safekeeping and Custody

- 1. Authorized Financial Dealers and Institutions.** MoDOT's Investment Advisor will serve as MoDOT's Financial Dealer and Institution. The Investment Advisor shall retain principal collection subject to MoDOT's direction and shall distribute income to MoDOT. All securities will be registered in the name of Missouri Highways and Transportation Commission unless otherwise instructed. An annual review of the financial condition and registration of MoDOT's Investment Advisor will be conducted by the investment officers. MoDOT's Investment Advisor will supply the following information as requested:
 - Audited financial statements; and
 - Certification of having read and understood and agreeing to comply with MoDOT's investment policy.
- 2. Internal Controls.** The investment officers are responsible for establishing and maintaining an internal control structure designed to ensure that the assets of MoDOT are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

Accordingly, the investment officers shall establish a process for an annual independent review by an auditor to assure compliance with policies and procedures. The internal controls shall address the following points:

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- Control of collusion;
- Separation of transaction authority from accounting and record keeping;
- Custodial safekeeping;
- Avoidance of physical delivery securities;
- Clear delegation of authority to subordinate staff members;
- Written confirmation of transactions for investments and wire transfers;
- Development of a wire transfer agreement with the lead bank and third-party custodian;
- Timely check of internal trade tickets and dealer confirmations; and
- Sufficiency check of repurchase agreement collateral on the day of trade execution.

3. Delivery vs. Payment. All trades where applicable will be executed by delivery vs. payment (DVP) to ensure that securities are deposited in an eligible financial institution prior to the release of funds. All securities will be held to avoid custodial credit risk as defined by Governmental Accounting Standards Board (GASB) Statement 40 pronouncement.

Suitable and Authorized Investments

1. Investment Types. In accordance with and subject to restrictions imposed by current statutes, the following list represents the entire range of investments that MoDOT will consider. MoDOT may directly invest in or purchase money market mutual funds with the following as underlying securities:

- **United States Treasury Securities.** MoDOT may invest in obligations of the United States government for which the full faith and credit of the United States are pledged for the payment of principal and interest.
- **United States Agency Securities.** MoDOT may invest in obligations issued or guaranteed by any agency of the United States Government as described in V.2.
- **Repurchase Agreements.** MoDOT may invest in contractual agreements between MoDOT and commercial banks or primary government securities dealers. The purchaser in a repurchase agreement (repo) enters into a contractual agreement to purchase U.S. Treasury and government agency securities while simultaneously agreeing to resell the securities at predetermined dates and prices. This includes the purchase of reverse repurchase agreements for not longer than 90 days.
- **Collateralized Public Deposits (certificates of deposit).** Instruments issued by financial institutions, which state that specified sums have been deposited for specified periods of time, and at specified rates of interest. The certificates of deposit are required to be backed by acceptable collateral securities as dictated by state statute.
- **Bankers' Acceptances.** Time drafts drawn on and accepted by a commercial bank, otherwise known as bankers' acceptances. MoDOT may invest in bankers' acceptances issued by domestic commercial banks possessing the highest rating issued by Moody's Investor Services, Inc. or Standard & Poor's Corporation.

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- Commercial Paper. MoDOT may invest in commercial paper issued by domestic corporations, which has received the highest rating issued by Moody's Investor Services, Inc. or Standard & Poor's Corporation. Eligible paper is further limited to issuing corporations that have total commercial paper program size in excess of five hundred million dollars (\$500,000,000).
- 2. Security Selection.** The following list represents the entire range of United States Agency Securities that will be considered and which shall be authorized for the investment of funds by MoDOT. Additionally, the following definitions and guidelines should be used in purchasing the instruments:
- U.S. Govt. Agency Coupon and Zero Coupon Securities. Bullet coupon bonds with no embedded options.
 - U.S. Govt. Agency Discount Notes. Purchased at a discount with maximum maturities of one (1) year.
 - U.S. Govt. Agency Callable Securities. Restricted to securities callable at par only with final maturities of five (5) years.
 - U.S. Govt. Agency Step-Up Securities. The coupon rate is fixed for an initial term. At coupon date, the coupon rate rises to a new, higher fixed term. Restricted to securities with final maturities of seven (7) years.
 - U.S. Govt. Agency Floating Rate Securities. The coupon rate floats off one index. Restricted to coupons with no interim caps that reset at least quarterly.
 - U.S. Govt. Mortgage Backed Securities. Restricted to securities with average life of five (5) years.
 - Collateralized Mortgage Obligations – Must pass Federal Financial Institutions Examinations Council (FFIEC) Test
- 3. Investment Restrictions and Prohibited Transactions.** To provide for the safety and liquidity of MoDOT's funds, the investment portfolio will be subject to the following restrictions:
- Borrowing for investment purposes ("Leverage") is prohibited.
 - Instruments known as Structured Notes (e.g., inverse floaters, leveraged floaters and equity-linked securities) are not permitted. Investment in any instrument, which is commonly considered a "derivative" instrument (e.g., options, futures, swaps, caps, floors, and collars), is prohibited.
 - Contracting to sell securities not yet acquired in order to purchase other securities for purposes of speculating on developments or trends in the market is prohibited.
 - No more than five percent of the total market value of the portfolio may be invested in bankers' acceptances issued by any one commercial bank and no more than five percent of the total market value of the portfolio may be invested in commercial paper of any one issuer.

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- 4. Collateralization.** Collateralization will be required on two types of investments: certificates of deposit and repurchase agreements. The market value (including accrued interest) of the collateral should be at least 100 percent. For certificates of deposit, the market value of collateral must be at least 100 percent or greater of the amount of certificates of deposits plus demand deposits with the depository, less the amount, if any, which is insured by the Federal Deposit Insurance Corporation, or the National Credit Unions Share Insurance Fund. All securities, which serve as collateral against the deposits of a depository institution, must be safe kept at a non-affiliated custodial facility. Depository institutions pledging collateral against deposits must, in conjunction with the custodial agent, furnish the necessary custodial receipts within five business days from the settlement date. MoDOT shall have a depository contract and pledge agreement with each safekeeping bank that will comply with the Financial Institutions, Reform, Recovery, and Enforcement Act of 1989 (FIRREA). This will ensure that MoDOT's security interest in collateral pledged to secure deposits is enforceable against the receiver of a failed financial institution.
- 5. Repurchase Agreements.** The securities for which repurchase agreements will be transacted will be limited to U.S. Treasury and government agency securities that are eligible to be delivered via the Federal Reserve's Fedwire book entry system. Securities will be delivered to MoDOT's designated Custodial Agent. Funds and securities will be transferred on a delivery vs. payment basis.

Investment Parameters

- 1. Diversification.** The aggregate investments shall be diversified to minimize the risk of loss resulting from over concentration of assets in specific maturity, specific issuer or specific class of securities. Diversification strategies shall be established and periodically reviewed. At a minimum, diversification standards by security type and issuer shall be:
- U.S. treasuries and securities having principal and/or interest guaranteed by the U.S. government..... <= 100%
 - Collateralized time and demand deposits..... <= 100%
 - U.S. Government agencies and government sponsored enterprises..... <= 100%
No more than 50 percent of portfolio in one government sponsored enterprise
 - Collateralized repurchase agreements..... <= 50%
 - U.S. Government agency callable securities..... <= 50%
 - Commercial Paper..... <= 30%
 - Bankers' Acceptances..... <= 30%
- 2. Maximum Maturities.** To the extent possible, MoDOT shall attempt to match its investments with anticipated cash flow requirements. MoDOT shall adopt weighted average life limitations for the portfolio that should not exceed three (3) years and is consistent with the investment objectives.

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Because of inherent difficulties in accurately forecasting cash flow requirements, a portion of the portfolio should be continuously invested in readily available funds such as in bank deposits or overnight repurchase agreements to ensure that appropriate liquidity is maintained to meet ongoing obligations.

Reporting

- 1. Methods.** The investment officers shall prepare an investment report at least quarterly, including a management summary that provides an analysis of the status of the current investment portfolio and transactions made over the last quarter. This management summary will be prepared in a manner that will allow MoDOT to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report should be provided to the MoDOT Investment Advisory Board. The Investment Advisory Board will be made up of the four fund managers investing funds outside of the State Treasurers Office, MoDOT's Chief Financial and Administrative Officer and the MoDOT investment officers. The report will include the following:
 - Listing of individual securities held at the end of the reporting period.
 - Realized and unrealized gains or losses resulting from appreciation or depreciation by listing the cost and market value of securities over one-year duration that are not intended to be held until maturity (in accordance with GASB requirements).
 - Average weighted yield to maturity of portfolio on investments as compared to applicable benchmarks.
 - Listing of investment by maturity date.
 - Percentage of the total portfolio that each type of investment represents.
- 2. Performance Standards.** The investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio should obtain a market average rate of return during a market/economic environment of stable interest rates. A series of appropriate benchmarks shall be established against which portfolio performance shall be compared on a regular basis.

Commercial paper and bankers' acceptances must be reviewed monthly to determine if the rating level has changed. The commercial paper and bankers' acceptances should be reviewed for possible sale if the securities are downgraded below the minimum acceptable rating levels.

- 3. Marking to Market.** The market value of the portfolio shall be calculated at least monthly and a statement of the market value of the portfolio shall be issued at least monthly. This will ensure that review of the investment portfolio, in terms of value and price volatility, has been performed. In defining market value, considerations should be given to the GASB Statement 31 pronouncement.

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Policy Considerations

- 1. Exemption.** Any investment currently held that does not meet the guidelines of this policy shall be exempted from the requirements of this policy. At maturity or liquidation, such monies shall be reinvested only as provided by this policy.
- 2. Amendments.** This policy shall be reviewed on an annual basis. Any changes must be approved by the investment officers and the MoDOT Investment Advisory Board, as well as the individual(s) charged with maintaining internal controls.

List of Attachments

The following documents, as applicable, are attached to this policy:
(The list of attachments that would be necessary upon implementation)

- Listing of authorized personnel,
- Relevant investment statutes and ordinances,
- Repurchase agreements and tri-party agreements,
- Listing of authorized broker/dealers and financial institutions,
- Credit studies for securities purchased and financial institutions used,
- Safekeeping agreements,
- Wire transfer agreements,
- Portfolio stress testing if necessary,
- Sample investment reports.