

**VILLAGE OF
CAROL STREAM, ILLINOIS**



INVESTMENT POLICY

**Adopted
October 2, 2017**



VILLAGE OF CAROL STREAM

INVESTMENT POLICY

1.0 **Policy:**

It is the policy of the Village of Carol Stream to invest public funds in a manner which will provide a competitive investment return with the maximum security while meeting the daily cash flow demands of the Village and conforming to all state statutes governing the investment of public funds.

2.0 **Scope:**

This investment policy applies to all financial assets of the Village of Carol Stream except for the Police Pension Fund which is subject to the direction of the Board of Trustees of that particular fund. These funds are accounted for in the Village of Carol Stream's Comprehensive Annual Financial Report and include:

2.1 **Funds:**

- 2.1.1 General Fund
- 2.1.2 Special Revenue Funds
- 2.1.3 Capital Project Funds
- 2.1.4 Enterprise Funds
- 2.1.5 Trust and Agency Funds
- 2.2.6 (Any new fund created by the Village Board, unless specifically exempt.)

2.2 **Pooling of Funds**

Except for cash in certain restricted and special funds, the Village will consolidate cash and reserve balances from all funds to maximize investment earnings and to increase efficiencies

with regard to investment pricing, safekeeping and administration. Investment income will be allocated to the proper funds based on their respective participation and in accordance with generally accepted accounting principles.

3.0 **General Objectives:**

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

3.1 **Safety:**

Safety of principal is the foremost objective of the investment program. Investments of the Village of Carol Stream shall be undertaken in a manner that seeks the preservation of capital in the overall portfolio. The objective will be to mitigate credit risk and interest rate risk.

A. **Credit Risk:**

Credit risk is the risk of loss due to the failure of the security issuer or backer. Credit risk may be mitigated by:

- Limiting investments to the safest types of securities listed in Section 7.0 of this Investment Policy.
- Prequalifying the financial institutions, broker/dealers, intermediaries, and advisers with which the Village will do business in accordance with Section 5.0 and,

- Diversifying the investment portfolio so that the impact of potential losses from any one type of security or from any one individual issuer will be minimized.

B. Interest Rate Risk:

Interest rate risk is the risk that the market value of securities in the portfolio will fall due to changes in general interest rates. Interest rate risk may be mitigated 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, and
- By investing operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools and limiting the average maturity of the portfolio in accordance with this policy (see Section 8.2).

3.2 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). Alternatively, a portion of the portfolio may be placed in money market mutual

funds or local government investment pools which offer same-day liquidity for short-term funds.

3.3 Return on Investment:

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 tertiary importance compared to the safety and liquidity objectives described above. The core of investments is 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:

- 1) a declining credit security could be sold early to minimize loss of principal;
- 2) a security swap would improve the quality, yield, or target duration in the portfolio; or
- 3) liquidity needs of the portfolio require that the security be sold.

4.0 Standards of Care

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.

4.1 Prudence:

The standard of prudence to be used by investment officials shall be the “**prudent person**” standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and the 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 appropriate action is taken to control adverse developments.

4.2 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 officials shall disclose any material interests in financial institutions with which they conduct business. They shall further 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 transaction with the same individual with whom business is conducted on behalf of their entity.

4.3 Delegation of Authority:

Authority to manage the Village of Carol Stream’s investment program is derived from the following:

The establishment of investment policies is the responsibility of the Village Board. Management and administrative responsibility for the investment program is hereby delegated to the Finance Director who, under the direction of the Village Manager, shall establish written procedures 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, collateral/depository agreements and banking service contracts. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Finance Director. The Finance Director shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials. The Finance Director may from time to time amend the written procedures in a manner not inconsistent with this policy or with state statutes.

The responsibility for investment activities of the Police Pension Fund rests with the Board of Trustees of the Police Pension Fund.

The Village Treasurer, appointed by the Mayor with advice of the Trustees, advises the Village Board on investment policy and is an ex-officio member of the Police Pension Fund.

5.0 **Authorized Financial Institutions, Depositories and Broker/Dealers:**

The Finance Director will maintain a list of financial institutions authorized to provide investment services. In addition, a list will also be maintained of approved security broker/dealers selected by credit worthiness. These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule). No public deposit shall be made except on qualified public depositories as established by state statutes.

The Village Board authorizes the Finance Director to invest up to \$250,000 in any FDIC insured financial institution.

All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the Finance Director with the following:

- Audited financial statements demonstrating compliance with state and federal capacity adequacy guidelines
- Proof of National Association of Securities Dealers (NASD) certification (not applicable to Certificates of Deposit counterparties)
- Proof of state registration
- Certification of having read the Village's investment policy
- Depository contracts

An audited financial statement is required to be on file for each financial institution and broker/dealer in which the village invests.

6.0 **Safekeeping and Custody:**

All trades of marketable securities 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.

Securities will be held by an independent third-party custodian selected by the Village as evidenced by safekeeping receipts in the Village's name. The safekeeping institution shall annually provide a copy of their most recent report on internal controls (Statement of Auditing Standard No. 70, or SAS 70).

6.1 **Internal Controls:**

The finance director is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the Village of Carol Stream are protected from loss, theft or misuse. Details of the internal controls system shall be documented in an investment procedures manual and shall be reviewed and updated annually. 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 the control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits require estimates and judgments by management.

The internal controls structure shall address the following points:

- Control of collusion.
- Separation of transaction authority from accounting and record keeping.
- Custodial safekeeping.
- Avoidance of physical delivery of securities.
- Clear delegation of authority to subordinate staff members.
- Written confirmation of telephone transactions for investments and wire transfers.
- Development of a wire transfer agreement with the lead bank and third-party custodian.

Accordingly, the Finance Director shall establish a process for annual independent review by an external auditor to assure compliance with policies and procedures.

7.0 **Suitable and Authorized Investments:**

The Village may invest in any type of securities allowed for in Illinois statutes (30ILCS 235/2) regarding the investment of public funds. Approved investments include:

- Bonds, notes, certificates of indebtedness, treasury bills, or other securities now or hereafter issued, which are guaranteed by the full faith and credit of the United States of America as to principal and interest;
- Bonds, notes, debentures or other similar obligations of the United States of America, its agencies, and its instrumentalities;
- Interest-bearing savings accounts, interest-bearing certificates of deposit or interest-bearing time deposits or any other investments constituting direct obligations of any bank as defined by the Illinois Banking Act;

- Short-term obligations of corporations organized in the United States with assets exceeding \$500,000,000 if (i) such obligations are rated at the time of purchase at one of the three highest classifications established by at least two standard rating services and which mature not later than 270 days from the date of purchase, (ii) such purchases do not exceed 10% of the corporation's outstanding obligations and (iii) no more than 1/3 of public funds may be invested in short-term obligations of corporations;
- Interest-bearing bonds of any county, township, city, village, incorporated town, municipal corporation, or school district of the State of Illinois, or of any other state. The bonds shall be registered in the name of the municipality or held under a custodial agreement at a bank. The bonds shall be rated at the time of purchase within the 4 highest general classifications established by a rating service of nationally recognized expertise in rating bonds of states and their political subdivisions;
- Illinois Public Treasurer's Investment Pool (Illinois Funds) and the Illinois Metropolitan Investment Fund (IMET);

7.1 **Collateralization:**

The Village requires that funds on deposit in excess of FDIC limits be secured by some form of collateral. The Village will accept any of the following assets as collateral:

- Government Securities
- Obligations of Federal Agencies
- Obligations of Federal Instrumentalities

(The Village reserves the right to accept/reject any form of the above named securities.)

The Village also requires that all depositories that hold Village deposits in excess of the FDIC limit execute a written collateralization agreement.

The amount of collateral provided will not be less than 105% of the fair market value of the net amount of public funds secured. The ratio of fair market value of collateral to the amount of funds secured will be reviewed monthly, and additional collateral will be required when the ratio declines below the level required and collateral will be released if the fair market value exceeds the required level. Pledged collateral will be held in safekeeping, by an independent third party depository designated by the Village of Carol Stream and evidenced by a safekeeping agreement. Collateral agreements will preclude the release of the pledged assets without an authorized signature from the Village of Carol Stream.

As an alternative to accepting pledged securities as collateral, the securitization of deposits may be achieved through issuance of an original irrevocable Letter of Credit issued by the Federal Home Loan Bank.

The Village of Carol Stream realizes that there is a cost factor involved with collateralization and the Village will pay any reasonable and customary fees related to collateralization.

8.0 **Investment Parameters:**

8.1 **Diversification:**

In order to reduce the risk of default, it is the policy of the Village of Carol Stream in accordance with the GFOA's Recommended Practices on the Diversification of Investments in a Portfolio, that the investment portfolio

of the Village of Carol Stream shall be diversified by:

- limiting investments to avoid over-concentration in securities from a specific issuer or business sector (excluding U.S. Treasury and Agency securities):
 - No financial institution shall hold more than 40% of the Village's investment portfolio (excluding third party safekeeping institutions and the Illinois Public Treasurer's Investment Pool).
 - Monies deposited at a financial institution shall not exceed 75% of the capital stock and surplus of that institution.
 - Commercial paper shall not exceed 10% of the Village's investment portfolio.
 - Brokered certificates of deposit shall not exceed 33% of the Village's investment portfolio.
- investing in securities with varying maturities, and
- continuously investing a portion of the portfolio in readily available funds such as local government investment pools (LGIP's), money market funds or overnight repurchase agreements to ensure that appropriate liquidity is maintained in order to meet ongoing obligations.

8.2 **Maximum Maturities:**

To the extent possible, the Village of Carol Stream will attempt to match its

investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the Village will not directly invest in securities maturing more than three years from the date of purchase.

Reserve funds may be invested in securities exceeding three years if the maturity of such investments are made to coincide as nearly as practicable with the expected use of the funds. Any investment purchased with a maturity longer than four years must be supported with written documentation explaining the reason for the purchase and must be specifically approved by the Board of Trustees.

9.0 **Reporting:**

The Finance Director shall prepare an investment report at least monthly, including a management summary that provides an analysis of the status of the current investment portfolio and the individual transactions executed over the last month. This management summary will be prepared in a manner which will allow the Village to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report should be provided to the Village Manager and the Village Board. The report will include the following:

- Listing of individual securities held, by fund, at the end of the reporting period.
- Listing of investments by maturity date.
- The purchase and safekeeping institutions.

9.1 **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. Portfolio performance should be compared to appropriate benchmarks on a regular basis. The benchmarks shall be reflective of the actual securities being purchased and risks undertaken and the benchmark shall have a similar weighted average maturity as the portfolio.

9.2 **Market Yield (Benchmark):**

The Village's investment strategy is passive. Given this strategy, the basis used by the Finance Director to determine whether market yields are being achieved shall be the six-month U.S. Treasury Bill.

9.3 **Marking to Market:**

The market value of the portfolio shall be calculated at least quarterly and a statement of the market value of the portfolio shall be issued at least quarterly.

10.0 **Investment Policy Adoption:**

The Village of Carol Stream's investment policy shall be adopted by the Village Board of Trustees. This policy shall be reviewed on an annual basis by the Finance Director and any modifications made thereto must be approved by the Village Board of Trustees.

GLOSSARY

AGENCIES: Federal agency securities.

ASKED: The price at which securities are offered.

BANKERS' ACCEPTANCE: A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

BID: The price offered for securities.

BROKER: A Broker brings buyers and sellers together for a commission paid by the initiator of the transaction or by both sides; he does not position. In the money market, brokers are active in markets in which banks buy and sell money and in inter-dealer markets.

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination CD's are typically negotiable.

COLLATERAL: Securities, evidence of deposit or other property which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report for the Village of Carol Stream. It includes five combined statements and basic financial statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

COUPON: (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on

the bond's face value. (b) A certificate attached to a bond evidencing interest due on a payment date.

DEALER: A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his own account.

DEBENTURE: A bond secured only by the general credit of the issuer

DELIVERY VERSUS PAYMENT: There are two methods for delivery of securities: delivery versus payment and delivery versus receipt (also called *free*). Delivery versus

payment is delivery of securities with an exchange of money for securities. Delivery versus receipt is delivery of securities with an exchange of sign receipt for the securities.

DISCOUNT: The difference between the cost price of a security and its value at maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

DISCOUNT SECURITIES: Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value, e.g., U.S. Treasury bills.

DIVERSIFICATION: Dividing investment funds among a variety of securities offering independent returns.

FEDERAL CREDIT AGENCIES: Agencies of the Federal Government set up to supply credit to various classes of institutions and individuals, e.g., S & L's, small business firms, students, farmers, farm cooperatives, and exporters.

FEDERAL DEPOSIT OF INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits, currently up to \$100,000 per deposit.

FEDERAL FUNDS RATE: The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

FEDERAL HOME LOAN BANKS (FHLB): The institutions that regulate and lend to savings and loan associations. The Federal Home Loan Banks play a role analogous to that played by the Federal Reserve Banks vis-à-vis member commercial banks.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA): FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing & Urban Development, HUD. It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans in addition to fixed-rate mortgages. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

FEDERAL OPEN MARKET COMMITTEE (FOMC): Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member while the other Presidents serve on a rotation basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

FEDERAL RESERVE SYSTEM: The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C., 12 regional banks and about 5,700 commercial banks that are members of the system.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA OR GINNIE MAE): Securities guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations and other institutions. Security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by FHA, VA or FMHM mortgages. The term *passthroughs* is often used to describe Ginnie Maes.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be *liquid* if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

LOCAL GOVERNMENT INVESTMENT POOL (LGIP): The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment.

MARKET VALUE: The price at which a security, if trading, could presumably be purchased or sold.

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase - reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default of the seller-borrower.

MATURITY: The date upon which the principal or stated value of an investment becomes due and payable.

MONEY MARKET: The market in which short-term debt instruments (bills, commercial paper, banker's acceptances, etc.) are issued and traded.

OPEN MARKET OPERATIONS: Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

PORTFOLIO: Collection of securities held by an investor.

PRIMARY DEALER: A group of government securities dealers that submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC)-registered securities broker-dealers, banks, and a few unregulated firms.

PRUDENT PERSON RULE: An investment standard. In some states the law requires that a fiduciary, such as a trustee, may invest money only in a list of securities selected by the state - the so-called *legal list*. In other states the trustee may invest in a security if it is one which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

QUALIFIED PUBLIC DEPOSITORIES: A financial institution which does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability and which as been approved by the Public Deposit Protection Commission to hold public deposits.

RATE OF RETURN: The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond or the current income return.

REPURCHASE AGREEMENT (RP or REPO): A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security “buyer” in effect lends the “seller” money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money that is, increasing bank reserves.

SAFEKEEPING: A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank’s vaults for protection.

SEC RULE 15C3-1: See uniform net capital rule.

SECONDARY MARKET: A market made for the purchase and sale of outstanding issues following the initial distribution.

SECURITIES & EXCHANGE COMMISSION: Agency created by Congress to protect investors in securities transactions by administering securities legislation.

TREASURY BILLS: A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months, or one year.

TREASURY BOND: Long-term U.S. Treasury securities having initial maturities of more than ten years.

TREASURY NOTES: Intermediate term coupon bearing U.S. Treasury securities having initial maturities of from one to ten years.

UNIFORM NET CAPITAL RULE: Securities and Exchange Commission requirement that member firms as well as non-member broker dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called *net capital rule* and *net capital ratio*. Indebtedness covers all money owed to a firm including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. *Liquid capital* includes cash and assets easily converted into cash.

YIELD: The rate of annual income return on an investment, expressed as a percentage. (a) *Income Yield* is obtained by dividing the current dollar income by the current market price for the security. (b) *Net Yield* or *Yield to Maturity* is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.