

# STATE OF WEST VIRGINIA

UPDATE OF THE  
PRELIMINARY PERFORMANCE  
REVIEW OF THE

## BOARD OF INVESTMENTS

**Major Issues of the Review Were Addressed Through  
Legislation**

**Four Recommendations are in Compliance or Planned  
Compliance**

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Performance Evaluation and Research Division  
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**CHARLESTON, WEST VIRGINIA 25305**

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PE 96-22-63

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November 1996

**WEST VIRGINIA LEGISLATURE**  
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Antonio E. Jones, Ph.D.  
Director

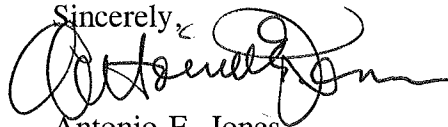
February 9, 1997

The Honorable Edwin J. Bowman  
State Senate  
Building 1, Room 231-WW  
1900 Kanawha Boulevard, East  
Charleston, West Virginia 25305

The Honorable Joe Martin  
House of Delegates  
Building 1, Room 213E  
1900 Kanawha Boulevard, East  
Charleston, West Virginia 25305

Gentlemen:

Pursuant to the West Virginia Sunset Law, we are transmitting an Update of the Board of Investments, which will be reported to the Joint Committee on Government Operations on Sunday, February 9, 1997. The issues covered herein are "Major Issues of the Review Were Addressed Through Legislation; and Four Recommendations are in Compliance or Planned Compliance."

Sincerely,  
  
Antonio E. Jones

AEJ/wsc

Enclosure



## Executive Summary

The West Virginia Board of Investments (BOI) is responsible for collecting, disbursing, managing and investing over \$1 billion dollars of public funds. In July 1995, the Performance Evaluation and Research Division (PERD) reported the results of a preliminary performance review. The review identified the following three issue areas:

- Issue 1. Excessive liquidity has resulted in the state receiving lower earnings over the past two years.
- Issue 2. The Board of Investments should use greater diligence in carrying out its investment responsibilities.
- Issue 3. Management fees do not reflect actual costs of managing funds.

This update report uses the following categories to measure agency compliance with recommendations of the original report.

Levels of Compliance
<u>In Compliance</u> - The Agency has corrected the problems identified in the final draft of the audit report.
<u>Partial Compliance</u> - The Agency has partially corrected the problems identified in the final draft of the audit report.
<u>Planned Compliance</u> - The Agency has not corrected the problem but has provided sufficient documentary evidence to find that the agency will do so in the future.
<u>In Dispute</u> - The Agency does not agree with either the problem identified or the proposed solution.
<u>Non-Compliance</u> - The Agency has not corrected the problem identified in the final draft of the audit report.
<u>Requires Legislation</u> - Statutory change is necessary to address the issue.

**Major issues of the review were addressed by passage of Enrolled HB 4866.** The BOI has complied or has planned compliance with four of the non-legislative recommendations and in partial compliance with two others. **Because of the importance of recommendation 1 which is still in the planning phase, the PERD recommends that the Board of Investments be given a one year continuance.**



**ISSUE AREA 1: Excessive Liquidity Has Resulted in the State Receiving Lower Earnings Over the Past Two Years**

**Recommendation 1**

*The BOI should work with the Legislative Auditor's Budget and Fiscal Affairs Division to develop annual projections of daily cash flow for the General Revenue Fund for the upcoming fiscal year. Thereafter, the BOI will develop these projections on its own. These 12 month projections should then be made available to advisors every month.*

**Level of Compliance: Planned Compliance**

The BOI is developing a method of annual projections of daily cash flow on its own, without the need for assistance from the Legislative Auditor's Budget and Fiscal Affairs Division. The following is an excerpt from the BOI's response to the recommendation, and outlines the plan.

*"Some of your recommendations concerned developing cash flow projections for the general revenue fund. After reviewing this recommendation, we determined that this accounted for only about one third of all funds that flow through the State's accounts each year. Therefore, we have taken two approaches to resolving this problem. The Board is currently a pilot agency for the WVFIMS ad hoc reporting tool (Crystal). In January Crystal will have a daily refresh providing our staff with more detailed information than has been available in the past. This will allow us to develop better cash flow projections for all funds.*

*The State Auditor's Office will be developing a program to provide our office and our disbursement bank with a daily file of checks issued. This will allow for daily reconciliation of our disbursement bank account. Therefore, we will know daily our future financial obligations to the bank since we only pay for our checks when they are presented for payment. In addition, Crystal will enable the Board to do daily projections for all invoices currently entered into WVFIMS. These two changes should provide our staff with better information concerning the liquidity needs of the state.*

*The daily revenue projections for the general revenue fund is only a small portion of the cash invested daily. Many other factors must be considered also: revenue projections for all special revenue funds, actual revenues for all funds, short and long term obligations, and daily 'float' to name a few. The B.O.I. was unable to make good use of daily revenue projections without these other pieces and indicated to the Budget Office not to provide us with these reports until this project could be fully addressed this spring."*

The documents supplied by the BOI indicate that the Crystal report software will be useful towards obtaining daily cash flow data for all funds from the FIMS system. The development of a system to accurately measure the daily cash obligations through the State Auditor's Office will also enhance the Board's information concerning the State's liquidity needs. The Board acknowledges the need for better cash flow data and it is moving in the right direction. However, much is still in the planning stages. **The PERD will update the Board's progress in this area.**

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### **Recommendation 2**

*The BOI should consider giving advisors more specific guidelines that reflect the BOI's objectives for the Consolidated Operating Fund overall. The BOI should provide advisors specific information on what levels of liquidity the BOI desires, how much of a liquidity cushion is needed, and specific ranges of average maturities within the pool's structure, instead of giving only the top maturity limit. The performance measures may need to be adjusted periodically if specific guidelines preclude the possibility of the advisor meeting the performance measures.*

Level of Compliance: **In Compliance**

Monthly reports on the Cash Liquidity Fund indicated that the average maturity was up sharply from approximately 39 days at the time of PERD's initial review to 73 days for calendar year 1996. The average repurchase agreement balance as a percent of the Cash Liquidity pool for 1996 was 40%. This is down from 56% at the time of PERD's initial review. The Board also encouraged one advisor to invest more in commercial paper because too much was being invested in overnight repurchase agreements resulting in a lower rate of return than another advisor. The advisor has since invested in commercial paper as of July 1996, resulting in a higher average maturity that compares well with the other advisor of the Cash Liquidity Fund. The Board does show evidence of taking a more active role in providing more specific guidelines to advisors concerning the Board's investment objectives.

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### **Recommendation 3**

*The BOI should consider rule changes that allow the Consolidated Operating Fund to be invested between the guidelines of a money market structure and a mutual fund structure.*

Level of Compliance: **Partial Compliance**

The Executive Director of the BOI responded to this reply as follows:

*"To the extent that the BOI can obtain better cash flows based on many of the above points (referring to response to **Recommendation 2**), we will be able to increase the amount of state dollars invested in longer term, higher yield investments. **However, a large portion of this fund is comprised of participants who do not want the risk of a mutual fund structure.**"*

Although the strict sense of the recommendation has not been complied with, the restructuring of the Enhanced Yield pool complies with some of the intent of the recommendation. The Enhanced Yield Pool was structured as a mutual fund during the audit period, however, it did not provide much of an enhanced yield. The basic contention of the audit was that most of the Consolidated Operating Fund was under a money market structure with no option for investing longer term except for the Enhanced Yield Pool, which was not a significant improvement over the money market structure. The restructure of the Enhanced Yield Pool doubled the average maturity restrictions. Agencies now have been offered the flexibility of investing shorter term or longer



term depending on each agency's liquidity needs (see Appendix A). A sizable amount of funds have been added to the Enhanced Yield Pool. **The PERD recommends that the BOI keep agencies informed of their investment options and strive for better cash flow management in order to avoid excessive liquidity.**

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#### **Recommendation 4**

*The BOI should consider restructuring the Enhanced Yield Pool to achieve a higher enhanced yield. The BOI should also consider increasing the amount within the Enhanced Yield Pool from the current level of \$25 million.*

Level of Compliance: **In Compliance**

According to BOI's new investment policy guidelines, the Enhanced Yield Pool was restructured as recommended to allow a longer average maturity (See Appendix B). The average maturity restriction was doubled from one to two years. Also, the amount in the Enhanced Yield Pool was increased above the \$25 million to \$190,133,231.55 as of January 9, 1997.

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#### **Recommendation 5**

*The Legislature should consider amending WVC §5-10D-4 to require the actuary for the pension funds to provide the BOI with monthly projections of withdrawals and contributions for the fiscal year for each pension plan. In addition, the amendment should include the requirement that the projections be updated each quarter or more frequently if necessary. The actuary currently projects annual contributions and benefit payments for the pension funds.*

Level of Compliance: **No Longer Applicable**

This recommendation no longer applies because of the creation of the West Virginia Trust Fund established by Enrolled HB 4132 in 1996. This legislation caused pension funds to be transferred away from the BOI and into this Trust Fund.

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#### **Recommendation 6**

*The Legislature should consider amending WVC §5a-2-11 to require the Department of Administration to provide the BOI with its monthly revenue projections. The Legislature should also consider requiring the Department of Administration to project daily revenue flows for the General Revenue Fund.*

Level of Compliance: **Partial Compliance**

This recommendation was resolved by the passage of Enrolled HB 4866 in 1996. This bill

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amended WVC §5A-2-11 as recommended. The Department of Administration is providing monthly revenue projections to the BOI. However, daily revenue projections for the General Revenue fund were not done because of the close proximity of the effective date of the bill to July, before which the estimates had to be performed, and the Board's response to the Department that it cannot make use of the information until a complete daily cash flow system can be developed. **The PERD will update the progress made on this recommendation.**

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**Issue Area 2: The BOI Should Use Greater Diligence in Carrying Out Its Investment Responsibilities**

**Recommendation 7**

*The Legislature should consider amending WVC 12-6-5(9) to require that the BOI use Delivery-versus-Payment or Tri-Party arrangements in conducting repurchase agreements.*

Level of Compliance: **In Compliance**

This recommendation was resolved by the passage of Enrolled HB 4866 in 1996. The Board is now required by law to take physical possession of securities involved in its repurchase agreements. The Board amended its Investment Policy and Guidelines to reflect the changes in the law (see Appendix B).

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**ISSUE AREA 3: Management Fees Do Not Reflect Actual Costs of Managing Funds**

**Recommendation 8**

*The Legislature should consider amending §12-6-6a to allow the BOI to calculate the management service fee using an actual cost allocation formula. An alternative amendment would be to have the fee based on net assets. Net earnings are volatile and do not reflect the actual cost of investing the funds. The service fee should pay for the BOI's actual expenses, not its appropriated budget.*

Level of Compliance: **No Longer Applicable**

This recommendation is no longer applicable because of passage of Enrolled HB 4132. This bill transferred pension funds from the BOI into the newly created West Virginia Trust Fund. Therefore, the BOI is no longer managing pension funds.

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**Recommendation 9**

*If the Legislature decides to amend §12-6-6a to base the service fee on net assets, PERD recommends that the language allow the BOI to transfer to the Consolidated Pension Fund and local governments, any excess service fees charged, rather than have any overcharge diverted to the General Revenue Fund.*

Level of Compliance: **No Longer Applicable**

This recommendation is also no longer applicable because of passage of Enrolled HB 4132. This bill transferred pension funds from the BOI into the newly created West Virginia Trust Fund.



## **Appendix A**

### **Letter to Agencies Announcing Investment Guidelines and Options**



Board Members:  
Honorable W. Gaston Caperton, III  
Governor/Chairman  
Mr. John T. Poffenbarger  
Executive Secretary/Member  
Honorable Larrie Bailey  
Treasurer/Member  
Honorable Glen B. Gainer, III  
Auditor/Member  
Mr. Carlyle Farnsworth  
Member  
Ms. Marie Prezioso  
Member  
Mr. William T. Tracy  
Member



## State of West Virginia Board of Investments

Suite E-122  
State Capitol  
Charleston, WV 25305  
Telephone: (304) 558-5000  
Telefax: (304) 344-9284

Staff:  
H. Craig Slaughter  
Executive Director  
D. Jerry Simpson  
Chief Operating Officer  
Matthew E. Jones  
Chief Financial Officer  
Diana Will  
Chief Investment Officer  
Mark E. N. Asaad  
General Counsel

To: All State Agencies  
From: Jerry Simpson  
Executive Director  
Date: June 25, 1996  
Subject: Investment Policy and Guidelines

A handwritten signature in cursive script, appearing to read "Jerry Simpson".

During the 1996 session of the West Virginia Legislature, HB-4132 was passed and signed into law by Governor Gaston Caperton. As a result of this legislation, the West Virginia Trust Fund will come into existence on July 1, 1996. On that day, the Trust Fund will assume responsibility for investing the assets that are currently part of the Consolidated Pension Fund. Some members of the current Board of Investments' (Board) staff will be employed by the Trust Fund. Craig Slaughter has become Executive Director of the Trust Fund and I have replaced him as Executive Director of the Board. Diana Will has also transferred to the Trust Fund as their Chief Investment Officer. Kara Brown, currently the internal auditor for the Board, will become responsible for the activities of the investment and investment accounting division.

The above referenced legislation also made other changes that will directly effect the operation of the Board. Many of the investment restrictions were changed or eliminated in WV Code section 12-6-10. Also, section 12-6-12 changed the standard of care to the prudent person rule. These changes provide the Board flexibility, but also more responsibility to define its investment objectives, investment policy and the method by which it will achieve its goals. As a result of these changes, the "Legislative Rules for the Administration of the Consolidated Fund" are no longer in compliance with the various code provisions. These rules are being withdrawn and are no longer in effective. Therefore, the Board at their June 13, 1996 board meeting approved the attached "Investment Policy and Guidelines" and they are effective immediately.

I want to call your attention to various attachments to the "Investment Policy and Guidelines".

Attachment 1 - West Virginia State Code - This is a reprint of the West Virginia Code after passage of HB-4132.

Attachment 2 - Authorization Forms - These are certification forms that authorize various members of the Board's staff to perform the responsibilities assigned to them. These forms will be updated as the need arises.

Attachment 3 - Objectives - These are the various objectives for the Consolidated Fund and the various investment funds contained therein.

Attachment 4 - Maturity and Security Guidelines - For each investment fund there are specific maturity and security guidelines.

Attachment 5 - Performance Benchmarks - These are the performance benchmarks that each advisor will be measured against. The Board expects each advisor to exceed the benchmark for the investment fund for which he is advising the Board.

Attachment 6 - Significant Accounting Policies - These are the significant accounting policies that the Board will follow.

Attachment 7 - Participant Accounting Forms - These are various forms used by various State agencies and political subdivisions of the State to notify the Board to invest or withdraw invested funds.

Attachment 8 - West Virginia Governmental Ethics Act - This is a code of conduct for public servants. It applies to both Board members and the Board's staff.

The Board has received inquiries from various State agencies about investing some of their funds in a longer term pool. With the new "Investment Policy and Guidelines", the Board is now able to offer this option. The Enhanced Yield Pool is a portfolio that allows for additional yield by allowing the advisor to invest out to five years while keeping an average portfolio life of two years. However, the Enhanced Yield Pool only allows withdrawal and deposits on the first working day of the month and is marked to market as of the close of the month. This pool does pose some principal risk if the money is withdrawn during a down month and should only be used for money that can be invested for a substantial period of time. If you have an interest in investing in this pool or would like more information, please contact me or a member of our investment staff.



Please review the "Investment Policy and Guidelines" and if you have any questions, please call me or any member of our staff. It is the belief of the Board that these changes will provide the Board with expanded flexibility in meeting the investment objectives they have established.



## **Appendix B**

### **Excerpts From BOI Investment Policy and Guidelines**



## West Virginia State Board of Investments Investment Policy and Guidelines

### I. Authority

The West Virginia State Board of Investments was created by statute §12-6 *see attachment #1* and has the responsibility of investing all state funds and accounting for those investments. When requested the board also has the ability to invest and account for moneys of any West Virginia political subdivision. The board delegates the day to day responsibilities to its chief executive officer, who has further delegated certain investing responsibilities to the staff. *See attachment #2*

### II. Investment Policy and Standard of Care

#### A. Investment Policy

"The board shall establish policy guidelines for the investment of moneys on deposit in each of the funds managed by the board based on the needs of the participants in the various funds. The board shall review the investments at least every three months and may require the purchase or sale of any investments. In order to effectuate its investment policies, the board shall require from each participant a schedule, on an annual or more frequent basis, of anticipated deposits and withdrawals." West Virginia State Code §12-6-12

#### B. Standard of Care

"Any investments made under this article shall be made with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. Fiduciaries shall diversify plan investments so as to minimize the risk of large losses, unless under the circumstance it is clearly prudent not to do so." West Virginia State Code §12-6-12

### III. Objectives

"This article, which may be cited as the 'Investment Management Law' is enacted to modernize the procedures for the investment of funds of the state and its political subdivisions for the purpose of increasing the investment return of such funds." West Virginia State Code §12-6-1

The boards broadly defined objective is to manage the state's moneys in an efficient and economical manner. The board, realizing the majority of the funds are for operating expenses of the state, has designed investment strategies that address the short term liquid needs of the various pools and participants, limiting risk but still allowing for a higher total rate of return. The board's long term goal is to realize a real rate of return, calculated after inflation, for all pools and participants.

The board has structured several pooled portfolios with differing characteristics and priority of objectives. *See attachment #3*

### IV. Investment Guidelines and Restrictions

Statutory imposed guidelines and restrictions that apply across all portfolios are as follows:

1. At no time shall more than seventy-five percent of the consolidated fund be invested in any bond, note, debenture, commercial paper or other indebtedness of any private corporation or association. Any such security, at the time of its acquisition, shall be investment grade paper;
2. At no time shall more than five percent of the consolidated fund be invested in securities issued by a single private corporation or association: and
3. At no time shall less than fifteen percent of the consolidated fund be invested in any direct obligation of or the obligation guaranteed as to the payment of both principal and interest by the United States of America." West Virginia State Code §12-6-10

The board has imposed further over all restrictions on the purchase of futures and option transactions and will only allow reverse repurchase agreements with the full consent of the board.

Due to the participants having differing liquidity, risk, and return requirements the board has formed multiple pools to meet the participant needs. The board has delineated guidelines and restrictions for each individual pool. *See attachment #4*

#### V. Performance Benchmarks

The board evaluates the performance of each pooled portfolio against at least two benchmarks. The evaluation looks at the performance of the advisor and the effect the portfolio's restriction on maturity and security type has on the return. *See attachment #5*

#### VI. Safekeeping and Custody

##### A. Custody

".. (a) The governor shall be the chairman and the custodian of all funds, securities and assets held by the board.." West Virginia State Code §12-6-4

##### B. Delivery vs Payment

All security transactions of the board will be handled on a delivery vs payment basis and held by the boards designee.

##### C. Collateral

"In financial transactions whereby the securities are purchased by the board under an agreement providing for the resale of such securities to the original seller at a stated price, the board shall take physical possession of the securities, directly, by its custodian bank or through a neutral third party: Provided, That an agreement with a neutral third party may not waive liability for the handling of the securities: Provided, however, That when the board is unable to take possession, directly, by its custodian bank or through a mutual third party, the board may leave securities in a segregated account with the original seller, provided the amount of the securities with any one seller may not exceed one hundred fifty million dollars." West Virginia State Code §12-6-9g

#### VII. Advisor Relations

The board hires outside managers to act as advisors to the board. The staff has been advised to execute all trade recommendations by the advisor unless the trade clearly violates the state code or board policy. Without the advice of an advisor the staff may only execute an overnight transaction. The advisor is required, by contract, to call the staff at least weekly, send confirmation on all trade recommendations, prepare a monthly report, and be available to meet with the board on a quarterly basis.

#### VIII. Trading Rules

##### A. Authorized Broker Dealers

The staff may only trade with financial dealers authorized by the Board. The list of authorized dealers must be reviewed by the Board on a yearly basis. The staff must keep on file the audited financials of all approved dealers. The senior investment officer may further limit the approved list in both the size of trades and number of times called..

##### B. Trading

All fixed income trades shall be done in competition using at least three dealers, unless for some reason the security can only be offered by one dealer. At least one West Virginia based firm shall be called on each trade, when possible. All effort shall be made to evenly spread over time the benefit of ties on bids and offers among the brokers. Any trade realizing a loss of over half the portfolio's normal

earnings must be approved by the senior investment officer. All trades must be executed on a ~~wire~~ phone. All trades must be checked by at least one other person on the Board's staff.

#### IX. Accounting Procedures

The board maintains separate accounting systems to account for the investment portfolios (assets) and the participants who have units of ownership with in the investment portfolio (liabilities). The two systems are reconciled on an ongoing basis to ensure the proper matching of ownership to the related investment portfolios.

Portfolio Accounting - The board follows Generally Accepted Accounting Practices (GAAP) for all accounting functions. This includes the accounting and auditing practices as prescribed by the AICPA's Audit Guide for Investment Companies and all related pronouncements of the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). See *attachment #6*

Participant Accounting - The Board operates two distinct types of investment portfolios. The first type is a commingled investment portfolio whose assets are owned by multiple participants. The Board follows standard industry practices relating to unit accounting of participant ownership in these portfolios. For portfolios operating as a money market mutual fund, the units are valued based on a dollar per share and all participant contribution and withdrawals are transacted at this level. Interest income is accrued and declared as a dividend to participants on a daily basis and is posted to each participants account on the last day of the month. Portfolios having a fluctuating per unit price are accounted for following policies for variable net asset value mutual funds. This policy mandates that a new price per share be determined for as often as participants are allowed to contribute or withdrawal from the fund. The monthly investment income of the fund is declared as a dividend on the last day of the month and is reinvested in the fund on the following day based on the previous day's closing price. Capital gains distributions are done on an annual basis. The second portfolio type is the participant directed accounts. In this type of portfolio, the participant is the sole owner of the assets and directs the Board's staff as to the investment restrictions. GAAP is used to account for the assets. Certain types of participant receive tax statements on an annual basis. This information is then reported to the IRS on a calendar year basis.

#### X. Participant Transactions

Participants requesting accounts in the consolidated pool must provide the board with all pertinent information on the account which includes the participant name, mailing address, phone number, tax ID number, authorized personnel, and legal authority to invest. Cash contributions may be made by wire, ACH, or check. The participant will start earning dividends on the day the board can invest the funds. Participants are required to keep a monthly average minimum balance of 100.00 in the account unless exempted by the board for legal purposes. There are no minimum withdrawal amounts but cash withdrawals less than 100.00 will be processed by ACH which has a one day delay. Deadlines for same day fund transactions are listed on the forms. See *attachment #7*

#### XI. Audit and Control

"The board shall cause to be conducted an annual external audit by a nationally recognized accounting firm in conjunction with the annual federal audit of all investment transaction of the board." West Virginia State Code §12-6-15

The board shall hire an internal auditor who shall report directly to the audit committee. The auditor shall present annually an audit plan to the audit committee. The auditor shall audit all investment transactions, perform an annual audit of all imprest funds, and work with the external auditor hired by the state for the annual audit.

The internal auditor shall also be responsible for a periodic review of internal controls designed to ensure that the assets of the state are protected from loss, theft, or misuse. This includes a review of the differing money and security transaction types, the preparation of those transactions, the accounting for those transactions, and the separation of those duties.

Personnel involved with monetary or security transactions or the accounting of those transactions are required to take at least five continuous working days off a year.

## XII. Reports

"The board shall prepare annually, or more frequently if deemed necessary by the board, a report of its operations and the performance of the various funds administered by it. A copy thereof shall be furnished to the chief financial officer of each participant, the president of the senate, speaker of the house, legislative auditor, and upon the request to any legislative committee, any banking institution or state or federal savings and loan association in this state, and any member of the new media, and such report shall be kept available for inspection by any citizen of this state." West Virginia State Code §12-6-14

".. the board shall on a monthly basis provide to each state agency and any other entity investing moneys in the consolidated fund an itemized statement of the agency's or the entity's account in the consolidated fund. The statement shall include the beginning balance, contributions, withdrawals, income distributed, change in value and ending balance." West Virginia State Code §12-6-15

The board shall also prepare a quarterly report on the investment performance of each pooled account.

## XIII. Continuing Education

The board requires those individuals having financial responsibility for state funds attend at least one continuing education program a year.

## XIV. Conflict of Interest and Ethics

### A. Conflict of Interest

Board members and staff shall refrain from personal business activities that could conflict with the proper execution, operations and management of the funds under the control of the Board, or that could impair their ability to make impartial decisions. Board members and staff shall disclose any material interests in business with which the board conducts business. They shall further disclose any personal financial positions that could be related to the performance of the investment portfolio. Board members and staff shall also refrain from undertaking personal investment transactions with the same individual with whom the business is conducted on behalf of the Board.

A conflict of interest exists for a board member or employee whenever they have a personal or private, commercial or business relationship that could reasonably be expected to diminish their independence of judgment in the performance of their duties to the Board of Investments. For example, a persons independence of judgment is diminished when the person is in a position to take action or not to take action with respect to the Board of Investment or its business and such act or failure to act is, may be, or reasonably appear to be influenced by considerations of personal gain or benefit rather than motivated by the interests of the Board of Investments.

### B. Ethics

The Board and staff shall maintain knowledge of and shall comply with all applicable laws, rules, and regulations of any governmental agency or regulatory agency governing the management of state and local government funds and shall not knowingly participate in, or assist, any acts in violation of the those law, rule or regulation. The Board and key personal are required to file yearly with the West Virginia Ethics Commission as governed by the West Virginia Government Ethics Act (West Virginia Code § 6B-1-1 et. seq. and § 6B-2-1 et. seq. ). *See attachment #8*

## XV. Policy Review and Amendments

This policy shall be reviewed on an annual basis. Any changes must be approved by the chief executive officer and the internal auditor.



## Enhanced Yield Fund

### Permissible Investments

1. Any direct obligation, or obligation guaranteed as to payment of both principal and interest by the United States of America.
2. Any evidence of indebtedness issued by any US Government Agency guaranteed as to the payment of both principal and interest, directly or indirectly, by the United States of America.
3. Any bond, note, debenture, commercial paper or other evidence of indebtedness of any private corporation or association.
4. Asset-Backed Securities which are backed by mortgages, letter of credit, credit card receivables, or auto receivables.

### Maturity Restrictions\*

1. Final Maturity shall not exceed five years (1827 days)
2. Weighted Average Maturity may not exceed two years (731 days).
3. Floating rate notes may use the coupon reset date for the calculation of final and average maturity as long as the note does not have a cap or floor restriction on the coupon reset. If there are any restrictions, or if there is any question as to whether the market value of the security will not reset at par at the next coupon reset date, then final maturity must be used.
4. The portfolio shall at all times maintain sufficient liquidity to meet unexpected monthly withdrawals.

### Restrictions, Credit Ratings, and Concentration Guidelines\*

1. The portfolio must at all times have at least fifteen percent (15%) of the portfolio in Treasury securities.
2. No more than seventy-five percent (75%) of the portfolio may be invested in corporate paper (this includes all asset classes except government securities and repurchase agreements). No more than five percent (5%) of the portfolio may be invested in any one corporate name across all asset types.
3. All securities must be rated by two nationally recognized statistical rating organizations as investment grade. Only five percent (5%) of the portfolio may be invested in the lowest investment grade category (BBB) paper and each issuer may only comprise three percent (3%) of the total portfolio. Only twenty five percent (25%) of the portfolio may be invested in paper rated in the two lowest categories (A or lower).
4. Yankee Bonds must be rated at least A. The corporate name exposure may not exceed three percent (3%) of the total portfolio. Total portfolio holdings may not exceed twenty percent (20%).
5. All commercial paper must be rated A2/P1 or A1/P2 or better. No more than twenty percent (20%) of the portfolio may be in commercial paper. Only five percent (5%) of the portfolio may be in split rated paper and each issuer may only comprise one percent (1%) of the total portfolio. The portfolio may own no more than ten percent (10%) of the outstanding short term corporate debt of any one company.
6. Floating Rate notes shall be based off a money market index and shall not have a final maturity longer than five years. No more than twenty five percent (25%) of the portfolio may be invested in floating rate notes.
7. Only twenty percent (20%) of the portfolio may be in asset backed securities.
8. The portfolio may not be leveraged in any manner.
9. The portfolio may not buy inverse floaters.
10. Any asset class other than government securities and repurchase agreements that is not listed specifically above is limited to five percent (5%) of the portfolio.

\*All maturity and concentration limits are calculated from trade date. All asset limitations and the weighted average maturity are calculated using amortized cost. The board will make the decision to hold or sell any security which no longer meets the rating or concentration restrictions. The board prefers to use Moody and S&P as it's rating services.

## Cash Liquidity Pool

### Permissible Investments

1. Any direct obligation, or obligation guaranteed as to payment of both principal and interest by the United States of America.
2. Any evidence of indebtedness issued by any US Government Agency guaranteed as to the payment of both principal and interest, directly or indirectly, by the United States of America.
3. Any bond, note, debenture, commercial paper or other evidence of indebtedness of any private corporation or association.
4. Asset-Backed Securities which are backed by mortgages, letter of credit, credit card receivables, or auto receivables.
5. Certificate of Deposits.

### Maturity Restrictions\*

1. Final Maturity shall not exceed 397 days
2. Weighted Average Maturity may not exceed 90 days.
3. Floating rate notes may use the coupon reset date for the calculation of final and average maturity as long as the note does not have a cap or floor restriction on the coupon reset. If there are any restrictions, or if there is any question as to whether the market value of the security will not reset at par at the next coupon reset date, then final maturity must be used.
4. The portfolio shall at all times maintain sufficient liquidity to meet daily withdrawals.

### Restrictions, Credit Ratings, and Concentration Guidelines\*

1. The portfolio must at all times have at least fifteen percent (15%) of the portfolio in Treasury securities.
2. No more than seventy-five percent (75%) of the portfolio may be invested in corporate paper (this includes all asset classes except government securities and repurchase agreements). No more than five percent (5%) of the portfolio may be invested in any one corporate name across all asset types.
3. All securities must be rated by two nationally recognized statistical rating organizations as investment grade. Only five percent (5%) of the portfolio may be invested in the lowest investment grade category (BBB) paper and each issuer may only comprise one percent (1%) of the total portfolio. Only twenty five percent (25%) of the portfolio may be invested in paper rated in the two lowest categories (A or lower).
4. Yankee Bonds must be rated at least A. The corporate name exposure may not exceed three percent (3%) of the total portfolio. Total portfolio holdings may not exceed ten percent (10%).
5. All commercial paper must be rated A2/P1 or A1/P2 or above. No more than thirty percent (30%) of the portfolio may be in commercial paper. Only five percent (5%) of the portfolio may be in split rated paper and each issuer may only comprise one percent (1%) of the total portfolio. The portfolio may own no more than ten percent (10%) of the outstanding short term corporate debt of any one company.
6. Floating Rate notes shall be based off a money market index and shall not have a final maturity longer than five years. No more than twenty five percent (25%) of the portfolio may be invested in floating rate notes.
7. Only fifteen percent (15%) of the portfolio may be in asset backed securities. Asset backed commercial paper falls into this category.
8. Only twenty percent (20%) of the portfolio may be in certificates of deposit. The issuing bank's senior debt must be rated A or better.
9. The portfolio may not be leveraged in any manner.
10. The portfolio may not buy inverse floaters.
11. Any asset class other than government securities and repurchase agreements that is not listed specifically above is limited to five percent (5%) of the portfolio.

\*All maturity and concentration limits are calculated from trade date. All asset limitations and the weighted average maturity are calculated using amortized cost. The board will make the decision to hold or sell any security which no longer meets the rating or concentration restrictions. The board prefers to use Moody and S&P as it's rating services.

## Investment Objectives

The Board of Investments has decided that the most economical and efficient manner of investing the state and local government monies is in pooled portfolios with the economy of scale being the main reason. The pooled concept also allows for a slightly longer maturity due to the differing schedule of investments and withdrawals by participants.

The Board has determined for that for the breadth of monies invested by the Board, the four following factors are the most important type of risk.

- A Market and Volatility Risk - The risk of losses due to market swings and the frequency of those market swings. The Board manages this risk by limiting final maturity and asset classes.
- B Default Risk - The risk that a bond may not make timely interest or principal payments. The Board manages this risk by limiting securities to investment grade bonds and then further limiting the amount allowed for each corporate name.
- C Liquidity Risk - The ease and timeliness to which a security can be bought or sold. The Code mandates that the Consolidated Fund must have a percentage of the portfolio in Treasuries.
- D Reinvestment Risk - The risk of reinvestment of cashflows due to maturities and coupon payments. The Board manages this risk by maturity diversification and cash management.

The priority of each risk is different depending on the individual portfolio. Listed below are the portfolios managed by the Board and objectives of each.

The **Cash Liquidity Fund** is a portfolio created to invest the majority of the state and local government operating funds. The objective of the portfolio is to maintain sufficient liquidity to meet the daily disbursements of the state and participants while earning a small return above inflation. The portfolio is structured as a money market fund with the goal being a stable dollar value a share thus preserving capital. The risk factor on this portfolio is low and managed through numerous maturity restrictions, diversification guidelines, and credit limits. The participants are paid on a income basis which includes only realized gains and losses. This compels the Board to calculate the return off current income as well as total return.

The **Government Money Market Fund** is a portfolio created to invest restricted monies of the state in treasury securities. The objective of the portfolio is to maintain sufficient liquidity to meet the daily disbursements of the participants while earning a small return above inflation. The portfolio is structured as a money market fund with the goal being a stable dollar value a share thus preserving capital. The risk factor on this portfolio is low and managed through maturity restrictions. The default risk has been practically eliminated through the purchase of securities which the market consider default free. The participants are paid on a income basis which includes only realized gains and losses. This compels the Board to calculate the return off current income as well as total return.

The **Enhanced Yield Fund** was created to invest monies of the state which have a perceived longer term investment horizon. The goal of the portfolio is to earn incremental returns over the cash liquidity fund with an objective of capital growth rather than current income. The portfolio is structured as a mutual fund and is restricted to monthly withdrawals and deposits. The risk factor on this portfolio is slightly higher than the cash liquidity and managed through maturity restrictions, diversification guidelines, and credit limits.

The **Municipal Bond's Fund** was created to invest monies managed by the Municipal Bond Commission. The portfolio is governed by both the Board's and the Municipal Bond's code. The objective of the portfolio is to maintain sufficient liquidity to meet the monthly debt service payments while earning a return above inflation. The risk to the portfolio is managed maturity limits and cashflow forecasting.

The **Single Agency Funds** are portfolios set up for individual agency who for some reason can not commingle their monies. The Board does not set objectives up for these pools as the purchase of securities is made by the agency. The Board acts only as an advisor and custodian on these accounts.