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## **INVESTMENT POLICY**

### **MARYLAND STATE TREASURER'S OFFICE**

#### **I. POLICY**

It is the policy of the Maryland State Treasurer's Office (hereinafter referred to as "the STO") to invest public funds in a manner which will provide the highest investment return with the maximum security while meeting the anticipated daily cash flow requirements of the State. The STO will not borrow funds for the express purpose of investing those funds. The policy will conform to all State laws governing the investment of public funds.

#### **II. SCOPE**

This investment policy applies to unexpended or surplus money over which the Treasurer has custody as authorized by State Finance and Procurement Article §6-222.

- A. General Fund.
- B. Funds invested on behalf of other State agencies and other outside parties.
- C. Bond Sale Proceeds.

#### **III. PRUDENCE**

Investment 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.

The “prudent person” standard shall be applied in the context of managing an overall portfolio. Investment officers shall act in accordance with written procedures and the investment policy while exercising due diligence. Deviations from expectations are to be reported in a timely fashion and appropriate action should be taken to control adverse developments.

The Treasurer shall have the discretion to direct or make investments that conform with the overall STO Investment Policy and strategy within the prudent person policy standard of high quality, safety and a return for the portfolio that may enhance a policy directive or imperative of the State.

#### **IV. OBJECTIVE**

The primary objectives of the State’s investment activities, in order of priority shall be:

- A. Safety: Safety of principal is the foremost objective of the investment program. To attain this objective, diversification, collateralization, third party safekeeping and delivery versus payment (DVP) will be required.
- B. Liquidity: The State’s investment portfolio will remain sufficiently liquid to enable the State to meet all operating requirements which might be reasonably anticipated plus a reasonable amount for unanticipated needs.
- C. Return of Investment: The State’s investment portfolio shall be designed with the objective of attaining a market rate of return at least equal to the three-month U.S. Treasury bill yield, with due regard for minimizing risk while maximizing return and considering the cash flow characteristics of the portfolio.

#### **V. DELEGATION OF AUTHORITY**

Authority over the State’s investment program is delegated to the State Treasurer in the Annotated Code of Maryland – State Finance & Procurement - Section §6-222. Management responsibility for the investments is delegated to the Chief Investment Officer, Director of Treasury Management, Chief Deputy Treasurer, Deputy Treasurer who shall establish written procedures and authorized signatories (see authorized signatories) for the operation of the investment program consistent with this investment policy.

Procedures should include reference to cash flow requirements, competitive bidding procedures, broker/dealer relationships, safekeeping, Master Repurchase Agreements, security, collateral, and mark-to-market requirements as well as oversight for the Local Government Investment Pool.

The procedures shall also 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 Director of Treasury Management. The Director shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

## **VI. 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 of the investment program, or which could impair their ability to make impartial investment decisions. Investment officials shall disclose to the State Ethics Commission any material financial interest in financial institutions that conduct business within the jurisdiction, and they shall further disclose any large personal financial/ investment positions that could be related to the performance of the State's portfolio. Employees and officers shall subordinate their personal investment transactions to those of the State, particularly regarding the time of purchases and sales.

## **VII. AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS**

The Treasurer shall maintain a list of financial institutions authorized to provide investment services. The following is a breakdown of the types of institutions used by the State along with the type of investment transactions handled by those institutions.

### **A. Primary Government Dealers:**

The Federal Reserve Bank of New York designates primary government dealers in government securities. The State can purchase all authorized and suitable investments as listed in Section VIII of this policy, except for the Maryland Local Government Investment Pool, from primary dealers.

### **B. Other Security Dealers:**

The State may conduct transactions including both purchases and sales across all the allowed securities Non-Primary Dealers and from dealer banks that market these securities. All dealers not identified as a Primary Dealer by the Federal Reserve will need to apply as a counterparty, have acceptable capital, market access and appropriate approvals from the STO prior to conducting transactions. The Treasurer's policy is to encourage and make sure that local, regional and minority firms have an opportunity to participate in transactions conducted for the State's investable funds.

All dealers must agree to the State's policy of delivery versus payment as described in Section X of this policy. Firms must have adequate capital to fulfill their commitments under adverse market conditions. All no-primary firms must provide copies of their audited financial statements and Financial and Operational Combined Uniform Single Report (FOCUS Report) for review and approval before initiating any transactions and annually thereafter.

## **VIII. PERMISSIBLE INVESTMENTS**

The State Treasurer is authorized by statute to invest in the following types of securities subject to the restrictions in the statute, State Finance and Procurement Article §6-222. Last updated July 2021.

1. **US Treasuries** - Obligations for which the United States has pledged its faith and credit for the payment of the principal and interest.
2. **Government Sponsored Enterprises (GSE's)** - Obligations that a Federal Agency or Federal instrumentality has issued in accordance with an act of Congress.
3. **Supranationals** - Obligations issued and unconditionally guaranteed by a Supranational issuer denominated in United States dollars and eligible to be sold in the United States; Supra National include but are not limited to World Bank (WB), International Finance Corporation IFC), Inter-American Development Bank IADB), European Investment Bank (EIB), European Union (EU), International Bank for Reconstruction & Development (IBRD); African Development Bank (AfDB)
4. **Repurchase Agreements** collateralized in an amount not less than 102% of the principal amount by an obligation of the United States, its agencies, or instrumentalities, provided that the collateral is held by a custodian other than the seller designated by the buyer.

5. **Banker's Acceptances** guaranteed by a financial institution with a short-term debt rating at the highest letter or numerical rating by at least one nationally recognized statistical rating organization as designated by either the United States Securities and Exchange Commission or the Treasurer.
6. **Certificate of Deposits, Yankee Certificate of Deposits -Time Deposits** are denominated in U.S. dollars and issued or endorsed by either (i) a bank or a savings and loan association organized and supervised under Federal or any State laws and regulated by the Federal Reserve or a trust company which is a member of the Federal Reserve system or (ii) a bank organized and supervised under the laws of G10 Nations that use Common Financial Law. Institutional Certificate of Deposits (CD) and Yankee Certificate of Deposits (YCD) are Timed Deposits and should be negotiable and tradeable in the secondary markets. These are securities versus cash deposited into a financial institution. Non-tradeable CD's/YCD's are subject to collateralization per State Finance and Procurement §6-201.
7. **Commercial Paper** – Short term promissory notes issue by companies, financial institutions to meet short term funding obligations. Commercial Paper can be unsecured based solely on the credit of the issuing institution as well as backed by Asset Backs, Letters of Credit, other acceptable collateral (US Treasuries)
8. **Corporate Bonds**, Notes, or other obligations of investment grade securities
9. **Municipal Bonds, Notes** or other obligations issued by or on the behalf of this or any other state or any agency, department, county, municipal or public corporation, special district, authority, or political subdivision thereof, or in any fund or trust that invests only in securities of the type described in this item.
10. **Money Market Mutual Funds** that:
  - i. Are registered with the Securities and Exchange Commission under the Investment Company Act of 1940, 15 U.S.C. – 80a-1 et seq., as amended.
  - ii. Are operated in accordance with Rule 2A-7 of the Investment Company Act of 1940, 17 C.F.R. – 270.2A-7 as amended, and
  - iii. Have received the highest possible rating from at least one nationally recognized statistical rating organization as designated by the United States Securities and Exchange Commission; and
11. **Maryland Local Government Investment Pool** - Any investment portfolio created under the Maryland Local Government Investment Pool (MLGIP) defined under – 17-301 through 17-309 of the Local Government Article of the Code that is administered by the Office of the State Treasurer.
12. **Foreign Sovereign Debt** denominated in US Dollars of securities issued by subject to the laws of subject to the laws of the G10 nations. All securities must meet duration and deliverability status listed in Section IX and X.

13. **Mortgage Related Securities** - Government National Mortgage Association, Federal National Mortgage Association or Federal Home Loan Mortgage Corporation mortgage-backed securities issued in the form of passthroughs; provided that, such securities have (i) been issued and guaranteed by the US Government or Government Agency and (ii) an average life not to exceed two years from the date of settlement (unless such securities are subject to periodic reset of coupon or interest rate, in which case the average life may not exceed three years from the date of settlement).
14. **Asset Backed Securities** - Securities collateralized by pools of auto loan receivables, credit card receivables, and equipment loans; provided that such securities have (i) the highest credit rating from at least two NRSROs and (ii) an average life not to exceed two years from the date of settlement (unless such securities are subject to periodic reset of coupon or interest rate, in which case the average life may not exceed three years from the date of settlement).

## IX. Credit Rating

The State Treasurer will in all cases place emphasis on securities of high credit quality and marketability. Holdings are subject to the following credit quality at the time of purchase.

All securities will be reviewed using the numeric and letter grading of the Securities and Exchange Commission's (SEC), Nationally Recognized Statistical Rating Organizations (NRSRO's)

1. **Negotiable certificates of deposit, Yankee Certificates of Deposit, Time Deposits, negotiable bank notes and bankers' acceptances. Negotiable certificates of deposit, negotiable bank notes and bankers' acceptances of domestic banks and domestic offices of foreign banks** must have at least two of the following ratings: at least A-1/P1/F-1 by Standard & Poor's, Moody's, or Fitch respectively for maturities of one year or less as defined by SEC Rule 2a-7. The securities must have at least two of the following ratings: at least AA/Aa/AA by Standard & Poor's, Moody's, or Fitch respectively for maturities exceeding one year and not exceeding five years.
2. **Commercial paper** must have at least two of the following ratings: at least A-1/P-1/F-1 by Standard & Poor's, Moody's, or Fitch respectively.
3. **Corporate notes and bonds.** Corporate securities must have at least two of the following ratings: at least A-/A3/A- by Standard & Poor's, Moody's, or Fitch respectively.
4. **Municipal securities.** Taxable and tax-exempt municipal securities must be rated at least A3/A- or equivalent, by two nationally recognized rating agencies, one of which must be either Moody's Investors Service or Standard & Poor's
5. **Asset-backed securities and mortgage related securities.** Asset-backed securities, mortgage-backed securities including all private label mortgage related-securities, Commercial Mortgage-Backed Securities (CMBS) and Collateralized Mortgage Obligations (CMOs) must be rated at least AAA or Aaa by two rating agencies. One

of the two qualifying ratings shall be at least AAA/Aaa/AAA by Standard & Poor's, Moody's, or Fitch respectively.

6. **U.S. Dollar denominated obligations of sovereign governments.** Sovereign debt must have received at least two of the following ratings: at least AA/Aa/AAA by Standard & Poor's, Moody's, or Fitch respectively. Foreign Sovereign Debt must be subject to the laws of the G10 that includes but not limited to Japan, Canada, United Kingdom, the Netherlands, Germany, France, Switzerland, Australia, New Zealand, Sweden, or Norway with ratings commensurate with the top Sovereign Debt Ratings of the comparable countries that all maintain AA or higher rating. The US currently maintains a double AA+ rating.
7. **Catastrophic Events** - The Treasurer reserves the right to deal, augment, defer changes to the portfolio based on short term catastrophic events that could dramatically shift credit ratings on any of the assets in the portfolio on a short-term basis.

## **X. COLLATERALIZATION**

Collateralization will be required on Repurchase Agreements. To anticipate market changes and provide a level of security for all funds, the collateralization level will be at least 102% of the market value of the principal and accrued interest for Repurchase Agreements. State law limits acceptable collateral to an obligation of U.S. Government to include Treasuries, Agencies and instrumentalities as defined in as full faith and credit by law of the Federal Government and the State Finance and Procurement Article §6-222. An independent third party with whom the State has a current custodial agreement will always hold the collateral. Clearly marked evidence of ownership must be supplied to the State and retained.

The right of collateral substitution is granted, and the seller will pay all associated costs. Collateral will be priced on a mark-to-market basis when the investment is initiated and daily for the term of the investment.

## **XI. SAFE KEEPING AND CUSTODY**

All security transactions, including collateral for repurchase agreements, entered by the State shall be conducted on a delivery versus payment (DVP) basis. A third-party custodian designated by the Treasurer and evidenced by safe keeping receipts will hold securities.

## **XII. DIVERSIFICATION**

The state will diversify its investments by security type and counterparty institutions with all subject to the appropriate credit criteria in section IX in the following manner as measured at the time of purchase up to the following maximum amounts. Note these are maximum potential allocations as a % of the overall portfolio and is not an indication of %'s that will be allocated to the various sectors:

Diversification by Security Type	Maximum % of Portfolio
1. US Treasury Obligations	100%
2. US Agencies & Instrumentalities	100% (33% any sole issuer)
3. Supra Sovereign Issuers	40%
4. Repurchase Agreements	75% (Term limited to 30% max per sole counterparty)
5. Bankers Acceptances, Certificate of Deposits, Yankee CD's, Time Deposits	20%
6. Commercial Paper	35% (Limit 10% any single name)
7. Corporate Bonds, Notes (Dom. / \$ G10)	25% (Limit 10% any single name)
8. Municipal Securities	25%
9. Money Market Government Mutual Funds	50%
10. MD Local Government Investment Pool	100%*
• Maximum \$ amount for the General Fund Allocation is \$2.5 Billion	
11. Foreign Sovereign Debt	20%
12. Mortgage-Backed Securities	25%
13. Asset Backed Securities	25%
Diversification by Institution	
14. Term Repurchase Agreements	30%

### **XIII. MAXIMUM MATURITIES**

To the extent possible, the State will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow or highlighted in specified asset classes above the State will not directly invest in securities maturing more than five years from the date of purchase. Given that the priority for the portfolio is liquidity and safety to ensure ample funds are available to cover all potential outflows the overall portfolio should have a minimum of 30% of the total available with under 1 year maturity and 50% under 2 ½ years of maturity on a rolling basis.



#### **XIV. INTERNAL CONTROL**

The Treasurer's Office and the Investment Division are audited annually by an independent auditor and approximately every 3 years by the Office of Legislative Audits. These reviews assess internal controls by examining compliance with written policies and procedures.

#### **XV. PERFORMANCE STANDARDS**

The investment portfolio is designed to obtain an average market rate of return during budgetary and economic cycles, considering the State's investment risk constraints and cash flow needs. The State's investment strategy is passive, and the benchmark yield comparison shall be the yield on the three-month U.S. Treasury Bill.

#### **XVI. REPORTING**

Section §6-222 of the State Finance and Procurement Article requires the Treasurer to file a report with the General Assembly on General Fund investments and all other investments by January 3<sup>rd</sup> of each year. At a minimum, the report shall specify the

- inventory of investments as of June 30.
- net income earned for the fiscal year.
- percentage share of each type of security in the portfolio.
- any sale of investments prior to maturity.

Inventory of the fund will be posted on the STO's website monthly to include all assets managed in summary, graphic and detailed form.

#### **XVII. INVESTMENT POLICY ADOPTION**

The Treasurer shall approve the State's investment policy. The policy shall be reviewed on an annual basis.

**DATE:** June 01, 2023

*Dereck E. Davis, State Treasurer*

*Investment Policy Update June 1, 2023*