

# UNDERSTANDING INVESTMENT BASICS

Presented To:  
**OHIO COUNTY TREASURERS ASSOCIATION**

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# “UNDERSTANDING INVESTMENT BASICS”

## Today's Presentation

- Purpose
- Objectives

## Topics

- O.R.C. 135.35
- Due Diligence
- CDs
- Bonds
- Strategy

# INVESTMENT POLICY

## County Inactive Moneys - O.R.C. 135.35

- Permissible Activities/Investments
  - Deposits
  - Securities
- Investment Policy
  - Investment Policy
  - Due Diligence

<http://codes.ohio.gov/orc/135.35>

## **Maturity of investments must within five years from settlement date unless paired**

- “unless the investment is matched to a specific obligation or debt of the county or to a specific obligation or debt of a political subdivision of this state, and the investment is specifically approved by the investment advisory committee.” ORC 135.35

# PERMISSIBLE INVESTMENTS FOR OHIO COUNTIES (O.R.C. 135.35)

**U.S. Treasury Bonds 100% of portfolio**

**U.S. Agency Bonds 100% of portfolio**

- FNMA, FHLMC, FHLB, TVA, and FFCB

**Bonds of the State of Ohio or its political sub-divisions**

**FDIC Insured CDs from Ohio banks 135.32**

- Bank must have a physical branch location in Ohio

**Up to 25% of the Counties portfolio in the following**

- (a) Commercial paper notes issued by an entity that is defined in division (D) of section 1705.01 of the Revised Code and that has assets exceeding five hundred million dollars, to which notes all of the following apply:
  - (i) The notes are rated at the time of purchase in the highest classification established by at least two nationally recognized standard rating services.
  - (ii) The aggregate value of the notes does not exceed ten per cent of the aggregate value of the outstanding commercial paper of the issuing corporation.
  - (iii) The notes mature not later than two hundred seventy days after purchase.
- (b) Bankers acceptances of banks that are insured by the federal deposit insurance corporation and to which both of the following apply:
  - (i) The obligations are eligible for purchase by the federal reserve system.
  - (ii) The obligations mature not later than one hundred eighty days after purchase.

# Permissible Investments for Ohio Counties (O.R.C. 135.35)

## Corporate Notes - up to 15% of the portfolio

- Corporation incorporated in the U.S.A.
- Operates within the 50 U.S. States
  - The notes are rates in the top two categories by two nationally recognized rating agencies
  - Must mature within 24 months from purchase

## No-Load Money Market Funds with the highest rating by one rating agency

## Star Ohio/Star Ohio Plus

## C.D.A.R.S.

## No derivative based investments

## Foreign Debt

- Full faith and credit of the issuing country
- No history of default
- Top three ratings categories by two ratings agencies

## Repurchase Agreements

- See appendix #1

# DUE DILIGENCE

## Involved Parties

- Access to marketplace
  - Bank
  - Broker
  - Money Manager
  - State through Star Ohio
- Safekeeping Agent
  - Independent Third Party?
- Banks (Physical, Collateralized, and Custodial CDs)



# CERTIFICATE OF DEPOSIT

**FDIC Insurance**

**Involved Parties**

**Types**

- Negotiable
- Physical
- Collateralized
- Custodial

**Position**

- Time Deposit
- CD (“Auto” Roll)

**Proof of Ownership**

**Who is the insured bank (or CU)?**

**Where is the CD held?**

**What is the coupon?**

Fixed / Callable

**Are there any fees?**

Wire Fees / Brokerage Fees /  
Withdrawal Penalties

# DEPOSIT INSURANCE

## INSURANCE

**Basic Coverage: \$250,000 per:**

- Permanent as of July 2010
- Public Unit
- Political Subdivision

**In-State Institution Only**

**Star Ohio and CDARS exemption**

**Temporary Provision**

- Unlimited deposit insurance in “noninterest-bearing transaction accounts” expired 12/31/12

## BANK FAILURES / ACQUISITIONS

**“Voluntary” Acquisition**

**“Forced” Acquisition**

**Acquisition of Deposits**

**Direct Payout**

**FDIC Insurance Coverage  
(post merger) were  
Grandfathered**



# PHYSICAL CD

Federally insured deposits in which funds are sent directly to the depository institution. Physicals can be either CDs or Time Deposits and are kept in a depository and the purchaser receives a safe keeping receipt.

- FDIC insured up to applicable limits
- Liquidity: Early withdrawal penalties are substantial
- No gains
- Available through brokers, listing services, and through direct purchase
- Settles directly or through a Fedwire®

Who is the insured bank/CU?

What is the coupon rate?

What is my yield?

Any fees (Wire in, wire out, broker)?

Interest payment frequency?

What are the early withdrawal penalties?

How are funds returned?

# NEGOTIABLE CD

Federally insured deposits held in safekeeping with the Depository Trust Company (DTC). Similar to a bond, DTC issues are held in street name and are registered and tracked by the CUSIP system. All negotiable CDs are time deposits that are held by a safekeeping agent.

- Safety
  - FDIC insured up to applicable limits 250K
  - New Issues: Only well-capitalized banks\*
- Liquidity
  - Secondary Market
  - Mark-to-Market
- Available through Broker/Dealer, Bank Bank, Primary and Secondary
- Settles in a security account either with or DVP

Who is the insured bank /CU?

What is the CUSIP?

Interest payment frequency?

What is the price / yield?

When does it settle?

\*adequately capitalized banks can apply for a waiver by the FDIC

# CUSTODIAL CD (CDARS)

Typically time deposits which are purchased by a custodian and participated out to eligible investors

- FDIC insured up to applicable limits
- Early withdrawal penalty “substantial”
- No gains
- Limited only through agent of custodian
- Custodial agent
- Custodial statement

Who is the insured bank/CU?

What is the coupon rate?

What is my yield?

Any fees (Wire in, wire out, broker)?

Interest payment frequency?

What are the early withdrawal penalties?

How are funds returned?

# COLLATERALIZED CD

Typically physical CDs which depository institutions back the uninsured amount by other approved collateral. They are kept in a depository and the customer received a safe keeping receipt.

- FDIC insured up to applicable limits
- Uninsured portion backed by collateral
- Available through some brokers and through direct purchase at banks
- Settles directly or through a Fedwire®

# OHIO STATE INVESTMENT FUNDS

## Star Ohio

- Convenience Fund
  - Monthly Rate
  - Short Duration
  - Liquidity

## Star Ohio Plus

- Longer Term
- Rates Fluctuate

- <http://www.ohiotreasurer.gov/starohio>

- <http://www.ohiotreasurer.gov/starplus.aspx>

# U.S. GOVERNMENT AGENCY

GSEs are privately-owned corporations created by Congress to provide funding to their respective agencies. Currently estimated to be over \$3 Trillion in outstanding debt.

- Implied full faith and credit of the U.S. Government
- AA+ (Downgraded 2012) – All US Debt
- Issued by: FHLB / Freddie Mac / FNMA / FFCB / TVA
- Multiple call and coupon structures and durations from one month to 30 years
- Strong liquidity
- Available through brokers as New and Secondary Issues

Price

Callable (Frequency)

Yields

YTM

YTC

YTW

Settlement

# DIVERSIFICATION

## Investments

- CDs – Physical, Negotiable, CDARS, Custodial
- Agencies – Issuers and call structures
- Treasuries

## Providers

- Local banks and pools
- Broker-Dealers
- Money Managers

# PRE-PURCHASE DUE DILIGENCE

Permissible?

Access prior to maturity/call date?

New issue or Secondary?

Priced at par, discount or premium?

- YTW?
- YTM?

Investment's purpose?

Participants involved?

Costs that will impact yield?



# WHAT TO EXPECT AFTER YOU INVEST

Confirmation from 3rd party

Regular statement

- Paper or online or both
- At least quarterly

Market values online or on statement

Is the current market price below par, at par, or above par?

# STRATEGIES – COST OF WAITING

## 6-month security/investment

- Rate 0.25%
- Interest on \$1,000,000 x 0.25% = \$1,250.00 over 6 months

## 12-month security/investment

- Rate 0.35%
- Interest on \$1,000,000 x 0.35% = \$3,500.00

## 36-month security/investment

- Rate 0.95%
- Interest on \$1,000,000 x 0.95% = \$9,500.00 per year and \$28,500.00 over 36 months

# COST OF WAITING

## (36-MONTH INVESTMENT COMPARISON)

To break even after the 6-month investment matures, a 30-month investment will have to yield 1.09%

To break even after the 12-month investment matures, a 24-month investment will have to yield 1.25%

(It works with a 2-year investment at 0.70% as well. The third year, you would need a investment rate of 1.45% to break even with the 36-month investment initially.)

# COST OF WAITING - \$1,000,000

Money Market ~ at .05%, earnings = \$500.00/year or \$1.37/day

6-month investment ~ at .20%, earnings = \$2,000/year or  
\$5.48/day

12-month investment ~ at .40%, earnings = 4,000/year or  
\$10.95/day

How can you possibly make up the difference?

# STRATEGIES – LADDER

Typically 3 to 5 years

- Invest similar amounts across all terms
- Can be monthly or quarterly
- Might have a weighting based on predictable needs
- Eliminates market guesswork
- Generates predictable cash flow and portfolio yields at or above market

# STRATEGIES - BARBELL

Concentration on short term, available funds for current expenses, projects, and extra for the “unpredictable”

- STAR, money markets, sweep accounts, CP, BAs and CDs six months and shorter

The rest is invested in longer term maturities to generate yield and income

- Treasuries, Callable and Non-Callable Agencies, Municipalities, Corporates, and CDs
- Step ups

# APPENDIX #1

(D) The investing authority may also enter into a written repurchase agreement with any eligible institution mentioned in section 135.32 of the Revised Code or any eligible securities dealer pursuant to division (J) of this section, under the terms of which agreement the investing authority purchases and the eligible institution or dealer agrees unconditionally to repurchase any of the securities listed in divisions (B)(1) to (5), except letters of credit described in division (B)(2), of section 135.18 of the Revised Code. The market value of securities subject to an overnight written repurchase agreement must exceed the principal value of the overnight written repurchase agreement by at least two per cent. A written repurchase agreement must exceed the principal value of the overnight written repurchase agreement, by at least two per cent. A written repurchase agreement shall not exceed thirty days, and the market value of securities subject to a written repurchase agreement must exceed the principal value of the written repurchase agreement by at least two per cent and be marked to market daily. All securities purchased pursuant to this division shall be delivered into the custody of the investing authority or the qualified custodian of the investing authority or an agent designated by the investing authority. A written repurchase agreement with an eligible securities dealer shall be transacted on a delivery versus payment basis. The agreement shall contain the requirement that for each transaction pursuant to the agreement the participating institution shall provide all of the following information:

(1) The par value of the securities;

(2) The type, rate, and maturity date of the securities;

(3) A numerical identifier generally accepted in the securities industry that designates the securities.

No investing authority shall enter into a written repurchase agreement under the terms of which the investing authority agrees to sell securities owned by the county to a purchaser and agrees with that purchaser to unconditionally repurchase those securities.