

### 3.05 Investments

**3.05.01 Investment Standard.** The State Bar shall invest its funds in a manner in which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but to, in order of priority, preserve and safeguard the principal amount invested, provide liquidity to meet operating cash flow needs, and earn the highest yield possible considering the required safeguards.

**3.05.02 Investment Manager.** The Board, through its Audit and Finance Committee, may contract with an investment manager for professional investment services. Pursuant to the Public Funds Investment Act, §2256.003, a contract for professional investment services may not be for a term in excess of 2 years. A renewal or extension of the contract for professional investment services must be made by order, ordinance or resolution of the Board. The selection of the investment manager shall be the subject of a request for proposal procedure every five years. At any time the Board may request that a request for proposal be issued for investment management services.

**3.05.03 Application.** This investment policy applies to the financial assets of all State Bar funds and funds of Bar-related groups, to include those of the General Fund, Client Security Fund, all special revenue funds, enterprise funds, sections and divisions.

**3.05.04 Committee Review.** The Board's Audit and Finance Committee shall review the investment policy annually. Recommendations for modifications to the policy may be made by the Executive Director, the Board's Audit and Finance Committee, an Officer, or Board Member. This policy and any amendments to it must be authorized by Board action.

**3.05.05 Approved Investments.** The Board authorizes the Executive Director and/or investment manager (as contracted by the Audit and Finance Committee of the Board) to invest funds of the State Bar that are available for investment in any account, time or demand, and the following "fixed income" securities:

**(A) U. S. Treasury Securities.** U.S. Treasury securities are direct obligations of the United States Government. U.S. Government obligations are the highest quality and are the most liquid and marketable of investment securities. Investments in this category will include Treasury bills, Treasury notes, and Treasury bonds. U.S. Treasury bills are sold on a discount basis and have initial maturities of three months, six months, and one year. U.S. Treasury notes and Treasury bonds are coupon-bearing instruments with initial maturities from two to ten years for notes and ten to thirty years for bonds.

The maximum average maturity of the U. S. Treasury securities portfolio will not exceed five years.

**(B) Federal Agencies.** After U. S. Treasury securities, Federal agency securities (government sponsored enterprises) are generally regarded as the next highest quality investment suitable for the portfolio. Agencies generally offer a rate of return higher than direct U.S. Treasury securities. The spread difference in yield will be affected by the general level of interest rates, markets, and economic conditions at any given time. Consideration should be given to the spread relationship existing when portfolio investment decisions are made.

Securities included in this category are debt issuance by the Federal Farm Credit System (Farm Credits), Federal Home Loan Bank (FHLB), the Federal National Mortgage Association (FNMA), the Student Loan Marketing Association (SLMA), the Federal Home Loan Mortgage Corporation (FHLMC or "Freddie Mac"), the Government National Mortgage Association (GNMA or "Ginnie Mae"), and Small Business Administration (SBA).

The maximum average maturity of the U.S. agency section of the portfolio will not exceed five years.

**(C) Collateralized Deposits:** The State Bar will monitor all deposits that are held with the State Bar's custodian bank(s) to ensure that all deposits are fully insured or collateralized, as required by the Public Funds Collateral Act, §2257, of the Texas Government Code ("PFCA"). Pursuant to §2257, the State Bar will require the custodian bank(s) to pledge securities that are authorized under §2256.009 of the Public Funds Investment Act ("PFIA"). In accord with the PFCA, deposits that exceed the FDIC insurance limit will be collateralized by the deposit institution holding such deposits. Since, generally, all deposits are fully invested in securities, the collateralization of such invested deposits will not be necessary when such deposits are fully and continuously invested in

securities. If there are any funds awaiting investment, such funds should be fully collateralized at all times pursuant to the PFCA. The custodian bank(s) will be notified regarding the collateralization and investment policy requirements. The State Bar's expectation of total and full compliance with the PFIA and the PFCA is of paramount importance and such expectation will be clearly communicated to custodian bank(s). Financial institutions serving as depositories will be required to sign an Agreement with the State Bar and its safekeeping agent for the collateral, perfecting the State Bar's rights to the collateral in case of default, bankruptcy or closure.

**(D) Money Market Investments.** Money market investments are short-term investments that normally have a maturity of one year or less and are used for liquidity and income maximization purposes. Acceptable investments that may appear in this category are:

**(1) Domestic CDs (time deposits).** Certificates of deposit issued by depository institutions, wherever located that are:

**(a)** guaranteed or insured by the Federal Deposit Insurance Corporation, or its successor, or the National Credit Union Share Insurance Fund, or its successor; or

**(b)** secured by obligations that are described in Subsections 3.05.05(A) and (B) above, with a market value of not less than the principal amount of the certificates plus accrued interest. Pledged collateral securities must be held in a third-party custody account authorized by the State Bar.

**(2) Banker's Acceptances.** Bankers acceptances must have a stated maturity of 270 days or less from the date of its issuance that will be liquidated in full at its maturity, is eligible for collateral for borrowing from a Federal Reserve Bank and is accepted by a bank organized and existing under the laws of the United States and if the short-term obligations of the bank, or of the bank holding company of which the bank is the largest subsidiary, are rated not less than A-1 or P-1 or an equivalent rating by at least one nationally recognized credit rating agency.

**(3) Repurchase Agreements (Repos)** Repurchase Agreements must be fully collateralized and have a defined termination date. They must be placed with a primary government securities dealer, as defined by the Federal Reserve, or a bank doing business in Texas. Repurchase agreements must be collateralized by U.S. Treasury or Agency securities and collateral must be held in a third-party custody account authorized by the State Bar.

**(4) Money Market Investments.** A no load money market mutual fund is an approved investment under this policy if the investment meets one of the following two criteria:

**(a)** It is registered with and regulated by the Securities and Exchange Commission; it provides the State Bar with a prospectus and other information required by the Securities Exchange Act of 1934 (15 U.S.C. Section 78a, et seq.) or the Investment Company Act of 1940 (15 U.S.C. Section 80a-1, et seq.); and it complies with federal Securities and Exchange Commission Rules 2a-7 (17 C.F.R. Section 270.2a-7) promulgated under the Investment Company Act of 1940 (15 U.S.C. Section 80a-1, et seq.); or

**(b)** It is registered with the Securities and Exchange Commission; it has an average weighted maturity of less than two years; and it either:

**(i)** has a duration of one year or more and is invested exclusively in obligations approved by this policy; or

**(ii)** has a duration of less than one year and the investment portfolio is limited to investment grade securities excluding asset-backed securities.

**(5) Commercial Paper** Commercial Paper must have a stated maturity of 270 days or less from the date of issuance and must have a credit rating of not less than A-1, P-1 or the equivalent by at least two nationally recognized credit rating agencies.

**(E) Investment Concentrations.** The State Bar intends to follow the guidelines described below on investment concentrations within the investment portfolio (IP):

**(1) U.S. Treasury and Federal Agency Securities.** Up to 100% of the IP.

- (2) *Mortgage-Backed Securities*. Guaranteed by U.S. Government Sponsored Agencies up to 30% of the IP.
- (3) *Certificates of Deposit*. Up to 30% of the IP, but no more than 5% with any single bank.
- (4) *Banker's Acceptance*. Up to 15% of the IP, but no more than 5% with any single issuer.
- (5) *Repurchase Agreements*. Up to 30% of the IP, but no more than 10% with any single issuer.
- (6) *Money Market Mutual Funds*. Up to 100% of the IP.
- (7) *Commercial Paper*. Up to 30% of the IP, but no more than 5% with any single issuer.

Investments in collateralized mortgage obligations are strictly prohibited. These securities are also disallowed for collateral positions. The State Bar will not be required to liquidate investments that were authorized investments at the time of purchase.

The investment manager will monitor the various investment alternatives and select the securities that best meet the State Bar's overall, long-term goals. Concentrations of each type of security will not exceed the maximum limits outlined above, but specific concentrations of investment types will be dictated by the following considerations: quality, liquidity, relative sector yield spreads vs. historical spreads, maturity concentrations, time horizon.

Investments will only be made with those firms and institutions which have been approved by the Board of Directors. The investment manager will be responsible for analyzing and evaluating the broker/dealer firms and for reporting their list of qualified firms to the Committee for approval.

It is the policy of the State Bar to require competitive bidding for all individual security purchases except for those transactions with money market mutual funds which are deemed to be made at prevailing market rates and for government securities purchased at issued through a primary dealer at auction price. At least three bidders must be contacted in all transactions involving individual securities. Competitive bidding for security swaps is also required. Bids may be solicited in any manner provided by law and shall be documented.

**(F) Collateralization.** In addition to the collateral requirements for State Bar deposits, as discussed in Subsection 3.05.05(C), Certificates of Deposit (CD) and Repurchase Agreements (Repo) must also be collateralized in accordance with State Law. Eligible securities for collateralization of CDs and Repo shall be U.S. Treasury and Agency securities. For CDs, the market value of the pledged collateral securities must at all times be equal to or greater than the par value of the CD plus accrued interest, less the amount insured by the FDIC. For Repos, the market value of the pledged collateral securities shall be a percentage of the par value of the agreement plus accrued interest and shall be maintained at the following levels:

Collateral Maturity	U.S. Treasury Securities	U.S Government Securities
1 year or less	101%	101%
1 to 5 years	102%	102%
Over 5 years	103%	104%

**(G) Reporting.** The Investment Manager for the State Bar of Texas will provide a detailed accounting and appraisal report detailing, among other things, investments' descriptions, coupons, maturities, CUSIP identification numbers, purchase cost, amortized cost and market values on a monthly basis. Market valuations are based on current information and appraisals taken from third party market makers, whom the Manager believes provides reliable information and valuations.

The investment manager will prepare a report for the State Bar quarterly. The report will include a listing of securities, a current appraisal reflecting gains or losses, a list of securities purchased or sold during the period, and an analysis of the IP's performance for the period and since inception.

Representatives of the investment manager will meet with the State Bar semi-annually or as needed to discuss

investment strategy, actions taken, and the general economic environment within which the State Bar's investments will be managed.

Not less than quarterly the Investment Officers will submit to the Audit and Finance Committee and the Board a written report of the status of the current investment portfolio. The report must meet the requirements of Chapter 2256 of the Government Code (Public Funds Investment Act) and:

- (1) describe in detail the investment position of the State Bar on the date of the report;
- (2) be prepared jointly by all investment officers of the State Bar;
- (3) contain a summary statement, prepared in compliance with generally accepted accounting principles of each pooled fund group that states the beginning market value for the reporting period, additions and changes to the market value during the period, ending market value for the period and fully accrued interest for the reporting period.
- (4) state the book value and market value of each separately invested asset at the beginning and end of the reporting period by the type of asset and fund type invested;
- (5) state the maturity date of each separately invested asset that has a maturity date;
- (6) state the account or fund or pooled fund group from which each individual investment was acquired; and
- (7) state the compliance of the investment portfolio as it relates to the investment strategy and relevant provisions of this Policy and the Public Funds Investment Act.

An independent auditor shall formally review the quarterly reports prepared under this Subsection at least annually, and that auditor shall report the results of the review to the Board.

**(H) *Exceptions to Policy.*** Exceptions to the investment policy must have prior approval by a majority of the Board at a called, regularly scheduled, or telephone call meeting. Changes to the investment policy will be made, as needed, after action by the Board.

**(I) *Methods to Monitor Market Price.*** The investment manager shall provide market valuations of all State Bar investments using Bloomberg, or another third-party market valuation service.

The Executive Director or investment manager shall report to the Audit and Finance Committee at least quarterly on the market prices and the performance of the investments made by, or on behalf of, the State Bar.

**(J) *Monitoring Rating Changes.*** Pursuant to the PFIA, Section 2256.021, an investment that requires a minimum rating under State law does not qualify as an authorized investment during the period the investment does not have the minimum rating. The State Bar's Investment Manager will be responsible for monitoring ratings of all State Bar investments placed with the Investment Manager. The Investment Manager will maintain a process whereby the State Bar's Investment Officer will be promptly notified in the event of a downgrade of an investment below State law or State Bar's Investment Policy limits. The Investment Manager will provide a recommendation on how best to resolve the issue with the intent to take all prudent measures that are consistent with State Bar's Investment Policy to liquidate an investment that does not have the minimum rating.

### **3.05.06 *Delegation of Authority***

**(A) *Investment Officer.*** The State Bar shall designate the Finance Division Director as investment officer responsible for the investment of its funds, under the direction and authority of the Executive Director. This includes investments for the State Bar General Fund, Client Security Fund and the special revenue funds.

**(B) *Procedures.*** The State Bar's investment officer shall establish written procedures for the operation of the investment program consistent with this Investment Policy. 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 written procedures. Authority granted to a

person to invest the State Bar's funds is effective until rescinded or until termination of the person's employment by the State Bar. The investment officers shall be responsible for all transactions undertaken and shall establish a system of controls, to be reviewed by the State Bar's independent auditor, to regulate the activities of subordinate officials. The investment officers shall possess sufficient working knowledge of economics and securities markets, as well as the supervisory experience and judgment necessary to carry out the responsibilities outlined in this Policy.

**(C) Ethics and Conflicts of Interest.**

**(1)** Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions.

**(2)** Officers and employees involved in the investment process shall sign annual statements agreeing to abide by this section of the Investment Policy and affirming no known conflicts of interest.

**(3)** Officers and employees involved in the investment process must file a disclosure with the State Bar of Texas if:

**(a)** the Officer or employee has a personal business relationship with a business organization offering to engage in an investment transaction with the State Bar of Texas; or

**(b)** the Officer or employee is related within the second degree by affinity or consanguinity, as determined under Chapter 573 of the Texas Government Code, to an individual seeking to transact investment business with the State Bar of Texas

**(4)** An officer or employee involved in the investment process has a personal business relationship with a business organization if:

**(a)** the Officer or employee owns 10 percent or more of the voting stock of shares of the business organization or owns \$5,000 or more of the fair market value of the business organization;

**(b)** funds received by the officer or employee from the business organization exceed 10 percent of his/her gross income for the previous year; or

**(c)** the Officer or employee has acquired from the business organization during the previous year investments with a book value of \$2,500 or more for his/her personal account.

**(D) Training.** The Investment Officers and the persons authorized to execute investment transactions shall attend at least one investment training session within 6 months after taking office or assuming duties and receive not less than 10 hours of instruction relating to investment responsibilities every two years. The training provider must be an independent source approved the Board of Directors.

**3.05.07 Investment Objectives.** All funds shall be managed and invested with three primary objectives, listed in order of their priority – safety and liquidity, diversification and yield:

**(A) Safety of Principal.** Safety of principal is the foremost objective of the State Bar. Investments of the State Bar shall be undertaken in a manner that seeks to insure the preservation of capital in the overall portfolio. To obtain this goal, diversification is required in the portfolio's composition. The suitability of each investment decision will be made on the basis of these objectives.

**(B) Diversification.** Diversification of the portfolio will include diversification by maturity and market sector when appropriate and will include the use of a number of broker/dealers for diversification and market coverage. Competitive bidding will be used on each sale and purchase.

**(C) Yield.** The State Bar's investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the State Bar's risk constraints and the cash flow requirements of the portfolio. "Market rate of return" may be defined as the average yield of the current

three-month U.S. Treasury Bill or such other index that most closely matches the average maturity of the portfolio.

The individual strategy of each of the State Bar's three types of funds are as follows. To the extent possible, the State Bar will match its investments with anticipated cash flow requirements while minimizing market risk. The State Bar will not directly invest funds needed for current operations in securities maturing more than twenty-four months or posing potential credit risk, such as corporate bonds. Reserve funds may be invested in securities authorized by this policy with maturities of such investments to coincide as nearly as practical with the expected use of the funds.

The State Bar's General Fund's and Client Security Fund's assets are not necessary for day-to-day operations. The General Fund and Client Security Fund portfolios may be invested in longer-term securities, but each portfolio will not exceed a five-year average maturity. While investments may be repositioned when prudent, the primary objective of both funds is capital preservation and stable, real (after inflation) increased income. The operation's funds are invested in very short-term investments while the General Fund and Client Security Fund are invested in medium term maturities providing good diversification and income stability over longer time periods for the State Bar's total investments.

The State Bar also directs the investment manager to not record any material book value losses on any security transaction without prior consent of the Executive Director and the Audit and Finance Committee.

**3.05.08 Accounting Department.** Interest income received by the State Bar from investments will be received by the Accounting Department for deposit to the State Bar's General Fund, Client Security Fund or special revenue funds accounts. The Accounting Department will be responsible for maintaining all investment and interest payment records for the purpose of reconciliation and preparation of financial statements.

**3.05.09 Settlement Method.** Settlement of all transactions made by or on behalf of the State Bar, except for investment in pool funds and mutual funds, shall be on a delivery versus pay method rather than delivery versus confirmation. The State Bar will contract with a bank or banks for the safekeeping of securities either owned by the State Bar as a part of its investment portfolio or held as collateral to secure certificates of deposits or repurchase agreements. These accounts shall be in the name of the State Bar.

**3.05.10 Public Funds Investment Act.** All actions taken in all of the State Bar's investment portfolios will be in compliance with the Public Funds Investment Act.

**3.05.11 Annual Compliance Audit.** In conjunction with the annual financial audit, a compliance audit shall be performed which includes an audit of management controls on investments and adherence to the State Bar's established policy.

**3.05.12 Certification.** A copy of this Investment Policy shall be provided to the investment manager under contract and the firm shall agree under the terms of the contract to transact all investment business according to the requirements and limitations of the Investment Policy.