POLICY: POL 003 – Cash and Investment Policy
OWNER: Chief Financial Officer

GOVERNING SOURCE REFERENCE(S):

(1) Wis. Stat. § 238.04

(2) WEDC (Wisconsin Economic Development Corporation) Audit and Budget Committee Charter

(3) WEDC Bylaws

DEFINITIONS:

(1) **Certificate of Deposit Account Registry Service (CDARS):** A U.S. for-profit service that breaks up large deposits (from individuals, companies, nonprofits, public funds, etc.) and places them across a network of more than 3,000 banks and savings associations around the U.S. This allows depositors to deal with a single bank that participates in CDARS but avoid having funds above the Federal Deposit Insurance Corporation (FDIC) deposit insurance limits in any one bank.

(2) **Collateral:** Securities, evidence of deposit or other property that a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposit of public monies.

(3) **Collateralized Mortgage Obligation (CMO):** A type of complex debt security that repackages and directs the payments of principal and interest from a collateral pool to different types and maturities of securities, thereby meeting investor needs.

(4) **Commercial Paper:** An unsecured promissory note issued primarily by corporations for a specific amount and maturing on a specific day. The maximum maturity for commercial paper is 270 days.

(5) **Convertible Debt Feature:** A provision in a loan, which has been originated by WEDC, where WEDC has the option to convert all or a portion of the loan balance into a specified number of shares of common stock in the company. Used as a financing tool by WEDC as part of the Technology Development Loan (TDL) program.

(6) **Delivery Versus Payment:** There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

(7) **Derivative:** A security whose price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the underlying asset. The most

common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes. Most derivatives are characterized by high leverage.

(8) **Equity Investment:** For the purposes of this policy, an equity investment is narrowly defined as an equity position held by WEDC, resulting from investment in a company or companies under WEDC's program guidelines, as defined above.

(9) **Federal Deposit Insurance Corporation (FDIC):** federal agency that insures bank deposits, currently up to $250,000 per deposit.

(10) **Federal Home Loan Banks (FHLB):** Government sponsored wholesale banks (currently 12 regional banks) which lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit institutions and insurance companies. The mission of FHLB is to liquefy the housing related assets of its members who must purchase stock in their district Bank.

(11) **Floater:** A bond or other type of debt whose coupon rate changes with market conditions (short-term interest rates).

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

(13) **Market Value:** The price at which a security is trading and could presumably be purchased or sold.

(14) **Rate of Return:** The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond the current income return.

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

(16) **Safekeeping:** A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

(17) **Strip:** For bonds, the process of removing coupons from a bond and then selling the separate parts as a zero-coupon bond and interest paying coupons. In options, a strategy created by being long in one call and two put options, all with the exact same strike price.

(18) **U.S. Instrumentalities:** An organization that serves a public purpose and is closely tied to federal government but is not a government agency. For purposes of this policy, U.S. Instrumentalities shall consist of Fannie Mae, Freddie Mac, Sallie Mae, Ginnie Mae, Federal Home Loan Bank and Federal Farm Credit.

POLICY DETAILS:

Overview of WEDC Fund Balance

This policy establishes the framework for WEDC's daily banking and investment activities. The guidelines are intended to be applied at the time of purchase and broad enough to allow staff to function properly within the parameters of responsibility and authority, yet specific enough to adequately safeguard WEDC's accounts.

Authorized Deposits and Investments

(1) **WEDC is authorized to deposit and/or invest cash in any of the following:**

- (a) Checking and saving accounts;
- (b) Local government investment pools either state-administered or developed through joint powers statutes and other intergovernmental agreement legislation, such as the Local Government Investment Pool and Wisconsin Investment Series Cooperative;
- (c) Non-negotiable certificates of deposits, certificates of deposit purchased through the Certificate of Deposit Account Registry Service (CDARS), other fully insured certificate of deposit programs such as the money market account offered by American Deposit Management Company or purchased via a registered investment advisor/company;
- (d) Negotiable certificate of deposits if the issuer/financial institution has a rating in the second highest tier, (e.g. AA, Aa) or higher by a nationally recognized rating agency;
- (e) Stable Net Asset Value Money market mutual funds regulated by Rule 2a-7 of the Securities and Exchange Commission and whose portfolios consist of only dollar-denominated securities;
- (f) Bonds and securities issued by the federal government, its agencies, or commissions, boards or other instrumentalities of the federal government;
- (g) Bonds of the State of Wisconsin;
- (h) Commercial paper if rated in the highest tier (e.g. A-1, P-1, or F1) by a nationally recognized rating agency; and
- (i) Overnight repurchase agreements with a public depository as defined in statute 34.01 (5), provided that the agreement is secured by bonds or securities issued or guaranteed as to principal and interest by the federal government and held by a third-party custodian with whom WEDC has a custodial agreement. WEDC shall be informed of the specific collateral and investments in the repurchase agreements and the agreement shall be collateralized at least 102% of the value of WEDC's investment.

(2) **Equity Investments**

Equity positions held in companies, with the primary purpose of encouraging the establishment or growth of business in Wisconsin as part of an economic development program approved by the Board of Directors, is classified as an investment for financial statement presentation. However, this holding of equity in companies is a function of WEDC's programs and is not a means of managing idle cash. This type of investment is specifically excluded from the remainder of POL 003 Cash and Investment Policy and is governed by WEDC's program guidelines approved by the Board of Directors.

Prohibited Investments - WEDC funds will not be invested in derivative type investments such as collateralized mortgage obligations, strips, floaters, etc.

Standards

The primary objectives of this policy for idle cash, in order of priority, are safety, liquidity and yield. This policy shall apply to all cash and investments of WEDC except as provided elsewhere in this policy. Funds subject to additional federal, state and/or contractual laws and regulations will be invested according to those laws and regulations. Unless legal and/or program requirements dictate otherwise, investment returns will be used for any authorized WEDC purpose.

Safety

Safety and preservation of principal in the overall portfolio is the foremost investment objective. To ensure the safety of WEDC's deposits and investments, this policy includes sections on how cash and investment balances are to be protected and provides guidelines on what institutions can be used.

(1) **Credit Risk and Authorized Investments**

Credit risk is the risk that WEDC would lose money due to the default or potential default of a bond or securities issuer. WEDC reduces our exposure to this risk by restricting our allowed investments. WEDC is not subject to Wisconsin statutes section 66.0603 regulating allowable investments. WEDC limits cash assets and investments to the authorized deposits and investments listed above.

WEDC will diversify investments by type, length of maturity and institution subject to limitations established in this policy and to the extent practicable considering safety of principal, yield, collateralization, investment costs and available bidders.

(2) **Concentration of Credit Risk**

Concentration of credit risk is the risk that losses become substantial due to the magnitude of WEDC's investment in a single issuer. WEDC shall reduce this risk by limiting our investments defined in section (1) above as follows:

- (a) Investments in individual federal agencies or instrumentalities of the federal government are limited to 40% of the total cash and investments;
- (b) Individual repurchase agreements as allowed under section (1)(i) will be limited to 40% of the total cash and investments;
- (c) All other issuers, excluding the federal government, are limited to 5% of the total cash and investment balances;
- (d) These limits would be calculated at the time of purchase;
- (e) There is no limit on U.S. Treasury investments.

(3) **Custodial Credit Risk**

Custodial credit risk is the risk of default by the holding institution, i.e. the bank holding cash or a custodian holding securities. WEDC shall reduce this risk by ensuring substantially all deposits are either insured or collateralized and that all securities are held in a third-party custodian account or registered to WEDC. The terms "substantially all deposits" recognizes that there are times when minimal amounts may not be protected in this manner, such as with cash on hand or in cases where the market value exceeds the face value of an investment. This risk is also reduced through WEDC's selection of Authorized Financial Institutions.

(a) WEDC deposits, excluding negotiable CDs, in Authorized Financial Institutions will be protected through Federal Deposit insurance.

(b) WEDC deposits in Authorized Financial Institutions in excess of Federal Insurance limits will be protected through collateral or letters of credit:

- With a market value of at least 102% of the uninsured balances;
- Consisting of bonds, securities, or letters of credit issued by the federal government, its agencies, or instrumentalities; and
- Held by an independent third-party custodian with whom WEDC has a current custodial agreement.
- Documentation of approved collateral agreements will include a perfected security interest.

Collateral agreements are to prohibit the release of pledged assets without WEDC's authorization; however, substitution of like collateral (value, type, and risk class) is allowed.

The market value increases on certificates of deposit where the face value is FDIC or National Credit Union Administration (NCUA) insured are exempt from this requirement.

(c) Proof of WEDC ownership of WEDC-owned securities will be protected as all security transactions will be conducted on a delivery-versus-payment (DVP) basis. Securities will be held in a separate account specific only to WEDC by a third-party custodian designated by the CFO.

(4) **Authorized Financial Institutions**

The CFO shall select and maintain a list of financial institutions, brokers, dealers, and financial advisors/companies or counterparties to be utilized by WEDC or this may be outsourced to a third-party registered investment advisor/company. For a financial institution or broker/dealer to be considered for use by WEDC's CFO, it must have:

(a) Provided proof of national or state registration or in the case of broker/dealer Securities and Exchange Commission registration or in the case of advisors/counterparties Financial Industry Regulatory Authority, Inc. (FINRA) registration.

(b) Completed a signed certificate of having read, understood, and agreeing to comply with WEDC's investment policy (included in Appendix B).

(c) Provide evidence of participation in FDIC, NCUA and/or SIPC programs, such as FDIC certificate number and specific name of registration.

(d) For depository accounts – a Safe and Sound rating of 3 (performing) or better according to the Bank Rate website. Another industry used rating system may be substituted.

(e) For depository accounts – the depository institution must meet all federal regulatory standards for a well-capitalized institution as of the date of the review of the institution. Benchmarks for well-capitalized banks are available on the FDIC's website. The benchmarks for well-capitalized credit unions are available on the NCUA website.
(f) Purchases of fully FDIC or NCUSIF insured investments, such as certificates of deposit, are exempt from the requirements of letters (d) and (e) above.
(g) Broker/dealers/counterparties will provide their most recent Brokercheck report from the Financial Industry Regulatory Authority, Inc. (FINRA) along with all Central Registration Depository (CRD) membership numbers.
(h) Safekeeping institutions will also provide a copy of their report on internal controls as applicable to custody procedures.
(i) Been reviewed by the WEDC Board or applicable WEDC Board Committee.

The items above will be obtained and reviewed by the Finance Division at a minimum of every two years for all authorized institutions.

WEDC may enter into a contract with an investment advisor/company. If used, the selection of an investment advisor/company will be based on the utilization of request for proposal, interviews, and reference reviews. The investment advisor/company will perform its own due diligence on the broker dealers and counterparties and will maintain those records for audit or any other purposes. Advisory services will be re-bid at least every three years.

Liquidity
The CFO shall ensure that WEDC has adequate funds in usable form to meet our ongoing business needs that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands (static liquidity). Furthermore, since all possible cash demands cannot be anticipated, the portfolio should include securities with active secondary or resale markets sufficient to meet expected liquidity needs (dynamic liquidity).

(1) **Interest Rate Risk**
This is the risk that changes in the market interest rates will negatively affect the fair value or cash flows of an investment. Generally, the fair value of longer maturity investments is more sensitive to changes in the market interest rate. WEDC shall mitigate this risk by:

(a) Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity.
(b) Limiting the maturities of all investments when purchased to less than five (5) years.
(c) Laddering investments to meet cash flow needs.
(d) Monitoring interest risk exposure.
(e) Maintaining a maximum duration of the investment portfolio of no more than three years.

Yield
The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, considering the investment risk

constraints and liquidity needs. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The core of WEDC's investment strategy is limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall generally be held until maturity with the following exceptions:

(1) A security with increasing credit risk may be sold early to minimize loss of principal.

(2) A security sale would improve the quality, yield, or target duration in the portfolio.

(3) Liquidity needs of the portfolio require that the security be sold.

Given the nature of WEDC's investment strategy and consideration of alternative investment opportunities, the appropriate benchmark for comparison will be the net return of the State of Wisconsin Local Government Investment Fund (LGIP) as reported by the Wisconsin Department of Administration.

Policy Considerations

The CFO shall provide a cash and investment report to the applicable WEDC Board Committee at least quarterly. The report shall summarize investments held and transactions made. It shall also discuss the current portfolio in terms of maturity, liquidity, rates of return, market values at risk and other features.

All bank and investment accounts will be reconciled monthly. For the purposes of financial statements, all cash and investments with an original maturity of three months or less will be considered cash and cash equivalents. Investments will be reported as required by governmental accounting standards. The Controller and CFO will ensure that adequate segregation of duties exists over the bank reconciliation and funds disbursement process.

RESPONSIBILITIES:

(1) This policy must be approved by the Board of Directors.

(2) Authority to manage WEDC's investments within the guidelines of this policy is delegated to the Chief Financial Officer (CFO). All purchases and sales of investments will be authorized by the CFO. Neither the CFO, nor any other individual, can both authorize and execute investment transactions. These two activities must be executed by different individuals. Execution of investment transactions approved by the CFO may be outsourced to a third-party registered investment advisor/company.

The standard of prudence to be used by the CFO shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio.

The "prudent person" standard states that, "Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived."

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.

RELATED DOCUMENTS & REPORTING:

(1) WEDC (Wisconsin Economic Development Corporation) Audit and Budget Committee Charter

(2) WEDC Bylaws