

# AN INVESTMENT AND COMPLIANCE REVIEW OF THE ORANGE COUNTY TREASURER

## **SUMMARY**

Orange County filed bankruptcy on December 6, 1994, and recorded a loss of \$1.7 billion, the largest loss by a local County Government investment pool.

The bankruptcy was a result of the County Treasurer's wrong-way interest rate gamble with public funds, and a leveraged investment strategy ignoring the wisdom that high return investments are invariably high risk. The Treasurer circumvented its fiduciary responsibilities by manipulating the \$7.6 billion investment pool with a strategy very few people in the County were aware of and even fewer understood. The Treasurer was risking funds belonging to the Orange County Government, Cities, Schools and Special Districts. Many of the approximate 200 Orange County agencies were required to invest their funds in the County Investment Pool. Other municipalities attracted by the high interest rates voluntarily joined.

The Treasurer's investment strategies stemmed from the loss of tax revenue that began with Proposition 13 and initiatives that severely limited the ability for local government to raise taxes. The pressure of these initiatives led to the State's decision to loosen municipal investment guidelines, clearing the way for the Treasurer to use pooled funds to borrow money, invest in derivatives and long-term bonds that paid high yields. The Treasurer freely pledged borrowed money as collateral.

The Investment Pool increased from \$7.6 billion to \$20.6 billion as the Treasurer borrowed \$2 for every \$1 on deposit increasing the investment pool by \$13.0 billion. The Treasurer borrowed funds to invest in securities with yields inversely related to interest rates. In 1994, interest amounted to twelve percent of revenue for Orange County compared to three percent for all other California counties. The interest earned from this strategy was a major source of revenue to the general fund. The Treasurer projected a 35 percent contribution from interest earnings to the general fund for fiscal year 1995.<sup>1</sup>

In 1994, the Federal Reserve Board began a series of interest rate increases that negatively affected the bond market. In 1994, the Orange County Supervisors realized that the portfolio was sensitive to interest rate changes and future interest rate adjustments were difficult to predict. Orange County's heavily leveraged interest-rate portfolio suffered a huge impact from the sudden increase in interest rates. The County was unable to sell off the risky securities as lenders threatened to seize pooled assets held as collateral. The County did not have the capital to withstand a "run on the investment pool" by local government depositors and soon after the first lender decided to take action, the County government declared bankruptcy. The bankruptcy prevented pooled participants from withdrawing funds, resulting in \$7.6 billion of frozen assets belonging to Orange County cities, school districts, transportation, water, and sanitation agencies.

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<sup>1</sup> The second annual California forum report dated March 18, 1998

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The bankruptcy forced the Board of Supervisors and State officials to respond to this crisis by enacting legislation directing local government to invest based on the principals of safety, liquidity and then yield. The legislators in 1995 introduced and enacted systems of checks and balances requiring the County to establish oversight committees with certain reporting responsibilities. In accordance with California Government Code Section 53600 and the Orange County resolution, the Treasurer has been charged with the authority to invest and re-invest county funds. The Treasurer retains the authority to amend the investment policy guidelines and procedures in order to comply with its responsibilities as chief investment officer and banker of county funds. The Treasurer annually prepares an Investment Policy and delegates the investment authority which is then reviewed by the Oversight Committee and approved by the Board of Supervisors.

The Treasurer plays a major role in the financial infrastructure of local government and is the custodian of county funds. While the changes may restrict some investment choices and require greater oversight, the Treasurer still maintains flexibility for making prudent investment choices within the investment policy guidelines. This freedom of choice allows the Treasurer to select investments that are best suited for the individual pooled participants.

### **REASON FOR STUDY**

The most recent Grand Jury review of the office of the Treasurer was in 2008. The Grand Jury, in 2008-2009, was concerned with the Treasurer's investment position in the Structured Investment Vehicles market. Structured Investment Vehicles are pooled investment assets that attempt to profit from credit spreads between short-term debt and long-term structured products such as asset backed securities.

Asset backed securities are the buying and bundling of loans consisting of mortgages, student debt and commercial loans and sold to investors. Often, a bundle of loans is divided into separate securities with different levels of risk, liquidity and transparency. Funding for these investments comes from the issuance of commercial paper that is continuously renewed or rolled over. This type of investment carries a very slim margin for error. One source of risk comes from the fact that the long-term security might lose value when compared to short-term investments. If this happens, one is essentially paying a higher rate of interest than the asset is earning. This is disastrous for a pooled investment portfolio.

In 2009, the Whistlejacket Structured Investment Vehicle defaulted as investors stopped buying hard to value securities as losses on subprime mortgages mounted.

The Structured Investment Vehicle could not sell short-term debt to finance high-yielding assets, forcing the County to liquidate its position for a loss of \$7.6 million on August 19, 2010. The Comprehensive Financial Annual Reports as (CAFR) as of June

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30, 2012, reported that the current Orange County Investment Pool does not include investments in derivatives and prohibited Structured Investment Vehicles.

The 2008-2009 Grand Jury also cited a breakdown in the oversight process related to the pooled investment selections and compliance.

### **METHOD OF INVESTIGATION**

Penal Code 925-933.6 provides the Grand Jury with the authority to access all required documents necessary to investigate the financial stewardship responsibilities of the Orange County Treasurer. The focus of this study was to evaluate the current investment practices and responsibilities of the Orange County Treasurer. For each discipline evaluated, the Grand Jury collected policies, state statutes, and directives related to the issues under study. The reports and documents collected demonstrate the approved investment and procedural choices made available to the Treasurer /Tax Collector. The analysis evaluates the systems the Treasurer employed to assess the relative safety, liquidity and yield. The Grand Jury researched the following resources for this study:

- ***Treasurer and staff education and experience***
- ***Weighted average to maturity and restrictions***
- ***Portfolio yields and market values***
- ***Credit quality portfolio allocation and restrictions***
- ***Internal Audit Reports and recommendations***
- ***Bylaws and statutes***
- ***Investment goals, conditions and restrictions***
- ***Investment choices and asset allocation requirements***
- ***Compliance reports***
- ***Follow-up audit reports***
- ***Investment composition summary***
- ***Approved Issuer list***
- ***Information systems***
- ***Standard and Poor's investment pool ratings***
- ***Investment evaluation platform and external investment support***
- ***Interviews with the Treasurer, staff and auditors***

### **BACKGROUND AND FACTS**

The Treasurer is a major principal in County financing. The Treasurer is an elected official and the Orange County banker in charge of receiving and investing County, City, School District and Special Districts funds. Pool participants deposit cash receipts and revenues with the County Treasurer, which are managed in pooled accounts under the auspices of the Treasurer's staff. The Treasurer is also responsible

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for the collection of taxes and revenues in order to satisfy the mandates imposed by the State of California.

This examination of the Treasurer provided the Grand Jury with an overview of the County Investment Policy, and the process used to determine if the investment choices are compliant. The review also provided an understanding of the methods used by the Treasurer to measure the risks and rewards associated with investment strategies that ideally work toward achieving and maintaining appropriate levels of success.

The investment requirements and strategies for the \$6 billion portfolio are extremely conservative and are required to conform to all State statutes and County resolutions. The Treasurer manages the County's investments by combining certain County funds and funds of other participating members into pooled accounts. The Treasurer invests and manages public funds in a manner that will provide security of principal as well as achieve yield to meet the cash requirements and liquidity schedules of pool members. The Treasurer also oversees a number of functions related to bonds issued by approved local entities.

Orange County government provides many essential services that affect every county resident while continuing to manage the many challenges of shrinking revenues. As with other Counties and jurisdictions, the state of the recent economy, and past experience have prompted the Treasurer to reassess its operations and consider cost saving measures for doing business while managing its many diverse responsibilities.

### **THE TREASURERS MISSION STATEMENT**

*IMPLEMENT BEST BUSINESS PRACTICES AND FISCAL ACCOUNTABILITY WHICH MAXIMIZE VALUE, MINIMIZE COSTS AND PROVIDE EXCELLENT TAXPAYER/CUSTOMER SERVICES TO EXTERNAL CUSTOMERS*

### **TREASURER/STAFF EXPERIENCE AND EDUCATION**

**The Treasurer** is a Certified Public Accountant with 16 years of public service experience in managing city finances and investment portfolios. The Treasurer earned a degree in Business Administration with an emphasis in Accounting from Washington State University and has achieved numerous industry Certifications. Industry related certifications serve as a benchmark of competency and signify that the designee has demonstrated the knowledge and skills required to execute critical functions related to their position.

Certification is the process by which an association or industry grants recognition to an individual who has met specific work qualifications or performance standards. Performance standards identify the knowledge an individual needs to

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advance, and is the basis for assessment and certification. The Treasurer has achieved, and maintains the following certifications:

- Certified California Municipal Treasurer (CCMT)

This certification was established for current financial professionals working in the field of public finance in an appointed or elected capacity. Municipal finance, like other professions, requires special knowledge and skills. This certification recognizes professional attainment, and insures that continuing education requirements are completed. The CCMT program is designed to advance the professionalism of a municipal treasurer, finance officer, or chief financial officer of municipalities.

- Certified Public Finance Administrator (CPFA)

This certification is awarded by the Association of Public Treasurers. The individual awarded this certification is an elected or appointed treasurer, deputy or assistant treasurer, responsible for the performance and supervision of investment, debt and treasury activities. The Treasurer also completed the requirements for the advanced certification for the CPFA. The advanced program focused on risk analysis, investment duration and the quantification of risk in a portfolio. The Treasurer is the current president of the Association of Public Treasurer of the United States and Canada, and the past President of the California Municipal Treasurers Association.

- Certified Public Funds Investment Manager (CPFIM)

The CPFIM program is provided by the Association of Public Treasurers of the United States and Canada. This certification recognizes the designees experience in investment policies, internal controls and mitigating risk. The Treasurer has also completed the required curriculum for the advanced ACPFIM certification.

**The Chief Assistant Treasurer/Tax Collector** is a Certified Public Accountant with 17 years of public service with the County of Orange. The Chief Assistant Treasurer earned a degree in Business Administration with an option in accounting from California State Long Beach and attained the following industry certifications:

- Certified Treasury Professional (CTP)

This certification recognizes a professional with a background in finance. The holder of this certification is disciplined in the following:

- Revenue collection and obligation payments
- Cash processing, reconciliation and analyzing financial statements
- Forecasting and monitoring cash flow requirements

- Certified Public Funds Investment Manager (CPFIM)

The CPFIM manager program is nationally recognized and offered by the Association of Public Treasurers of the United States and Canada. This certification recognizes the designees experience in investment policies, internal control, identifying and mitigating risk, investment options and characteristics.

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- **Certified Fixed Income Practitioner (CFIP)**

The holder of this certification has demonstrated their commitment to financial literacy, transparency and excellence in fixed income investing. This designation is designed for public agencies, institutional bond investors and fiduciaries. As with all certifications, the CFIP has continuing education requirements in order to maintain its use and promotion by the designee.

**The Assistant Treasurer/Tax Collector** has earned an MBA and a degree in Business Economics from USC-Marshall School of Business and has served the County of Orange for 6 years. The Assistant Treasurer holds the following certification:

- **CHARTERED FINANCIAL ANALYST (CFA)**

The CFA charter holder is required to pass exams covering areas of accounting, economics, ethics, money management and security analysis. The CFA certification is considered the gold standard in the field of investment analysis. An advance degree (MBA) is a prerequisite for achieving this certification. The CFA is a specialized credential that is structured for candidates working in the areas of investment management and as an analysis/portfolio manager.

**The Assistant Treasurer/Tax Collector Investments** has a Bachelor of Arts degree in Business Economics from Chapman University. The portfolio manager is responsible for staying current with market trends, and assisting the staff members with strategic decisions.

### **2011- 2012 TREASURER AND STAFF ACCOMPLISHMENTS**

The Grand Jury reviewed the following published summary of accomplishments related to this review of the Orange County Treasurer.

- *Held user conferences to streamline procedures*
- *Revamped investment credit process to focus on safety*
- *Increased use of cost effective payment options*
- *Held cash handling class for pool participants*
- *Reduced fees by implementing a temporary transfer program*
- *Implemented a "Follow the Money" training program*
- *Reduced expenses by \$2.3 million*
- *Reduced credit card fees and charge on property tax payments*

In addition to the above, the Treasurer has published a complete list of accomplishments at [www.ttc.ocgov.com](http://www.ttc.ocgov.com).

### **INVESTMENT GUIDANCE AND SUPPORT SYSTEMS**

The Grand Jury is aware that all investments involve some form of risk, and that efficient financial management combines safety of principal alongside opportunities for growth. Equally important is that a diversified investment portfolio is designed to neutralize economic volatility and provide for steady returns amidst numerous economic

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scenarios, and yet still carry distinct risks. Diversification strategies are dynamic, and vary according to risk tolerance and particular goals and requirements. For example, liquidity requirements must ensure that pooled participants have sufficient funds available to meet required expenses.

As mandated by the Orange County Treasurer Investment Policy Statement, the Treasurer has the authority under California Government Code Section 53600, to invest in specific types of securities.

The Treasurer may execute an authorized investment transaction with or through broker/dealers, banks or counterparties. The broker-dealer partnership provides the Treasurer and staff support with specific categories of investments. Investments may not be made for speculation, but for considering first the safety and liquidity of capital and finally yield. Investments are made with the same judgment, care, prudence, discretion, and intelligence that a person would use managing their own financial affairs.

The Treasurer annually reviews the financial conditions, services provided, and registration status of current broker-dealers authorized to provide financial services to the County. Financial Institutions and broker-dealers who desire to become qualified for investment transactions within the County must provide the following for consideration:

- \* *Broker Dealer Questionnaire*
- \* *The Firms' Audited Annual Report*
- \* *Broker-Dealer Status Reports*
- \* *Wiring and Delivery Instructions*
- \* *Municipal Securities Rulemaking Board G-37 filing for the past two years*

### **THE BLOOMBERG INVESTMENT SYSTEMS AND GUIDANCE**

The Grand Jury understands that prudent financial decisions depend on a sound financial platform and resources. It is not enough to know how to determine success or make prudent investment selections without an infrastructure of checks and balances.

The Bloomberg investment platform utilized by the Treasurer provides guidance and measures a portfolio's performance and compliance on a daily basis. Bloomberg is globally recognized and has more than 300,000 subscribers. The Bloomberg membership provides 24-hour access seven days a week, and is a reliable and consistent resource used by the Treasurer and staff. The Treasurer also has access for support in the areas of market surveillance, fundamental analysis valuation, statistical analysis, and portfolio and risk analytics. The Treasurer is one of only a few California county Treasurers using the Bloomberg support system to manage and evaluate pooled funds on a daily basis.

### **INVESTMENT POOL RATINGS**

Standard and Poor's rates the Orange County Money Market Fund and the Educational Money Market Fund on a regular basis. The rating service assigned its

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highest rating of AAA for the two Investment Pooled Portfolios. The rating is determined by the fund's high credit quality, low market price exposure, and prudent asset management. This rating reflects the fund's extremely strong capacity to maintain principal stability and to limit exposure to principal losses due to credit, market, and/or liquidity risks.

Standard and Poor's reviews pertinent information weekly as a part of the rating process. The Treasurer's investment staff is responsible for the pool's day-to-day management. The Treasurer's staff also includes an Investment Credit Analyst who focuses entirely on credit and provides the investment team with ongoing updates. The Chief Assistant Treasurer/Tax Collector is responsible for establishing and maintaining an internal control structure and is responsible for monitoring the portfolio daily.<sup>2</sup>

### **CREDIT QUALITY FOR APPROVED INVESTMENTS**

One of the principal criteria for judging the investment quality of a portfolio is the credit quality rating. Credit quality informs the Treasurer of the investments' credit worthiness or risk default. The credit quality is determined by a private rating agency such as Standard & Poor's, Moody's or Fitch. The credit quality designations range from a high (AAA to AA), to a medium (A to BBB), and a low (BB,B,CCC,CC,C) The following is an analysis from the credit quality report for the Orange County Investment Pools dated January 31, 2013.

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<sup>2</sup> Standard and Poor's

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	<b>Analysis By Fund</b>			
	County Money Market Fund	Educational Money Market Fund	Extended Fund	John Wayne Airport
AAA Total	8.47%	6.80%	N/A	2.42%
AA Total	9.19%	6.50%	1.56%	12.70%
A Total	3.41%	2.43%	7.71%	4.63%
A-1 Total	0.69%	0.82%	N/A	N/A
US GOV	78.24%	83.45%	90.73%	80.25%
Total	100.00%	100.00%	100.00%	100.00%

	<b>Analysis By Pool</b>	
	Orange County Investment Pool	Orange County Educational Investment Pool
AAA Total	3.94%	3.91%
AA Total	5.11%	4.40%
A Total	5.71%	4.67%
A-1 Total	0.32%	0.47%
US GOV	84.92%	86.55%
Total	100.00%	100.00%

AA Includes AA+, AA- and AA  
A Includes A+, A- and A  
A-1 Includes A-1+, F1+, A-2 and F2  
US GOV Includes Agency & Treasury Debt

**THE INFLOW OF CASH FOR INVESTMENT POOLS**

The inflow of cash rarely matches the timing of expenditures. For example, property tax revenues are generally derived from semi-annual installments, while local agency obligations and spending commitments occur more frequently throughout the year. The Treasurer may also receive lump sum proceeds from the sale of bonds issued to pay for capital improvements. Under most conditions, bond proceeds are not spent immediately. Without the ability to invest cash balances, pending the need to make expenditures, the Treasurer might accumulate large amounts of liquid cash.

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The following chart (Column #4 Cumulative Available Cash) for January 2013- July 2013 illustrates the importance of investing pooled funds. The projected cumulative available cash column represents how much cash would be idle if not invested, resulting in a loss of yield (income) to the portfolio. By investing cumulative cash balances, the invested balance generates a return until the funds are required for expenditures.

<b>ORANGE COUNTY INVESTMENT POOL</b>				
Month	Investment Maturities	Projected Deposits	Projected Disbursements	Cumulative Available Cash
January 2013 - Ending Cash				\$ 11,280,252
February	\$ 385,507,644	\$ 390,573,820	\$ 344,984,875	442,376,841
March	747,982,780	832,870,332	510,353,155	1,512,876,797
April	304,590,486	1,607,830,826	1,565,565,138	1,859,732,972
May	143,732,843	267,558,142	599,186,257	1,671,837,700
June	166,982,268	298,503,631	465,943,415	1,671,380,184
July	160,643,853	365,452,383	564,808,444	1,632,667,976

<b>ORANGE COUNTY EDUCATIONAL INVESTMENT POOL</b>				
Month	Investment Maturities	Projected Deposits	Projected Disbursements	Cumulative Available Cash
January 2013 - Ending Cash				\$ 4,064,583
February	\$ 539,412,657	\$ 163,478,039	\$ 500,254,576	206,700,704
March	424,952,588	303,852,913	516,166,999	419,339,206
April	278,876,046	941,804,226	606,770,940	1,033,248,539
May	93,636,426	189,231,045	509,189,323	806,926,688
June	54,778,238	227,241,615	496,117,424	592,829,116
July	61,476,844	649,573,413	424,925,367	878,954,006

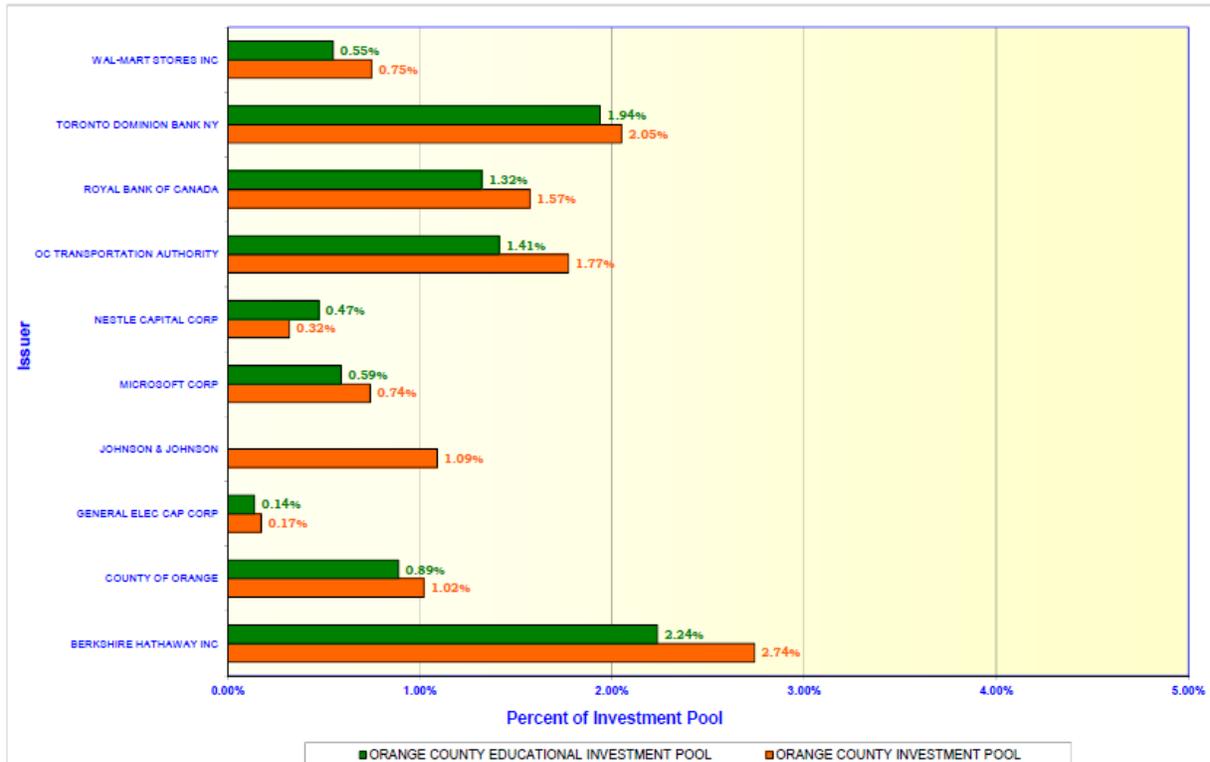
**ISSUER CONCENTRATION**

The County Treasurer will diversify the investment portfolio to minimize the risk of loss resulting from an over concentration of assets. Over concentration of assets results from investing a large portion of assets into one security, one sector, industry, or maturity duration. Over concentration of assets is not suitable for most investment portfolios and undermines the principles of prudent asset management. Under the Investment Policy Statement the Treasurer is generally not authorized to invest more than five percent with any approved issuer.

Diversification of investments cannot, by itself, guarantee a profit or protect against loss, it can reduce the effects of volatility within the portfolio and mitigate the issue of over concentration. The Grand Jury reviewed the following published issuer concentration dated January 31, 2013.

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## ORANGE COUNTY TREASURER - TAX COLLECTOR ISSUER CONCENTRATION-By Investment Pool January 31, 2013



### **AUTHORIZED INVESTMENTS AND MATURITY RESTRICTIONS**

In addition to the concentration requirements, the Grand Jury also recognizes that maturity durations are an important indicator of a portfolio's ability to maintain a stable net-asset-value (NAV), and that shorter maturities generally sacrifice yield to obtain greater liquidity and stability. It is also clear that having a long position related to maturity duration is not ideal with a low interest rate environment, and interest rate increases cause bond prices to decline. Treasury Bills and bonds move in the opposite direction of interest rates, which may reduce the value of treasuries and bonds.

With interest rates in 2013 at an historic low, keeping allocations in proper balance becomes a greater challenge. The Grand Jury understands the compromises associated with liquidity and yield, and that market conditions and cash flow requirements are vital when determining the term of an investment maturity. Each of the investments described below carry varying degrees of risk.

Under the Government Code Section 53601-53635, securities may not be held for a period exceeding five years. The Code also regulates the risk level of the portfolio. To mitigate risk, the securities in the extended fund generally must be listed between the

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top two categories of a national rating agency. The Grand Jury reviewed the following Treasurer’s Investment Report dated January 31, 2013, outlining the current authorized investment composition and compliance restrictions.

**Authorized Investments and Maturities**

Type of Investments	Cal Gov. Code <sup>3</sup> (% of Funds Permitted)	Orange County IPS	Cal Gov. Code <sup>4</sup> (Maximum Final Maturity)	Orange County IPS Maximum Final Maturity	
				Long-Term Extended Fund	Short-Term Money Market Fund
U.S. Treasury Securities	100%	100%	5 years	5 years	397 days
U.S. Gov. Agency Securities	100%	100% Total	5 years	5 years	397 days
		>  30% in one issuer			
Municipal Debt	100%	30% Total	5 years	5 years	397 days
		>  5% in one issuer except 10%-County of Orange			
Medium-Term Notes	30%	30% Total	5 years	5 years	397 days
		>  5% in one issuer			
Bankers Acceptance	40%	40% Total	180 days	180 days	180 days
	30% of a single issuer	>  5% in one issuer			
Commercial Paper	40%	40% Total	270 days	270 days	270 days
	10% of a single issuer	>  5% in one issuer			
Negotiable Certificates of Deposits	30%	30% Total	5 years	5 years	397 days
		>  5% in one issuer			
Repurchase Agreements	100%	20% Total	1 year	1 year	1 year
		>  10% in one issuer			
Investment Pools/Mutual Funds	20%	20% Total	N/A	N/A	N/A
	10% of a single issuer	>  10% in one issuer			

**DESCRIPTION OF AUTHORIZED INVESTMENTS**

**United States Treasury Securities**

The United States government is the world’s largest issuer of debt, making Treasury Securities the primary instrument in the fixed income market. Treasuries are guaranteed by the full faith and credit of the U.S. Government. The California Code prohibits a Local County Treasurer from investing in Treasuries with a maturity of more than five years. Maturity levels can be extended with the approval of the Orange

<sup>3</sup> Source: California State Code Sections 53601-53635

<sup>4</sup> Source: California State Code Sections 27000.1, 53607, and 53608

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County Board of Supervisors. There are no concentration limits or minimum rating restrictions for this equity.

### United States Government Agency Securities

Federal agency securities are issued by government sponsored entities. The Federal Farm Credit Bank and the Federal Home Loan Bank are examples of federal agencies. Unlike Treasuries, most Government Agency securities are not guaranteed, but are considered a moral obligation of the United States Government.

The exceptions are the Federal National Mortgage Association and the Federal Home Loan Mortgages Corporation which are under conservatorship and currently guaranteed by the Federal Government.

### Commercial Paper

Commercial paper is a short-term unsecured promissory note issued for a specified maturity and is a financing process primarily used by corporations. Public entities may purchase commercial paper only from corporations that are organized and operating in the United States. As outlined in the Treasurers 2013 Investment Report the following are approved issuers for commercial paper:

- \* Wal-Mart Stores
- \* Net Jets Inc.
- \* Chevron Corp.
- \* Johnson & Johnson
- \* Microsoft Corp
- \* Nestle Capital Corp
- \* Automatic Data Processing
- \* Berkshire Hathaway Incorporated
- \* Berkshire Hathaway Finance

### Repurchase Agreements

Repurchase agreements are utilized as a cash management tool within the confines of the County banking system. Securities, as they relate to a repurchase agreement, mean securities from the same issuer, description, issue date and maturity. Repurchase agreements are collateralized by authorized securities and must comply with delivery requirements and maturity provisions.

### Bankers Acceptance

Also known as time drafts, these are drawn and guaranteed by a commercial bank. (Purchase of banker's acceptance shall not exceed a maturity of 180 days and limited to 40 percent of the fund's portfolio).

### Money Market Mutual Funds And Issuers

Mutual Fund shares are issued by diversified management companies that are mutual fund registered with the Securities and Exchange Commission. This fund only invests in direct obligations in United States Treasury bills, notes and bonds, United

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States Government Agencies, and repurchase agreements with a weighted average of 60 days or less. Money Market Funds are limited to 20 percent of the portfolio with a 10 percent limit in a single Money Market Fund. The following are approved issuers in this category of investments:

- \* *Invesco Government & Agency*
- \* *Goldman Sachs Financial Square Government Fund*
- \* *Morgan Stanley Liquidity Government Fund*
- \* *Northern Institutional Treasury Portfolio*

### Municipal Debt

Municipal bonds are debt securities issued by municipal government agencies. Issuers of municipal bonds include cities, counties, school districts, publicly owned airports and any other government entity or group below the state level. Municipal bonds are guaranteed by a local government or a group of local governments and are assessed for risk. Municipal Bonds Issued for certain purposes may not be tax exempt.

### Medium Term Notes

Medium term notes are debt instruments that are issued through financial institutions or government obligations. Medium term bonds are offered through agents or dealers on a best effort basis, rather than a firm's commitment (underwriting) basis. For the benefit of diversification, medium term notes provide a broad range of investment across industry sectors and are as liquid as the traditional bond market.

### **INELIGIBLE INVESTMENTS**

- \* Principal or interest only strips (securities with cash flows based entirely on the monthly interest payment received from mortgage pools)
- \* Securities that result in zero interest accrual if held to maturity
- \* Common stock
- \* Financial futures and options (the agreement to buy or sell at a certain date or price)
- \* Structured Investment Vehicles

### **ECONOMIES OF SCALE AND THE POTENTIAL FOR GROWTH**

The wealth of staff education, experience and success in managing investment pools, affords the Treasurer the opportunity to extend its best practices to non-participating entities. The benefits of becoming a member participant in the County Investment Pool are ease of administration, access to otherwise unavailable investment for small investors, diversification, liquidity and a highly educated experienced staff.

Economies of scale, also called increasing returns to scale, is a term used by economists to refer to situations in which the cost of producing an additional unit of service output (marginal cost) decreases as the volume of output (services) increases.

A simple meaning of economies of scale is achieving more efficiently as the size of operation increases. Costs may decrease as the volume of output increases for a

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number of reasons. An advantage for the County is that a greater number of pooled participants allow fixed costs to spread over a larger base. Fixed costs are those that do not change regardless of the number of pooled agencies participating.

### **INFORMATION SYSTEMS**

For security reasons, the Grand Jury will not provide specifics regarding the Treasurer's information systems. The data stored in the current system is highly sensitive, confidential and includes a significant amount of proprietary financial data.

The County Treasurer leverages several information system solutions to support the billing, collection and investment of County tax revenues. The majority of the information systems are older legacy systems. These systems have limited flexibility and are expensive and difficult to change and enhance. The one exception is the information system used by the Investment and Treasury Divisions.

The Investment Division utilizes Bloomberg and Sun Guard Quantum information systems software to execute and monitor investment strategies. Bloomberg software is recognized as one of the premiere portfolio management platforms in the industry and the level of data security, and flexibility inherent in this web-based tool is unequaled.

### **FINDINGS**

In accordance with California Penal Code Sections §933 and §933.05, the 2012 - 2013 Grand Jury requests responses from each agency affected by the recommendations presented in this section. The responses are submitted to the Presiding Judge of the Superior Court.

Based on this study of the Orange County Treasurer/Tax Collector, the 2012-2013 Orange County Grand Jury has arrived at the following four findings:

- F1. The Treasurer does not have a securities representative (staff member). The Treasurer shall consider the benefits of having a member of the investment team equity licensed.
- F2. Having a licensed securities representative on staff could be a conflict of interest.
- F3. The Treasurer leverages several information systems for tax collection and investments. The majority are older legacy systems. These systems have limited flexibility and are expensive to change and enhance.

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**RECOMMENDATIONS**

Based on this study of the Orange County Treasurer, the 2012-2013 Orange County Grand Jury has arrived at the following four recommendations:

- R1. The Treasurer shall consider the benefits of having a current staff member licensed as a Securities representative. (series 7, 51 and 63)
- R2. The Treasurer shall address the conflict of interest issues with having a securities licensed staff member.
- R3. The Treasurer shall address the expense, time restraints and expectations related to improving the information systems.

The California Penal Code §933 requires any public agency which the Grand Jury has reviewed, and about which it has issued a final report, to comment to the Presiding Judge of the Superior Court on the findings and recommendations pertaining to matters under the control of the agency. Such comment shall be made *no later than 90 days* after the Grand Jury publishes its report (filed with the Clerk of the Court); except that in the case of a report containing findings and recommendations pertaining to a department or agency headed by an elected County official (e.g. District Attorney, Sheriff, etc.), such comment shall be made *within 60 days* to the Presiding Judge with an information copy sent to the Board of Supervisors.

Furthermore, California Penal Code Section §933.05 (a), (b), (c), details, as follows, the manner in which such comment(s) are to be made:

(a) As to each Grand Jury finding, the responding person or entity shall indicate one of the following:

- (1) The respondent agrees with the finding
- (2) The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefore.

(b) As to each Grand Jury recommendation, the responding person or entity shall report one of the following actions:

- (1) The recommendation has been implemented, with a summary regarding the implemented action.
- (2) The recommendation has not yet been implemented, but will be implemented in the future, with a time frame for implementation.

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- (3) The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a time frame for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This time frame shall not exceed six months from the date of publication of the Grand Jury report.
  
- (4) The recommendation will not be implemented because or is not reasonable it is not warranted, with an explanation therefore.

(c) If a finding or recommendation of the Grand Jury addresses budgetary or personnel matters of a county agency or department headed by an elected officer, both the agency or department head and the Board of Supervisors shall respond if requested by the Grand Jury, but the response of the Board of Supervisors shall address only those budgetary /or personnel matters over which it has some decision making aspects of the findings or recommendations affecting his or her agency or department.

Comments to the Presiding Judge of the Superior Court in compliance with Penal Code section §933.05 are required.

Responses are required from Office of the Treasurer-Tax Collector County of Orange for **F1, F2, F3, R1, R2, R3.**