

VOLUNTARY GUIDELINES

FOR THE MANAGEMENT OF STABLE NET ASSET VALUE LOCAL GOVERNMENT INVESTMENT POOLS

Recommended Best Practices for Stable NAV LGIPs



NATIONAL ASSOCIATION OF
STATE TREASURERS



NASACT

National Association of State
Auditors, Comptrollers
and Treasurers

Copyright © 2016 by the National Association of State Treasurers (NAST) and the National Association of State Auditors, Comptrollers and Treasurers (NASACT).

This paper was prepared by a work group comprised of members of NAST and NASACT.

It was reviewed and approved by the executive committees of both associations in the spring of 2016 and released in May 2016.

NAST / NASACT LGIP Work Group

Steve McCoy, Chairman

State Treasurer
Georgia

Christy Allen

Office of State Treasurer
Tennessee

Gerry Boaz

Technical Manager
Office of the Comptroller of the Treasury
Tennessee

Bernadette Benik

Chief Deputy Treasurer
Maryland

Manju Ganeriwala

State Treasurer
Virginia

Whitney Goetz

Public Policy Advisor,
Office of State Treasurer
Tennessee

Laura Glenn

Portfolio Manager
Office of the State Treasurer
Georgia

Mary Christine Jackman

Director of Treasury Management
Office of the State Treasurer
Maryland

Tim McClure

Director of Cash Management and Administration
Office of State Treasurer
Tennessee

Randy Roberts

Director of Professional Practice,
Office of the Auditor General
Arizona

Alan Skelton

State Accounting Officer
Georgia

David Von Moll

State Comptroller
Virginia

Tim Wilhide

Director, Cash Management and
Investments
Office of State Treasurer
Virginia

RECOMMENDED BEST PRACTICES

INTRODUCTION

The National Association of State Treasurers (NAST) and the National Association of State Auditors, Comptrollers and Treasurers (NASACT) represent both elected and appointed government officials tasked with the management of state finances, including the investment of state and local government funds. Both organizations share a common goal of promoting safe, effective and efficient management of public funds, including those invested in external investment pools known as local government investment pools (LGIPs).

Unlike money market funds (MMFs), LGIPs are operated for the exclusive benefit of governmental entities. Although enabling legislation for each LGIP is unique, they all share common objectives and most are designed to serve as short-term investments for funds needed by participants on a day-to-day or near-term basis. Most participants use LGIPs for both principal preservation and as a cash management tool. Consequently, LGIPs attract public fund participants who are unable or unwilling to tolerate even small losses. Such entities can be loss averse for a variety of reasons, including general risk tolerance, legal restrictions, budget constraints, investment limitations or liquidity requirements.

Each LGIP operates under the constraints of its respective legislation and regulating body which creates certain disparities

among various LGIPs. However, it is in the best interest of all LGIPs to preserve the reputation and financial integrity of governmental external investment pools. For this reason, NAST released *Guidelines for Local Government Investment Pools* in 1989 and updated these guidelines in 1995 to better provide a framework for the formulation of prudent policies and disclosure for LGIPs. Since that time, LGIPs have experienced sizeable growth in assets and complexity.

Given their common interest in promoting sound financial management principles and practices, NAST and NASACT desire to provide guidance to state and local government officials who sponsor or operate LGIPs designed to provide principal stability to participants in such pools. This guidance is recommended as voluntary best practices to serve as general guidelines for the investment and operation of LGIPs intended to maintain a stable net asset value (NAV). The intent is to help assure both sponsors and pool participants that such pools are highly likely to maintain a NAV of \$1.00 while providing a reliable source of liquidity for participants. These voluntary guidelines should assist state leaders with guidance for managing investment pools in a manner that provides both state and local government participants with investment options that, when prudently managed, provide safety of principal and liquidity.

These voluntary guidelines should assist state leaders with guidance for managing investment pools in a manner that provides both state and local government participants with investment options that, when prudently managed, provide safety of principal and liquidity.

BACKGROUND

We understand that there are more than 107 LGIPs in existence.¹ Of these pools, 83 currently carry ratings from nationally recognized rating agencies. Rated funds tend to have similar characteristics, as they must adhere to specific criteria to maintain their ratings. However, a rating is not a requirement for an LGIP and may not meet the objectives of sponsors of some LGIPs. Some state-sponsored pools, whether rated or non-rated, have historically been managed as “2a7-like pools” in order to comply with GASB Statement No. 31 and have elected to measure for financial reporting purposes all investments at amortized cost. Originally GASB chose to define 2a7-like pools by reference to the U.S. Securities and Exchange Commission’s Rule 2a7, rather than by incorporating its current provisions into Statement No. 31. The GASB recently issued Statement No. 79, *Certain External Investment Pools and Pool Participants*, which - provides new guidance for LGIPs that elect to report on an amortized cost basis. This replaces the 2a7-like language with criteria that are similar in many respects to those in Rule 2a-7. An LGIP that does not comply with GASB Statement No. 79 may continue to operate as a stable NAV pool but must use fair value for financial reporting purposes, in accordance with GASB Statement No. 31.

In response to the credit crisis of 2008, the SEC amended Rule 2a-7 in 2010 and again in 2014. The 2010 amendments tighten the risk-limiting conditions of Rule 2a-7 by, among other things, requiring funds to maintain a portion of their portfolios in instruments that can be readily converted to cash, reduce the maximum weighted average maturity of portfolio holdings, and improve the quality of portfolio securities. The amendments were designed to make MMFs more resilient to certain short-term market risks and to provide greater protections for investors in MMFs that are unable to maintain a stable NAV. These amendments were widely accepted by the money market industry and its investors and by those states operating LGIPs as 2a7-like funds. However, the SEC felt more regulation was necessary, and the 2014 amendments brought additional requirements for 2a-7 funds, and thus, 2a7-like funds. The amendments make structural and operational reforms to address risks of investor runs in MMFs. The 2014 rules built upon the reforms adopted by the SEC in 2010 that were intended to reduce the interest rate, credit and liquidity risks of MMF portfolios. The new rules require a floating NAV for institutional prime MMFs. Unlike 2010, the money fund industry and state-managed LGIPs operating as 2a7-like funds responded unfavorably to the 2014 amendments.

In particular, the floating NAV requirement for institutional prime MMFs, as well as transacting shares to four decimal places, was of concern to sponsors of LGIPs. As the 2014 amendments were being considered, many states voiced their concerns to GASB since GASB had linked the use of amortized cost accounting for financial reporting for external investment pools to SEC Rule 2a-7.

GASB put External Investment Pools on its research agenda in August 2014 and added the project to its current agenda in December 2014. The pre-agenda research indicated that the 2014 amendments would affect investment pools to such an extent that few governments would be able to adopt them. GASB’s research also indicated that pool sponsors of LGIPs have a more complete understanding about cash flow and liquidity needs of pool participants and thus differ from SEC-registered MMFs. GASB’s pre-agenda research also discovered that some investment pools are assuming significant interest rate risk.

In June 2015, GASB released an exposure draft of a proposed statement entitled *Accounting and Financial Reporting for Certain External Investment Pools*. In the ED, GASB specified that if an external investment pool meets the specified criteria, the pool would be able to elect to measure for financial reporting purposes all of its investments at amortized cost. These provisions were designed to replace the existing concept of a 2a7-like pool. GASB has in effect delinked itself from the SEC and provided its own criteria as a standard for reporting investments at amortized cost. Pools that do not elect to comply could still transact (operationally) at a \$1.00 NAV but would be required to measure for financial reporting purposes at fair value. In December 2015, the GASB approved Statement No. 79, *Certain External Investment Pools and Pool Participants*. Statement No. 79 replaces the reference in existing GASB literature to SEC Rule 2a-7 with criteria similar in many respects to those in Rule 2a-7 with the exception of requiring a daily floating NAV and the potential imposition of pool gates and fees during times of financial stress. Statement No. 79 provides management standards for LGIPs electing to report LGIP investments at amortized cost.

However, many stable NAV LGIPs may not elect to use amortized cost for financial reporting purposes. Therefore, NAST and NASACT believe it would be beneficial to develop best practices for LGIPs that would provide guidance in terms of investment policies, investment and operational management,

¹ iMoneyNet Special Report Government Investment Pools: Investment Strategies, Facts, Figures and Trends (Dec. 2011).

internal controls, transparency, oversight and other key components of managing an LGIP. These voluntary best practices are operational in nature to encourage certain uniformity among stable NAV LGIPs as well as to enhance the ability of an LGIP to maintain a stable NAV.

The following voluntary guidelines for the management of stable NAV LGIPs are intended to

be best practices taking into consideration that some LGIPs may be constrained by statutory or other sponsor-related constraints that may not allow full compliance with all sections of these recommended guidelines. While some LGIPs may be prohibited from adopting all sections of these suggested guidelines, NAST and NASACT believe that adherence to these guidelines will help preserve the financial integrity and reputation of LGIPs that adhere to them.

BEST PRACTICES FOR STABLE NAV LGIPs

The primary goal of a stable NAV pool is principal preservation. Participants may utilize a stable NAV LGIP as both a cash management and investment vehicle. Therefore, an LGIP should be carefully managed in a manner to protect principal and maintain sufficient liquidity while adhering to both prudent investment and sound administrative practices.

Although LGIPs should always be managed in a manner so as to fully comply with respective statutory requirements, in order to provide reasonable assurance to participants that an LGIP will maintain a stable NAV, all of the following criteria should be met.

SECTION A: RISK MANAGEMENT

1. Investment Policies & Procedures

LGIPs should have clearly articulated and documented policies and procedures to define the credit, liquidity, maturity, and diversification objectives and the means to achieve these objectives. Each LGIP should have a clearly defined investment policy and specific guidelines for conducting its investments so as to guide investment personnel in managing risks when making investment decisions.

The objectives in managing a stable NAV LGIP's investment activities should require:

- Safety of capital as a priority so as to ensure preservation of principal.
- Sufficient liquidity be maintained to enable funding of all reasonably expected cash needs given the participant composition and history as well as economic and market conditions.
- Investment return taking into consideration an LGIP's cash flow expectations.
- Diversification of investments including deposits adequate to reduce portfolio risks from an over concentration in any specific maturity, issuer, counterparty, depository, security, or class of securities.

2. Management Team

The strengths and weaknesses of an LGIP's management may affect the LGIP's ability to preserve a stable NAV, whether managed in-house or outsourced. An LGIP should have personnel that are knowledgeable and experienced in managing a stable NAV LGIP. An LGIP should maintain appropriate segregation of duties. Each member of the LGIP's investment team should be adequately trained in the investment policies and guidelines of an LGIP. Investment personnel should purchase only investments that fall within their scope of expertise.

3. Managing Credit

A thorough, constant and independent credit analysis process helps preserve a stable NAV. The LGIP sponsor should clearly define credit exposure guidelines and have resources, policies and procedures to adequately assess and manage the credit risk of an LGIP's investments. An LGIP should utilize an experienced credit analyst that has the ability to manage and analyze relevant credit risk. Any credit decision should be independent of investment decisions and trading authority. For securities other than *U.S. Treasuries* and *U.S. Agencies*, an LGIP should maintain an approved issuer list that is updated regularly. Purchases should be limited to credits that have been approved by an independent credit analyst or internal credit committee, and the amounts must be deemed appropriate given the size and characteristics of the respective LGIP. The list of approved issuers should be documented in regular credit evaluations or formal credit meetings. An LGIP's credit selection and monitoring process should include procedures for conducting due diligence on issuer exposure, counterparties and depositories as well as for regularly monitoring all approved issuers for credit deterioration. Finally, an LGIP should have policies and procedures that address assessing and liquidating positions in distressed credit situations as well as assessing and monitoring the credit quality and value of pledged collateral.

BEST PRACTICES FOR STABLE NAV LGIPS (continued)

4. Managing Diversification

Maintaining a diversified portfolio is a means of limiting losses and preserving the NAV. When evaluating issuer and counterparty diversification, an LGIP should aggregate affiliated counterparties and include all related counterparties as one issuer in considering concentration of investments. Limiting exposure to affiliated entities will limit the risk of loss among LGIP holdings. A well-diversified LGIP should reduce the impact of an adverse credit event. For investments other than U.S. Treasuries and Agencies, an LGIP should have clear policies and guidelines in regards to diversification among various asset classes. The criteria for a principal stability fund published by a nationally recognized statistical rating organization (NRSRO) provide parameters for applicable limits for overnight and term investments (including collateralized and non-collateralized) as well as metrics for credit holdings. Issuer concentrations that exceed stated percentages by NRSRO's may lead to greater risk for an LGIP and the potential of "breaking the buck" in the event of a credit event. It is a best practice for an LGIP to adhere to such established parameters when investing in asset classes other than U.S. Treasuries and Agencies.

5. Managing Maturity

The maturity of individual investments and an LGIP's weighted-average maturity (WAM) and weighted average life (WAL) are important measures of an LGIP's tolerance and sensitivity to rising interest rates (interest rate risk). The LGIP's guidelines should address how management will define, monitor and control interest rate risk. An LGIP that chooses the amortized cost method of accounting for financial reporting purposes should follow GASB's rules for final stated maturity, WAM and WAL.

LGIPs not choosing the amortized cost method of accounting for financial reporting purposes should adhere to the prescribed final maturity limitations as well as clearly define and disclose the permitted interest rate exposure in terms of WAM, WAL and final stated maturity. These LGIPs should:

- Limit the maximum final maturity for any fixed rated investment to 397 days.
- Limit the maximum final maturity for any floating U.S. government (including government sponsored enterprises) to two years.
- Limit the maximum final maturity for any floating rate non-government investment to 397 days.
- Prevent the WAM of a stable NAV LGIP from exceeding 60 days unless the sponsor has

demonstrated the capability and historical experience to maintain a stable NAV with a longer WAM when appropriate stress tests were applied. Further, limit an LGIP to a maximum WAM of 90 days and a maximum WAL of 120 days unless an LGIP's history, including participant activity, and any other measures warrant a WAM or WAL longer than the recommended maximums. A WAM or WAL longer than the prescribed maximums should be clearly documented and stress tested by the LGIP's portfolio managers. Stress testing and shadow NAV pricing should be conducted on a regular basis (at least monthly) to confirm that a stable NAV can be maintained through various interest, credit and redemption scenarios. The results of the stress test should be disclosed and reviewed with the oversight board on a regular basis. It is recommended that stress testing results be shared with participants on an LGIP's website.

- Limit the types of collateral it accepts as security for deposits and repurchase agreements to investments in which the LGIP's investment team has investment experience and expertise in trading, unless such LGIP has contracted with a qualified third party to monitor collateral and, if necessary, to liquidate securities due to a counterparty default.

The value of collateral pledged to secure deposits and repurchase agreements should be based on the quality and liquidity of pledged securities with a minimum of 102 percent fair market value of U.S. Treasuries and Agencies and a minimum of 105 percent fair market value of other pledged securities. Collateral should be held by a qualified third party custodian and frequently marked-to-market, preferably daily.

6. Managing Liquidity

It is critical that management maintain procedures to monitor redemptions and reduce risk of unusually high redemptions in order to meet participants' daily cash flow needs. An LGIP can accomplish these goals through maintaining good communication with its participants as well as positioning its portfolio so as to be able to fund unexpected withdrawals. An LGIP should hold high levels of securities that mature overnight and within seven days in an amount deemed appropriate by management based on the composition of the LGIP's participants and current economic and market conditions. An LGIP should also conduct cash flow analysis based on the expected timing of participant deposits and withdrawals. The level of liquidity may be adjusted to take into consideration distinctive characteristics of an LGIP's participant base and historical redemption patterns for the pool.

BEST PRACTICES FOR STABLE NAV LGIPS (continued)

LGIPs should have a management continuity plan in place to manage unusually high redemptions. Consideration should be given to developing strategies for funding unexpectedly high redemptions. Although some LGIPs may be constrained by statutory authority that limits their ability to utilize certain strategies, when permitted and prudently managed, LGIPs may consider contingency plans including a line of credit from a rated financial institution, reverse repurchase agreements, and maintaining reserves to serve as a capital buffer to protect the NAV.

Although the percentage of liquidity that an LGIP should maintain is dependent upon factors including cash flow expectations, composition of participants, market and economic conditions, and statutory requirements, a stable NAV LGIP should meet or exceed the following minimum liquidity standards:

- A minimum of 90 percent of an LGIP portfolio should be comprised of highly liquid investments and deposits. Liquid investments includes investments that can be redeemed or sold within five business days.
- A minimum of 10 percent of an LGIP portfolio should be comprised of overnight investments or demand deposits.
- A minimum of 30 percent of an LGIP portfolio should be comprised of investments maturing or subject to demand within five business days.

7. Stress-Testing

Stress tests are an important tool for LGIPs to utilize. Stress tests help to assess and monitor the overall portfolio impact from changes in interest rates, an increase in participants' redemptions, the downgrade or default of particular portfolio securities, and the widening or narrowing of credit spreads. Stress testing should be performed at least monthly and reviewed by the portfolio manager as well as an investment committee, oversight board, or other representative of the LGIP sponsor independent from the portfolio manager of an LGIP. Written procedures for conducting regular stress tests and reporting stress test results should be maintained to document results and the assumptions used. An LGIP should maintain written procedures for managing deviations in the NAV when the fund is marked-to-market. Such procedures should include the specific NAV percentage deviations triggering when action will be taken and the personnel responsible for taking such actions. The portfolio manager, compliance officer, investment committee and representative of the LGIP sponsor should be familiar with the NAV deviation plan.

8. Shadow NAV

LGIPs that utilize amortized cost accounting should calculate a "shadow" NAV at least monthly. For an LGIP with a targeted NAV of a dollar, the "shadow" NAV calculated using market prices should be within one-half of one percent of a dollar (a price of \$0.995 or higher or \$1.005 or lower). An LGIP with a shadow NAV within this range is considered to be a stable NAV and may continue utilizing amortized cost accounting for calculating the LGIP's NAV. An LGIP's sponsor should have procedures in place for addressing any material deviations from the stated NAV.

SECTION B: GOVERNANCE

1. Managing Participant Relationships

It is of high importance that an LGIP's management team understand the composition of participants that comprise its investor base, the historical pattern affecting large deposits and withdrawals, participant cash flow and investment expectations, and other issues that may affect an LGIP's balances and liquidity needs. If statutorily allowed, an LGIP should limit the maximum amount any single participant may invest if it deems that the unexpected withdrawal of such deposits could pose a liquidity risk to the pool. Except for participants for which an LGIP's management team has a clear understanding of their cash flow needs and investment expectations, it is recommended that any single participant's assets not exceed 10 percent of the total assets of the pool. If statutorily allowed, it is recommended that an LGIP be able to reject accepting any large deposits that it deems would be a detriment to the pool due to market conditions or uncertain cash flow expectations.

2. Accounting & Recordkeeping

LGIPs should provide participants with accurate and timely reports. LGIPs should regularly (at least monthly and preferably daily) perform reconciliation of records between the front office, back office, and custodian bank to verify that records are correct. Participants should have ready access to account balances and activity as well as the ability to execute transactions. At a minimum, retention of LGIP documents should comply with the sponsor's retention policy.

3. Internal Controls

Proper internal controls should be established and maintained to ensure an LGIP operates efficiently and effectively, safeguards assets, accurately and reliably reports information about operations and investments, and complies with applicable policies, laws and

BEST PRACTICES FOR STABLE NAV LGIPS (continued)

regulations. Some crucial functions of internal controls include documenting operating processes and risk preferences, maintaining appropriate separation of duties, confirming trade tickets, documenting stress-testing procedures, reviewing third-party service providers, maintaining and regularly testing business continuity plans, and reviewing IT services and service providers. An LGIP should establish a plan for handling the liquidation of any investment or collateral pledged to secure deposits and repurchase agreements in the event that an issuer, depository or counterparty defaults. An LGIP should perform a review of its internal controls at least annually.

4. Compliance

The LGIP's security selection, counterparty exposure, diversification and adherence to policies and guidelines should be reviewed by personnel other than portfolio managers or personnel reporting to investment personnel. Compliance reviews should be performed at least weekly to assure compliance with investment policies, guidelines and procedures. An LGIP should be audited at least annually by an external auditor independent of the LGIP. A copy of the independent auditor's opinion should be made available to all pool participants. All contracts and agreements with custodians, counterparties, depositories, broker-dealers and vendors providing critical services should be maintained in readily accessible locations to enable timely access by management.

5. Transparency, Reporting & Disclosure

LGIPs should provide participants with monthly account statements. LGIPs should disclose the shadow NAV to participants at least monthly and provide investment holdings reports on a monthly or quarterly basis. LGIPs should issue separate annual financial statements to assist users to adequately understand an LGIP's financial condition.

Each LGIP should issue to participants a disclosure circular which discloses pertinent information about the LGIP's statutory authority, offerings, investment policy and practices, financial condition and investment strategy. It is recommended that disclosure include (a) current and historical amounts of liquid assets; (b) current and historical shadow NAVs; (c) the WAM and WAL of pool assets; (d) list of investment holdings; (e) policies, procedures and frequency of performing shadow NAV calculations and stress tests; (f) retention policies; and (g) procedures to stabilize the NAV if necessary.

Most important, there should be complete disclosure about risks to participants including a statement making

clear if the sponsor or other government entity does not guarantee invested monies and any operational risks, including errors, omissions, or fraud that could adversely impact participants.

It is recommended that LGIPs utilize a website as a means of readily providing disclosure information to participants and other users.

LGIPs should provide necessary information to participants and prospective participants to enable them to determine if an LGIP is a suitable investment. Participants also need access to their account information in order to manage liquidity, verify yield earned on its investment, and to satisfy themselves with the investment holdings and liquidity of an LGIP. In order to provide such information on a timely basis, it is recommended that an LGIP post financial and disclosure information online and provide account-specific information to participants online or via email.

Within five business days of an event that threatens to diminish the NAV, an LGIP sponsor should disclose specific measures that it has authority to take to cure or otherwise support the LGIP. Such measures include but are not limited to:

- Line of credit from a financial institution.
- Reserves to purchase distressed assets or serve as a capital buffer.
- Ability to conduct reverse repurchase agreements to provide liquidity.
- Ability of the sponsor to provide other capital support.
- Other facilities providing liquidity or credit support.

6. Custody

An LGIP should use custodian banks whose creditworthiness is deemed consistent with the objective of principal preservation and liquidity. LGIPs should conduct appropriate due diligence when choosing a custodian bank.

7. Authority

It should be noted that investment authorization granted to each LGIP is generally derived from statute from the state in which a respective LGIP sponsor resides. Management should monitor proposed and recently enacted legislation to determine if an LGIP will be affected and, if so, that proper action is taken to comply with new statutory requirements and that proper disclosures to participants and the general public are made.

BEST PRACTICES FOR STABLE NAV LGIPS (continued)

8. Oversight

Proper oversight should ensure that LGIP management acts in the best interest of participants and is in full compliance with investment policies and approved operational procedures. Oversight should ensure that appropriate controls and procedures are implemented to safely and effectively manage day-to-day investment and operations of an LGIP. Oversight of an LGIP may include a board of directors, board of trustees, advisory board, or independent third party which may include an NRSRO.

9. Approving Broker-Dealers

Information on brokerage firms and individual brokers is publicly available online through the Financial Industry Regulatory Authority's Broker Check Program. A thorough review should be completed to determine if a broker has any history of disciplinary problems or

received any serious complaints from investors. If a firm is not a primary dealer, it is recommended that an approved dealer qualify under SEC Rule 15c3-1 (Uniform Net Capital Rule). A review of the firm's audited financial statements, its operating history, and its expertise in securities that an LGIP will be trading in should be considered in the approval process.

10. Currency Risk

LGIPs should only purchase instruments denominated in U.S. dollars and issuers domiciled in the U.S.

CONCLUSION

GASB Statement No. 79 establishes accounting and financial reporting standards for qualifying external investment pools that elect to measure for financial reporting purposes all of their investments at amortized cost.² Statement No. 79 does not prevent LGIPs that do not qualify to measure all investments at amortized cost from continuing to transact with participants at a stable NAV. These best practices are designed to provide guidance to preserve safety of capital and liquidity for all stable NAV funds regardless if they qualify to measure for financial reporting purposes all investments at amortized cost. Several of Statement No. 79's risk-limiting requirements such as diversification, maturity and liquidity are included as best practices as well as suggested operational standards. With over \$250 billion in assets, LGIPs play a vital role in the investment management of public funds. With a solid investment policy, qualified staff and adherence to prudent governance standards as stipulated in these best practices, an LGIP should be positioned to continue to operate as a stable NAV through various economic and interest rate cycles.

The 2008 financial crisis brought about sweeping reforms and legislation such as the Dodd-Frank Wall Street Reform and Consumer Protection Act, amendments to SEC Rule 2a-7, and Basel III. All these reforms were intended to strengthen financial institutions and money funds. Likewise, these best practices were designed to ensure that all stable NAV LGIPs maintain principal stability and continue to operate as a safe and liquid investment option for states and local governments. As future economic cycles may create new legislation or reforms that will impact LGIPs, an annual review of these best practices jointly by NAST and NASACT should ensure that these practices do not become outdated or fail to incorporate the essential criteria that LGIPs should adhere to in order to maintain a stable NAV.

As stated in the background, these voluntary guidelines are intended to be best practices taking into consideration that some LGIPs may be constrained by statutory or other sponsor-related constraints that may not allow full adoption of all sections of these recommended guidelines. While some LGIPs may be prohibited from adopting all sections of these suggested guidelines, NAST and NASACT believe that adherence to these guidelines will help preserve the financial integrity and reputation of LGIPs that adhere to them.

All LGIPs should be managed in accordance with the prudent man rule. Each LGIP sponsor may have similar objectives for managing its pool but qualified staff, a history of participant cash flows, or other LGIP specific data may allow an LGIP sponsor to deviate from best practices. In those instances, it is suggested that an LGIP sponsor should be transparent and fully disclose information so that participants can understand the reasons and risks associated with such deviation from best practices.

² Governmental Accounting Standards Board, Statement No. 79, Certain External Investment Pools and Pool Participants (Dec. 2015).

ANNEX

Securities Lending

Caution should be taken if securities lending is utilized to improve performance or provide liquidity for an LGIP. Any securities lending program should have clear objectives and be fully disclosed to LGIP participants. All securities lending counterparties should be monitored and should adhere to the same standards established for other counterparties. Maximum maturities should be established for securities lending transactions as well as a maximum aggregate stated as a percentage of net assets. The portfolio manager should fully understand the effects of securities lending on a pool's liquidity and WAM as well as any risk added from securities lending transactions. Securities lending exposure should be considered when stress-testing an LGIP. Securities lending can increase the risk level of an LGIP. For those LGIPs electing to utilize a securities lending program to enhance performance or to provide liquidity to the LGIP, it is recommended that an LGIP adhere to criteria established by an NRSRO for a principal stability fund in terms of maximum maturity and percentage of net assets in transactions for each maturity range. In addition, the reinvestment of cash collateral from a securities lending transaction should be treated the same as other assets in an LGIP's portfolio.



NATIONAL ASSOCIATION OF STATE TREASURERS

Headquarters

201 E. Main Street, Suite 540
Lexington, KY 40507
(859) 721-2190

Federal Relations Office

701 Eighth Street, NW
Suite 540
Washington, DC 20001
(202) 347-3865

www.nast.org



NASACT

National Association of State
**Auditors, Comptrollers
and Treasurers**

Headquarters

449 Lewis Hargett Circle, Suite 290
Lexington, KY 40503-3590
(859) 276-1147

Washington Office

The Hall of the States
444 N. Capitol Street, NW, Suite 234
Washington, DC 20001
(202) 624-5451

www.nasact.org