



COUNTY OF ORANGE

OFFICE OF THE TREASURER-TAX COLLECTOR

HALL OF FINANCE & RECORDS
12 CIVIC CENTER PLAZA, ROOM G76
P. O. BOX 4515
SANTA ANA, CA 92701

JOHN M. W. MOORLACH, C.P.A., CFP
TREASURER-TAX COLLECTOR
(714) 834-2288

GARY J. COWAN
ASSISTANT TAX COLLECTOR
(714) 834-3545

RICHARD G. HILDE
ASSISTANT TREASURER
(714) 834-2918

FAX (714) 834-2912

April 27, 2001

To: Board of Supervisors

From: John M. W. Moorlach, C.P.A., CFP
Treasurer-Tax Collector

Re: Treasury Investment Workshop 30-Day Update

As a result of the Internal Audit Department's "audit" of our Edison International holdings, some eleven recommendations for modifications to my Investment Policy Statement were provided.

Internal Audit determined that they were to broker an agreeable resolution between the Board of Supervisors and the Treasurer, so four of the proposals were reviewed by the Treasury Oversight Committee prior to submittal to the Board at the March 27 Treasury Investment Workshop (the "Workshop").

Following this expedited process, Internal Audit provided five more recommendations. In total, nine recommendations were included in their report presented at the Workshop. Subsequent to the Workshop, Internal Audit provided two additional recommendations.

This memorandum is to fulfill the 30-day directive of the Board of Supervisors as to the Treasurer's response to the additional seven recommendations. The Treasury Oversight Committee and the Treasurer's Advisory Committee have concurred with these positions at its April 24 meeting (see the attached summary).

1. Limit corporate debt investments to an industry maximum of 25 percent.

Although this seems rather simplistic on its surface, as they say "the devil is in the details." The Commercial Paper market is \$1.54 trillion large. One segment of this market is Asset-Backed Commercial Paper, which represents roughly \$653 billion of the issues, or 42 percent of the market. Determining appropriate industry descriptions for these issuers has been problematic and is still being researched.

The Investment Management Committee invited Mr. Douglas A. Rivkin of Moody's Investors Service to meet with us yesterday. He is the author of the attached Special Report, entitled "U.S. Money Market Funds: Hungry for Asset-Backed Commercial Paper." Even this well versed industry expert was at a loss on providing precise industry sector descriptions for these issuers.

His report does make some interesting observations:

- * Asset-Backed Commercial Paper has grown from 27 percent to 42 percent of outstanding commercial paper in the last three years.
- * Asset-Backed Commercial Paper's competitive yields, short-term structures, and abundant supply make them very attractive to money market funds in today's market.
- * Most of the Asset-Backed Commercial Paper issues are rated "P-1" and credit losses have been non-existent, adding to their attractiveness.

If all "Asset-Backed Commercial Paper" were to be categorized as "Financial," then we would be restricting the County from the full benefit of this growing sector of the market place. It would appear that this recommendation has not taken recent market trends into account.

Defer: Allow the Treasurer's Office to continue its research in this area in order to acquire accepted industry standards for useful stratification. It is anticipated that a recommendation will be provided with the annual approval of the Investment Policy Statement in December.

2. Reduce the 5 percent per issuer maximum.

This also sounds rather simplistic on its surface, yet it can get cumbersome in its implementation. This would restrict larger investments in stronger credit issuers and may require smaller investments in weaker, but acceptable credits.

Prudence would dictate that the 5 percent limit be retained, but that lower limits be self-imposed by the Treasurer when economic and credit conditions warrant such a maneuver.

Oppose: The Treasurer does not believe that a further overall holding constriction by issuer is warranted and that the current policy is satisfactorily prudent.

3. Reduce the maximum percentage allowed for Commercial Paper and Medium Term Notes.

Our current maximum limitations are 40 percent for Commercial Paper and 30 percent for Medium Term Notes. Cumulatively, this provides for a 70 percent maximum holding in short-term corporate paper.

Ironically, Rule 2a-7 allows for a 100 percent maximum holding in short-term corporate paper. To date, only one money market fund has "broken the buck," and it was not due to corporate paper holdings. Not one "rated" money market fund has "broken the buck." Even with our Edison International holding, the School Pool has not "broken the buck." We need to address real credit issue concerns, not hypothetical or imaginary ones.

Oppose: The Treasurer does not believe restricting an asset class is a prudent recommendation. In fact, in the money market fund industry, the investment type has not necessarily been the cause of any industry conflicts.

4. Perform monthly “stress test.”

A “stress test” for a money market-like fund is a redundancy. Perhaps our Extended Fund may be a candidate, but even that could be viewed as a misuse of public funds. Since our investments have short maturities and fall within the net asset value parameters of GASB 31, this exercise is not warranted.

Oppose: The Treasurer does not believe that performing a “stress test” on the money market pools is a proper expenditure of public funds.

5. Revise the Investment Policy Statement’s references to the term “yield.”

This is another redundancy. In contrast to other county pools, Orange County’s money market emphasis speaks volumes about its perspective on the importance of safety and liquidity over yield.

Oppose: The Treasurer believes that the current emphasis on yield is balanced and satisfactory.

6. Require Medium Term Notes to have a minimum rating of “AA” and a first tier short-term rating.

The current Investment Policy Statement has stringent credit quality requirements for Medium Term Notes that are similar to this recommendation. Over-tightening is over-simplistic and further constricts the investment availability of prime quality paper to the Treasurer.

Oppose: The Treasurer believes that the current rating requirements for Medium Term Notes are satisfactory and should remain in place.

7. Require Medium Term Notes to have a minimum rating of “AAA” when the maturity is longer than 13 months.

The Treasurer already abides by this standard. It is also a requirement of the rating agency.

Concur: As this requirement is implicit, i.e. it is not specifically stated in the Investment Policy Statement, it will be added with the Investment Policy Statement approval this upcoming December.

If you have any questions regarding the above, please do not hesitate to contact me.

cc: Treasury Oversight Committee
Treasurer’s Advisory Committee
Peter Hughes, Internal Audit Director

Attachments

Enhancement/Recommendation	TAC Recommendation	TOC Recommendation
Prohibit Commercial Paper on "Credit Watch-Negative"	IPS revised 3-27-01	IPS revised 3-27-01
Prohibit split rated Commercial Paper	IPS revised 3-27-01	IPS revised 3-27-01
Senior management review of daily investment purchases	IPS revised 3-27-01	IPS revised 3-27-01
Annually submit to Board of Supervisors names and qualifications of individuals authorized to invest	IPS revised 3-27-01	IPS revised 3-27-01
Limit corporate debt investments to a 25% industry maximum	Still reviewing procedure to implement	Concur with TAC 5-0
Reduce the 5% per issuer maximum	Not practical	Concur with TAC 4-0-1 (Schumacher requested further discussion)
Reduce the maximum percentage allowed for Commercial Paper and Medium Term Notes	“Proposal lacks logic and understanding”	Concur with TAC 4-0-1 (Schumacher requested further discussion)
Perform monthly a "stress/shock test" on the portfolio	Waste of time and money	Concur with TAC 5-0
Revise the Investment Policy Statement's references to yield.	Satisfied with current language	Concur with TAC 5-0
Require MTNs to have a minimum rating of AA and a top tier short-term rating	Not practical	Concur with TAC 5-0
Add language to IPS specifying AAA requirement for MTNs with a maturity longer than 13 months	Already being done; will memorialize by including in next IPS revision - 12-01	Concur with TAC 5-0