

Mayor and Council Communication

DATE: 08/24/21

M&C FILE NUMBER: M&C 21-0594

LOG NAME: 13OPEB INVESTMENT POLICY AND STRATEGY 2021

SUBJECT

(ALL) Adopt Attached Revised Investment Policy and Strategy for the City's Other Post-Employment Benefit Trust

RECOMMENDATION:

It is recommended that the City Council adopt the attached revised Investment Policy and Strategy for the City's Other Post-Employment Benefit (OPEB) Trust.

DISCUSSION:

The purpose of this Mayor and Council Communication (M&C) is to adopt an amended and revised Investment Policy and Strategy (IPS) for the Other Post-Employment Benefit (OPEB) Trust in accordance with the requirements of the OPEB Investment Policy. Pursuant to the Policy, the governing body (City Council) is required to formally review and approve the City's IPS at least annually. The IPS was last approved on September 22, 2020 (M&C 20-0687). The OPEB Investment Policy and Strategy provides the foundation for solid fiscal management of the Trust portfolio. The policy provides guidance on appropriate investment practices ensuring long-term financial success for the OPEB Trust.

The OPEB Trust consists of money that the City Council has set aside to be used for future retirement healthcare costs. The OPEB Trust was established in 2009 through City Council Resolution No. 3779-08-2009.

Staff and the Investment Committee have reviewed the IPS and are recommending a revision to add clarity to the below sections on Quality, Duration and Diversification in the policy.

Section III. Investment Guidelines, item 1. Existing Investments, Quality

- **From:** The portfolio will maintain a minimum weighted average quality of A- at all times. Individual securities shall have a minimum quality rating of Baa3 by Moody's or BBB- by Standard & Poor's (S&P). Note, high yield fixed income can be purchased only in a diversified mutual fund or exchange traded fund.
- **To:** The portfolio will maintain a minimum weighted average effective quality of A- at all times. At the time of purchase, individual securities shall have a minimum effective quality rating of BBB-. Note, high yield fixed income can be purchased only in a diversified mutual fund or exchange traded fund.

The purpose of the quality change is just to update the guidelines to more of a market standard and bond index standard. Note there is no change to the average rating minimum or minimum individual security rating and instead this is more for clarification as well as consistency. The bond market and associated indices typically look toward the ratings of the 3 major Nationally Recognized Statistical Ratings Organization (NRSRO)'s which include S&P, Moody's, and Fitch. Further, in order to determine index credit ratings, a waterfall methodology is used to create an effective rating. The underlying index for the fixed income portion of the account, the Bloomberg Barclays U.S. Aggregate Index uses the exact effective rating waterfall noted above when calculating rating qualification as well as weighted average quality for the index.

Section III. Investment Guidelines, item 1. Existing Investments, Duration

- **From:** The manager will maintain the portfolio duration within +/- 25% of the benchmark duration at all times.
- **To:** The manager will maintain the portfolio duration within +/- 25% of the Bloomberg Barclays U.S. Aggregate Bond Index duration at all times.

The Investment Managers Compliance Department felt an actual benchmark was needed.

Section III. Investment Guidelines, item 1. Existing Investments, Diversification, Second paragraph

- **From:** No more than 10% of the portfolio may be invested in securities issued under Rule 144A.
- **To:** No more than 30% of the portfolio may be invested in securities issued under Rule 144A without registration rights (no limit on Rule 144A securities with registration rights).

Given the increased issuance of rule 144A and rule 144A with registration rights, an inability to fully invest in the area can be costly from a performance and diversification perspective. Further, issue size, issuer name, and credit rating are the largest drivers of liquidity within the corporate bond market as opposed to when a bond is 144A or not. As such we are recommending increasing the amount of 144A bonds available in the portfolio to a number closer to that of the investment grade corporate bond market in general (30%) while not placing any limit on bonds issued as 144A with registration rights given that is simply a timing issue between when the bond is issued and when it is swapped into an identical fully registered bond.

A redline is attached for your convenience. See page 5.

A Form 1295 is not required because: This M&C does not request approval of a contract with a business entity.

FISCAL INFORMATION / CERTIFICATION:

The Director of Finance certifies that approval of this recommendation will have no material effect on City funds.

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