The following is a document from the San Mateo County Treasurer Lee Buffington based on a meeting with the County Superintendents sub committee and the two school board representatives.

The meeting was held on October 22, 2008

I appreciated the opportunity to meet with representatives from the various schools districts last week to discuss the issues and concerns raised by the Lehman Brothers' bankruptcy. I hope that representatives from the school districts will be able to attend the November 4, 2008 meeting of the Board of Supervisors to hear my presentation to the Board addressing questions regarding the pool and its investments. In the meantime, there were specific areas that I was requested to provide immediate information, which I shall address below. If I have failed to fully address any of these areas, please let me know.

As an initial matter, it is important to understand the fiscal objectives of the Investment Pool, which include the primary objective of preserving principal, as well as the maintenance of a margin of liquidity in order to meet known as well as unanticipated expenses. Satisfaction of the Pool's on-going objectives is affected by the fact that, notwithstanding the need to provide for payments to participants throughout the year, there are only three time periods during the year when the Pool receives more tax money than it pays out. These operational concerns, as well as the requirements set forth in State law and the Investment Policy, impact the type and amount of investments that my office purchases for the Pool. For example, in light of the above, the Pool purchases corporate instruments with the intent of holding such paper until its scheduled maturity date or to benefit from the income of the instrument, as opposed to timing such purchases and sales for maximum profit.

Are There Limits in the Concentration of Pool Investments by Sector?

All investment decisions of Investment Pool assets are governed by Government Code Section 53600 *et seq.*, which provides strict guidelines for investments made by public agencies in the State of California. The allowable investment vehicles set forth in the statute are limited to such items as corporate bonds and medium term notes as well as commercial paper and floating rate notes. In addition, the San Mateo County Pooled Fund Investment Policy imposes additional limitations and establishes specific ratings criteria and investment limits for each type of security available for purchase. For your convenience, I have enclosed a copy of the Investment Policy and direct your attention to pages 5-6. Please note that neither state statute nor the Investment Policy have limitations related to sector concentration. Further, as noted above, it is important to understand the objectives for which investment decisions are made as well as the state law and Investment Policy limitations regarding the types of instruments that can be purchased. At the time the Pool purchased Lehman Brothers securities, for example, the ratings of government sector instruments were low. Additionally, industrial sector instruments, which typically have longer maturity terms and lower rates of return, are relatively rare and are difficult to find.

Please be assured that each of the Pool's investments was purchased in accordance with not only the Policy but also the requirements set forth in the Government Code.

Can Districts Direct Investments of Pool Funds?

You have additionally asked that I address the question of "directed investments." I take this to mean whether a particular school district has the authority to direct the Treasurer to purchase or sell particular instruments with the district's funds in the pool. As the County Counsel has advised, school districts have the authority to either invest surplus funds themselves or to delegate that authority to the County Treasurer, and when the responsibility to invest resides with the Treasurer a school district cannot direct that certain investments be made with pooled funds. Because investments are pooled, it would be unworkable to invest as directed by a specific entity in any event. Separate from the pooled investment fund, the Brisbane School District deposited surplus moneys with the Treasurer over ten years ago for the purchase of instruments whose maturity exceeded that of those in the Investment Pool. Such funds were not placed in the Investment Pool and the district did not retain the authority to direct the purchase of specific instruments.

Under What Conditions May Districts Withdraw Funds from the Pool?

Pursuant to state law (Government Code §§ 27133(h) and 27136), each county's investment policy is required to set forth criteria for the treasurer's consideration of requests for withdrawal from the pool and the treasurer must consider such criteria before approving a withdrawal. Further, the treasurer must ensure that no withdrawal will adversely affect the interest of other depositors in the pool. Finally, school districts are subject to the additional restrictions of the Education Code. In particular, school district withdrawals are generally limited to "surplus funds" as defined in Cal. Educ. Code § 41015 (*i.e.*, monies not required for the immediate necessities of the district).

In accordance with state law, the Pooled Fund Investment Policy places certain conditions and limitations upon a participant's withdrawal of funds from the pool. The Policy generally limits withdrawals to a maximum rate of 20% of the participant's principal balance per month, unless otherwise authorized by the Treasurer. Further, all withdrawal requests are subject to the Treasurer's consent and must be set forth in writing. All such requests are subject to the Treasurer's consideration of the stability, liquidity, and predictability of the pooled investment fund and the adverse effect on the interests of the other depositors in the pooled investment fund.

What is Currently Being Done to Minimize the Risk?

Since the Lehman bankruptcy, our office has taken a number of steps to reduce our risk consistent with the Policy's guidelines and State law. First, we have instituted an internal operational investment limit of 5% per issuer pending consideration of changes to the County Investment Policy. This percentage decrease will ensure a broader diversification than the 10 % set forth in the Policy. Further, consistent with our past practice, we are continuing to evaluate each of the Pool's investments on a daily basis in light of current market conditions. We are not adding any financial sector investments to the fund with the exception of the highest rated commercial paper and CDs. This office will continue to evaluate each of its investments in light of any developments which may occur. Finally, as an on going process, I continue to work with my staff to determine additional steps that can be taken to address any potential problems in the portfolio.

Lee Buffington

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