



BEST PRACTICES FOR SAFEKEEPING OF INVESTMENTS

Most public entities have adopted investment policies that focus on three main objectives: safety, liquidity and yield. What does safety mean when it comes to the purchase of an investment? In the case of a security, the answer is two-fold. It means the return of principal at maturity and protection against fraud. By selecting an independent third-party safekeeping agent or custodian, a public entity can minimize the potential of loss related to theft or investment fraud. A safekeeping agreement requires investments (and pledged collateral) to be held in a separate account, in the name of the buyer, and not in “street name” or the name of the broker/dealer.

Entering in to a safekeeping agreement with a third party (a firm other than the one that sold the security) ensures that public funds are not at risk during an investment transaction because securities are settled through a process called “delivery versus payment.” Through this settlement process, funds for payment are not released to the selling firm until securities are delivered to the buyer’s custody account. Many investment policies require these safekeeping procedures to be reviewed by auditors on an annual basis.

In October 2010, The Government Finance Officers Association (GFOA) released Best Practices titled *Using Safekeeping and Third-Party Custodian Services*.

The GFOA recommends that governmental entities:

- Competitively select third-party custodians and safekeeping agents;
- Have safekeeping/custodial agreements reviewed by legal counsel prior to execution;
- Evidence their safekeeping or custodial relationship with a signed, written security agreement that is reviewed by counsel and establishes the firm as an agent;
- Execute all investment transactions on a delivery- versus-payment basis;
- Designate a specific DDA (demand deposit account) clearing account or custody account for monitoring and reporting purposes, if cost effective;
- Require that the independent third-party safekeeping agent or custodian mark the portfolio to market at least monthly. Ideally, marking should take place daily with independent pricing;
- Require reports and monthly statements to be received directly by the government entity from the agent;
- Ideally, have electronic access to the safekeeping or custody account for monitoring and reporting purposes, if cost effective;
- Require safekeeping or custodial agents to be insured for error and omissions;
- Require review of internal safekeeping and custodial procedures with the independent auditor.

WHAT SHOULD AN ENTITY DO IF ITS INVESTMENTS ARE HELD IN STREET NAME OR CURRENT CUSTODIAL SERVICES SEEM EXTRAORDINARILY EXPENSIVE?

The Board of Commissioners of the Wisconsin Investment Series Cooperative (WISC) have partnered with BMO Bank NA to provide free or low cost safekeeping services for participating public entities. Members that purchase fixed rate investments including DTC eligible CDs, government agencies and municipal securities through PMA Securities, Inc. receive free custodial services and separate monthly account statements through BMO Bank. Members that have securities portfolios that were purchased through other firms have access to the same services through BMO Bank at a significantly lower cost than similar providers.

GFOA Best Practices related to safekeeping and other topics are available at: <http://www.gfoa.org/best-practices>.

To receive more information related to safekeeping accounts or investment options, please contact your Portfolio Advisor at 1-800-783-4273.

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