



BEST PRACTICE

Using Mutual Funds for Cash Management Purposes (2003, and 2006) (TIM)

Background. State and local government cash managers may benefit from investing public funds through mutual funds. Mutual funds are SEC-regulated investment instruments that pool and jointly invest the funds of multiple investors. Mutual funds are available for both fixed income and equity investments. Short-term liquid mutual funds that maintain a weighted average maturity of 90 days or less and maintain investor shares with a constant one dollar (\$1) Net Asset Value are called money market mutual funds. Other non-money market fixed income mutual funds generally have a longer-term weighted average maturity and have a fluctuating price or Net Asset Value.

The Government Finance Officers Association (GFOA) has endorsed the use of money market mutual funds by public cash managers through the GFOA's model investment legislation for state and local governments. Portfolio safety, liquidity, diversification, and professional management are desirable features of these investment vehicles. The safety of assets, which is the foremost objective of public cash managers, may be impaired by market price risks associated with short-, intermediate-, and long-term bond funds.

Recommendation. The GFOA recommends that state and local governments restrict their use of mutual funds for cash management purposes exclusively to money market mutual funds and short-term bond funds.

Public cash managers should check applicable statutes to determine if the use of money market mutual funds and/or short-term bond funds is permitted within their jurisdictions. Further, GFOA recommends that governments review and understand the fund's prospectus and statement of additional information to determine:

- portfolio composition,
- risk characteristics,
- the duration and weighted average maturity of the mutual fund,
- the reputation and experience of the investment company,
- the performance history relative to appropriate benchmarks,
- total expense ratio,
- philosophy, strategies, and portfolio policies,
- if the fund is rated by a nationally recognized rating agency, and
- whether the fund can meet the compliance requirements of the government's approved investment policy, for example, minimum ratings, maximum sector allocations, or specific criteria such as social investing.

GFOA recommends that governments consider money market mutual funds that are in the federal Treasury, government, or first tier categories and receive the highest ratings available from at least one nationally recognized rating agency. Short-term bond funds should receive the highest credit quality ratings and the lowest risk ratings available. State and local government cash managers should exercise prudence and caution when investing in short-term bond funds. Short-term bond funds (if used) investing in short- and intermediate-term instruments may be appropriate investments in some jurisdictions for funds that are not needed for near-term disbursement. However, mutual funds of an intermediate or long-term duration should be avoided by investors of short-term funds needed for liquidity purposes.

References

- *An Introduction to Investment Advisers for State and Local Governments, Second Edition*, Sofia Anastopoulos, GFOA, 2007.
- *A Public Investor's Guide to Money Market Instruments, Second Edition*, edited by M. Corinne Larson, GFOA, 1994.
- *Investing Public Funds, Second Edition*, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.
- GFOA Best Practice, "Managing Market Risk in Investment Portfolios," 2007 and 2009.

Approved by the GFOA's Executive Board, October 6, 2006.