INVESTMENT POLICY

CITY OF KYLE, TEXAS

Reviewed & Adopted:

August ___, 2016

INVESTMENT POLICY

TABLE OF CONTENTS

Page

I. PURPOSE 1

II. INVESTMENT OBJECTIVES 1

III. RESPONSIBILITY AND STANDARD OF CARE 2

IV. INVESTMENT ADVISORS AND BROKER / DEALERS 4

V. AUTHORIZED INVESTMENTS 5

VI. SAFEKEEPING AND COLLATERALIZATION 8

VII. REPORTING 10

VIII. INVESTMENT OFFICER TRAINING 11

IX. INVESTMENT STRATEGIES 12

GLOSSARY OF TERMS 12

I. PURPOSE

It is the policy of City of Kyle, Texas that, giving due regard to the safety and risk of investment, all available funds shall be invested in conformance with State and Federal Regulations, applicable Bond Ordinance requirements, formal Investment Policy and informal investment strategy.

Effective cash management is recognized as essential to good fiscal management. Cash management and effective investment strategy development will be pursued to take advantage of interest earnings as viable and material revenue to all City funds. The City's portfolio shall be designed and managed in a manner responsive to the public trust and consistent with this Policy.

A. Formal Adoption

This Investment Policy is authorized by the City of Kyle City Council in accordance with Chapter 2256, Texas Government Code, the Public Funds Investment Act, as amended, which requires the adoption of a formal written Investment Policy

B. Scope

This Investment Policy applies to all of the investment activities of the City of Kyle, including but not limited to investment of general funds, reserve funds, interest and sinking funds and bond funds. Retirement funds are not governed by this policy. This Policy establishes guidelines for who can invest City funds, how City funds will be invested, and when and how a periodic review of investments will be made. In addition to the guidelines of this Policy, bond funds (as defined by the Internal Revenue Service) shall be managed in accordance with their governing resolution and all applicable State and Federal Law.

C. Review and Amendment

This written investment policy and related fund strategies shall be reviewed annually by the City Council. Amendments must be approved and adopted by the City Council. The City Council shall adopt a written resolution stating that it has reviewed the investment policy and investment strategies.

II. INVESTMENT OBJECTIVES

A. Safety of Principal

The primary objective of all investment activity is the preservation of capital and the safety of principal in the overall portfolio. Each investment transaction shall seek to ensure first that capital losses are avoided, whether from security defaults or erosion of market value.

The City shall seek to control the risk of loss due to the failure of a security issuer or grantor. Such risk shall be controlled by investing only in the safest types of securities as defined in the Policy; by collateralization as required by law; and through portfolio diversification by maturity and type.

B. Maintenance of Adequate Liquidity

The investment portfolio will remain sufficiently liquid to meet the cash flow requirements that might be reasonably anticipated. Liquidity shall be achieved by matching investment maturities with forecasted cash flow requirements; investing in securities with active secondary markets; maintaining appropriate portfolio diversification; and by investing in eligible money market mutual funds and local government investment pools.

A security may be liquidated to meet unanticipated cash requirements, to redeploy cash into other investments expected to outperform current holdings, or otherwise to adjust the portfolio.

C. Return on Investments

The City shall invest local funds in investments that yield a competitive market rate of return while providing necessary principal protection consistent with stated objectives. For bond proceeds to which arbitrage restrictions apply, the primary objectives shall be to obtain a fair market rate and to minimize the costs associated with the investment of such funds within the constraints of the investment policy and applicable bond covenants.

III. RESPONSIBILITY AND STANDARD OF CARE

A. Delegation of Authority

The Director of Finance shall be the "Investment Officer" of the City. The Investment Officer is authorized by the City Council to cause the investment of all available funds consistent with this policy. In the absence of the Director of Finance, the City Manager shall serve as the Interim Investment Officer. The City Council may also appoint additional Investment Officer(s) by resolution. Because of the various duties and responsibilities related to managing the investment portfolio, the Director of Finance may delegate specific duties and responsibilities to other finance department employees; however, no person shall engage in an investment transaction except as provided under the terms of this policy.

B. Standard of Care

The standard of care used by the City shall be the "prudent investor rule" as set forth in Tex. Gov't Code Ann. Sec. 2256.006, and shall be applied in the context of managing the overall portfolio within the applicable legal constraints. The Prudent Investor Rule states that:

> "Investments shall be made with judgment and care, under circumstances then prevailing, that a person of prudence, discretion and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived."

Investment of funds shall be governed by the following investment objectives, in order of priority:

1) preservation and safety of principal,

2) liquidity, and

3) yield

The designated Investment Officers shall perform their duties in accordance with the adopted Investment Policy and internal procedures. In determining whether an Investment Officer has exercised prudence with respect to an investment decision, the investment of all funds over which the Investment Officer had responsibility, rather that the prudence of a single investment shall be considered. Investment Officers acting in good faith and in accordance with these policies and procedures shall be relieved of personal liability. The designated Investment Officers shall adhere to the City of Kyle Investment Policy and Ethic Ordinance.

C. **Conflict of Interest**

The designated Investment Officers shall act as custodians of the public trust avoiding any transaction which might involve a conflict of interest, the appearance of a conflict of interest, or any activity which might otherwise discourage public confidence. Investment Officers shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Additionally, all Investment Officers shall file with the Texas Ethics Commission and the City a statement disclosing any personal business relationship with any business or individual seeking to sell investments to the City, or any relationship within the second degree by affinity or consanguinity to an individual seeking to sell investments to the City. For purposes of this subsection, an Investment Officer has a personal business relationship with a business organization if:

1) The Investment Officer owns 10 percent or more of the voting stock or shares of the business organization or owns $5,000 or more of the fair market value of the business organization;

2) Funds received by the Investment Officer from the business organization exceed 10 percent of the Investment Officer's gross income for the previous year; or

3) The Investment Officer has acquired from the business organization during the previous year investments with a book value of $2,500 or more for the personal account of the Investment Officer.

D. **Establishment of Internal Controls**

The Director of Finance shall establish written administrative procedures for the operation of the investment program consistent with this Policy. The controls shall be designed to prevent, identify and control losses of public funds arising from deviation from this policy, fraud, employee error, misrepresentation by third-parties, or imprudent actions by employees and officers of the City.

Duties related to investment activities will be delegated so that segregation of duties will be maintained with respect to purchasing, recording, authorizing and reconciling investment accounts. All investment transactions must be authorized by the Director of Finance.

IV. INVESTMENT ADVISORS AND BROKER / DEALERS

A. Investment Advisors

The Finance Director may select an Investment Advisor to advise the City in the investment of City funds and other responsibilities including but not limited to broker compliance, security selection, competitive bidding, security reporting and documentation. The Investment Advisor must be registered with the Securities and Exchange Commission (SEC) under the Investment Advisor's Act of 1940 as well as with the Texas State Securities Board.

Investment Advisors shall agree that investment advice shall at all times be given with the judgment and care, under circumstances then prevailing, which persons paid for their special prudence, discretion and intelligence, in such matters exercise in the management of their client's affairs, not for speculation by the client or production of fee income by the advisor or broker but for investment by the client with emphasis on the probable safety of the capital while considering the probable income to be derived.

An appointed Investment Advisor shall act solely in an advisory and administrative capacity, within the guidelines of this Investment Policy and without any discretionary authority to transact business on behalf of the City.

The term of any Investment Advisor contract may not exceed two years. Any renewal or extension of the Investment Advisor contract must be made by the City Council by resolution.

Investment Advisors shall additionally prepare, at least on a quarterly basis, a comprehensive portfolio report that includes, at a minimum, the following information:

- ✓ Current portfolio status,
- ✓ Transactions and activity for the period,
- ✓ Investment maturity schedule,
- ✓ Security-type allocation,
- ✓ Income earned,
- ✓ Yield analysis (including benchmarks), and
- ✓ Book value versus market value comparison.

B. Broker / Dealer Selection and Due Diligence

The City shall establish a list of approved broker/dealers, which qualify under SEC rule 15C3-1 (uniform net capital rule) from which it will conduct security transactions. Each prospective business organization must provide current financial statements, resumes of key sales personnel and a completed broker/dealer questionnaire. The Financial condition of each qualified firm shall be reviewed annually.

In addition, business organizations eligible to transact investment business with the City shall be presented a written copy of this Investment Policy. Additionally, the qualified representative of the business organization offering to engage in an investment transaction with the City shall execute a written instrument in a form acceptable to the City and the business organization substantially to the effect that the business organization has:

1) Received and reviewed the investment policy of the City; and

2) Acknowledged that the business organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the City and the organization that are not authorized by the City's investment policy, except to the extent that this authorization is dependent on an analysis of the makeup of the City's entire portfolio or requires an interpretation of subjective investment standards.

The City shall not enter into an investment transaction with a business organization prior to receiving the written instrument described above.

The City Council shall, at least annually, review, revise, and adopt a list of qualified Investment Providers that are authorized to engage in investment transactions with the City.

If the City has contracted with an Investment Advisor, the advisor shall be responsible for performing financial due diligence on the City's behalf. The advisor will annually provide the City with a list of authorized Broker/Dealers as well as the written acknowledgement above.

V. AUTHORIZED INVESTMENTS

A. **Eligible Investments**

City funds governed by this Policy may be invested in:

1) Obligations of the United States or its agencies and instrumentalities, *excluding* mortgaged backed securities, collateralized mortgage obligations, and real estate mortgage investment conduits.

2) Direct obligations of the State of Texas or its agencies and instrumentalities;

3) Other obligations, the principal and interest on which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, the State of Texas or the United States or their respective agencies and instrumentalities including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation (FDIC) or by the explicit full faith and credit of the United States;

4) Obligations of states, agencies, counties, cities, and other political subdivisions of any State having been rated as to investment quality by a nationally recognized investment rating firm and having received a rating of not less than "A" or its equivalent;

5) Fully collateralized repurchase agreement having a defined termination date; placed through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in Texas; and secured by obligations described by a combination of cash and securities listed in 1- 4 above and pledged with a third-party selected or approved by the City; and having a market value of not less than the principal amount of the funds disbursed. The term repurchase agreement includes reverse repurchase agreements. Repurchase agreements must also be secured in accordance with State law.

Each counter party to a repurchase agreement is required to sign a copy of the Security Industry and Financial Markets Association (SIFMA) Master Repurchase Agreement as approved by the City. An executed copy of this Agreement must be on file before the City will enter into any transaction with a counter party.

6) Certificates of deposit must be issued by a depository institution that has its main office or a branch office in the state of Texas that are:

- Guaranteed or insured by the FDIC or its successors; or

- Secured by obligations that are described by 1-4 above, which are intended to include all direct Federal agency or instrumentality issued mortgage backed securities, but excluding those mortgage-backed securities that have a market value of not less than the principal amount of the certificates; or

- Secured in any other manner provided by law for deposits of the City; or

- Governed by a Depository Agreement that complies with Federal and State regulation to properly secure a pledged security interest.

7) Money market mutual funds regulated by the Securities & Exchange Commission, with a dollar weighted average portfolio maturity of 60 days or less that fully invest dollar-for-dollar all City's funds without sales commissions or loads and, whose investment objectives include seeking to maintain a stable net asset value of $1 per share. The City may not invest funds under its control in an amount that exceeds 10% of the total assets of any individual money market mutual fund or exceeds 80% of its monthly average fund balance, excluding bond proceeds and reserves and other funds held for debt service in money market mutual funds;

8) Commercial paper with a stated maturity of 270 days or less from the date of issuance and rated no less than A-1 or P-1 or an equivalent rating by at least two nationally recognized rating agencies;

9) Local government investment pools organized and operating in compliance with the Interlocal Cooperation Act, as amended, whose obligations are exclusively of the obligations that are described by 1-7 above and whose investment philosophy and fund strategy is consistent with this policy.

To maintain eligibility to receive funds from and invest funds on behalf of the City, an investment pool must be continuously rated no lower than AAA or AAA-m, or an equivalent rating by at least one nationally recognized rating service.

In addition, an investment pool must furnish an offering circular or other similar disclosure instrument that contains, at a minimum, the following information:

- the types of investments in which money is allowed to be invested;
- the maximum average dollar-weighted maturity allowed, based on the stated maturity date, of the pool;

- the maximum stated maturity date any investment security within the portfolio has;
- the objectives of the pool;
- the size of the pool;
- the names of the members of the advisory board of the pool and the dates their terms expire;
- the custodian bank that will safekeep the pool's assets;
- whether the intent of the pool is to maintain a net asset value of one dollar and the risk of market price fluctuation;
- whether the only source of payment is the assets of the pool at market value or whether there is a secondary source of payment, such as insurance or guarantees, and a description of the secondary source of payment;
- the name and address of the independent auditor of the pool;
- the requirements to be satisfied for the City to deposit funds in and withdraw funds from the pool and any deadlines or other operating policies required for the entity to invest funds in and withdraw funds from the pool; and
- the performance history of the pool, including yield, average dollar-weighted maturities, and expense ratios.

To maintain eligibility to receive funds from and invest funds on behalf of the City under this chapter, an investment pool must furnish to the investment officer or other authorized representative of the City:

- Investment transaction confirmations; and
- A monthly report that containing the following information:
  - ✓ the types and percentage breakdown of securities in which the pool is invested;
  - ✓ the current average dollar-weighted maturity, based on the stated maturity date, of the pool;
  - ✓ the current percentage of the pool's portfolio in investments that have stated maturities of more than one year;
  - ✓ the book value versus the market value of the pool's portfolio, using amortized cost valuation;
  - ✓ the size of the pool;
  - ✓ the number of participants in the pool;
  - ✓ the custodian bank that is safekeeping the assets of the pool;

- ✓ a listing of daily transaction activity of the entity participating in the pool;
- ✓ the yield and expense ratio of the pool, including a statement regarding how yield is calculated;
- ✓ the portfolio managers of the pool; and
- ✓ any changes or addenda to the offering circular.

B. **Ineligible Investments**

The following are not authorized investments for the City:

1) Obligations whose payments represent the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal (IO's);

2) Obligations whose payments represent the principal stream of cash flow from the underlying mortgage-backed security collateral and pays no interest (PO's);

3) Collateralized Mortgage Obligations (CMO's) that have a stated final maturity date of greater than 10 years; and

4) Collateralized mortgage obligations whose interest rates are determined by an index that adjusts opposite to the changes in the market index (Inverse Floaters).

C. Downgrade Provision for Investment Ratings

An Investment that requires a minimum rating does not qualify as an authorized investment during the period the investment does not have the minimum rating. The City shall take all prudent measures that are consistent with its Investment Policy to liquidate an investment that does not have the minimum rating. The City shall also monitor the credit ratings on securities that require minimum ratings. This may be accomplished through research, or with the assistance of investment advisors, broker dealers, banks or safekeeping agents.

VI. SAFEKEEPING AND COLLATERALIZATION

A. **Delivery versus Payment Requirement**

The purchase of individual securities shall be executed "delivery versus payment" (DVP) through the City's Safekeeping Agent. By so doing, City's funds are not released until the City has received, through the Safekeeping Agent, the securities purchased.

B. **Safekeeping Agreement**

The City shall contract with a bank, or banks, for the safekeeping of securities either owned by the City as a part of its investment portfolio or as part of its depository agreements. All collateral securing bank and savings bank deposits must be held in the City's name by a third-party banking institution acceptable to and under contract with the City, by the Federal Reserve Bank.

Evidence of perfected ownership shall be provided through monthly safekeeping statements which shall be promptly reconciled to internal investment records.

C. Collateralization

Consistent with the requirements of State law, the City requires all bank and savings bank deposits to be federally insured or collateralized with eligible securities. Financial institutions serving as City's Depositories will be required to sign a Depository Agreement with the City and the City's safekeeping agent. The safekeeping portion of the Agreement shall define the City's rights to the collateral in case of default, bankruptcy, or closing and shall establish a perfected security interest in compliance with Federal and State regulations, including:

1) The Agreement must be in writing;

2) The Agreement has to be executed by the Depository and the City contemporaneously with the acquisition of the asset;

3) The Agreement must be approved by the Board of Directors or the loan committee of the Depository and a copy of the meeting minutes must be delivered to the City;

4) The Agreement must be part of the Depository's "official record" continuously since its execution.

D. Required Collateral Levels

1) <u>Certificates of Deposit</u>
The market value of the principal portion of collateral pledged for certificates of deposit must at all times be equal to or greater than the par value of the certificates of deposit plus accrued interest, less the applicable level of FDIC insurance.

2) <u>Repurchase Agreements</u>
A repurchase agreement's security value shall be the par value plus accrued interest, and the security's market value must be maintained as a minimum of 102% of the principal value of the repurchase agreement.

E. Monitoring Collateral Adequacy

1) <u>Certificates of Deposit</u>
The City shall require monthly reports with market values of pledged securities from all financial institutions with which the City has collateralized deposits. The Investment Officers will monitor adequacy of collateralization levels to verify market values and total collateral positions.

2) Repurchase Agreements

Weekly monitoring by the Investment Officer(s) of market values of all underlying securities purchased for City repurchase transactions is required. More frequent monitoring may be necessary during periods of market volatility.

F. **Additional Collateral and Securities**

1) Certificates of Deposit

If the collateral pledged for a deposit falls below the par value of the deposit, plus accrued interest and less FDIC insurance, the institution holding the deposit will be notified by the Investment Officer(s) and will be required to pledge additional securities no later than the end of the next succeeding business day.

2) Repurchase Agreements

If the value of the securities underlying a repurchase agreement falls below the margin maintenance levels specified above, the Investment Officer(s) will request additional securities. If the repurchase agreement is scheduled to mature within five business days and the amount is deemed to be immaterial, then the request is not necessary.

G. **Collateral Substitution**

Collateralized deposits often require substitution of securities. Substitution is permitted if the substitution maintains a pledged value equal to or greater than the required security level. Substitution is allowable for all transactions, but should be limited, if possible, to minimize potential administrative problems and transfer expense.

VII. REPORTING

A. **Required Reports**

Investment performance will be monitored and evaluated by the Investment Officer(s). The Investment Officers will provide a quarterly comprehensive report signed by all Investment Officer(s) to the City Council. This investment report shall:

1) Describe in detail the investment position of the City,

2) Contain a summary statement, prepared in compliance with generally accepted accounting principles, of each pooled fund group that states the:

- ✓ beginning market value for the reporting period;
- ✓ ending market value for the period; and
- ✓ fully accrued interest for the reporting period;

3) State the book value and market value of each separately invested asset at the end of the reporting period by the type of asset and fund type invested;

4) State the maturity date of each separately invested asset that has a maturity date;

5) State the account or fund or pooled group fund for which each individual investment was acquired; and

6) State the compliance of the investment portfolio with the City's Investment Policy and strategy and the Public Funds Investment Act.

B. **Market Pricing**

The investment portfolio will be marked to market monthly. These sources may include, but are not limited to, the City's Investment Advisor, the Wall Street Journal, Bloomberg and the City's safekeeping agent.

C. **Compliance Audit**

The City, in conjunction with its annual financial audit, shall require a compliance audit of management controls on investments and adherence to the City's Investment Policy and strategies. If the City invests in other than money market mutual funds, investment pools or accounts offered by its depository bank in the form of certificates of deposit, or money market accounts or similar accounts, the reports prepared by the Investment Officer(s) shall be formally reviewed at least annually by an independent auditor, and the result of the compliance audit shall be reported to the City Council.

D. **Performance Measurement**

The City will normally seek to invest its funds with an average maturity of one year or less. As a result, an appropriate benchmark to gauge relative performance shall be the one year Constant Maturity Treasury (CMT).

E. **Strategic Planning and Finance Committee**

The Strategy Planning and Finance Committee shall meet quarterly to review investment performance and strategy, serving as the investment advisory committee to the City Council.

VIII. INVESTMENT OFFICER TRAINING

All those designated as Investment Officers by the City Council must attend at least one training session relating to the Investment Officers' responsibilities within 12 months after taking office or assuming duties; and attend an investment training session not less than once in a two-year period that begins on the first day of the City's fiscal year and consists of the two consecutive fiscal years after that date, and receive not less than 10 hours of instruction relating to investment responsibilities from an independent source approved by the City Council or the Strategic Planning and Finance Committee.

Training under this section must be provided by an independent source and approved by the City Council. Appropriate training shall include education in investment controls, security risks, strategy risks, market risks, and compliance with the Public Funds Investment Act.

IX. INVESTMENT STRATEGIES

In order to minimize risk of loss due to interest rate fluctuations, investment maturities will not exceed the anticipated cash flow requirements of the funds. Investment strategies by fund are as follows:

A. Operating Funds

Investment strategies for operating funds have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity. The secondary objective is to create a portfolio structure which will experience minimal volatility during economic cycles. This may be accomplished by purchasing quality, short-to- medium term securities which will complement each other in a laddered structure. The dollar-weighted average maturity of 18 months or less will be calculated using the stated final maturity dates of each security and the maximum allowable maturity shall be five years.

B. Bond Proceeds

The investment maturity of bond proceeds (excluding reserve and debt service funds) shall generally be limited to the anticipated cash flow requirement or the "temporary period," as defined by Federal tax law. During the temporary period, which is generally three years for capital projects, bond proceeds may be invested at an unrestricted yield. After the expiration of the temporary period, bond proceeds are subject to yield restriction and shall be invested considering the anticipated cash flow requirements of the funds and market conditions to achieve compliance with the applicable regulations. The maximum maturity for all bond proceeds shall not exceed the anticipated project spending dates. Interest in excess of the allowable arbitrage earnings will be segregated and made available for necessary payments to the US Treasury.

C. Debt Service Funds

Investment strategies for Debt Service Funds shall be to ensure adequate funding for each consecutive debt service payment. The Investment Officers shall invest in such a manner as not to exceed an "unfunded" debt service date with the maturity of any investment. An unfunded debt service date is defined as a coupon or principal payment date that does not have cash or investment securities available to satisfy said payment.

D. Bond Reserve Funds

Market conditions, Bond Ordinance constraints and Arbitrage regulation compliance will be considered when formulating Reserve Fund strategy. Maturity limitation shall generally not exceed the call provisions of the Bond Ordinance and shall not exceed the final maturity of the bond issue.

E. **Other Funds**

The anticipated cash requirements of other City funds will govern the appropriate maturity mix. Appropriate portfolio strategy shall be determined based upon market conditions. Policy compliance, City financial condition, and other risk return constrains will be considered when formulating investment strategy. Maximum maturity shall not exceed five years.

Glossary of Cash Management Terms

Accretion – common investment accounting entry in which the book value of securities purchased at a discount are gradually written up to the par value. The process has the effect of recording the discount as income over time.

Accrued Interest – Interest earned, but not yet paid, on a bond.

Agency – See Federal Agency

Amortization – common investment accounting entry in which the book value of securities purchased at a premium are gradually written down to the par value.

Basis Point - A unit of measurement used in the valuation of fixed-income securities equal to 1/100 of 1 percent of yield, e.g., "1/4" of 1 percent is equal to 25 basis points.

Benchmark – Index used to compare risk and performance to a managed portfolio.

Bid - The indicated price at which a buyer is willing to purchase a security or commodity.

Book Value – The original acquisition cost of an investment plus or minus the accrued amortization or accretion.

Broker – A financial firm that brings securities buyers and sellers together in return for a fee. The term “broker” is often used interchangeably with “dealer” to refer to a seller of investment securities.

Callable Bond - A bond issue in which all or part of its outstanding principal amount may be redeemed before maturity by the issuer under specified conditions.

Cash Settlement - A transaction which calls for delivery and payment of securities on the same day that the transaction is initiated.

Collateralization - Process by which a borrower pledges securities, property, or other deposits for the purpose of securing the repayment of a loan and/or security.

Collateralized Mortgage Obligation (CMO) – A derivative mortgage-backed security (MBS) created from pools of home mortgage loans. A single MBS is divided into multiple classes, each class containing a unique risk profile and security characteristics. A number of CMO classes are expressly prohibited by Texas State law.

Commercial Paper - An unsecured short-term promissory note issued by corporations, with maturities ranging from 1 to 270 days. Commercial paper must carry a minimum rating of A1P1 in order to be eligible under the Texas Public Funds Investment Act.

Constant Maturity Treasury (CMT) – A calculated average released by the Federal Reserve of all Treasury yields along a specific maturity point. This calculation is frequently used as a benchmark for conservative government portfolios.

Coupon Rate - The annual rate of interest received by an investor from the issuer of certain types of fixed-income securities. Also known as the "interest rate."

Credit Risk - The risk to an investor that an issuer will default in the payment of interest and/or principal on a security.

Derivative – Financial instruments whose value is derived from the movement of an underlying index or security.

Dealer – A dealer, as opposed to a broker, acts as a principal in all securities transactions, buying and selling for their own account. Often times, the terms "broker" and "dealer" are used interchangeably to refer to a seller of investment securities.

Delivery Versus Payment (DVP) - A type of securities transaction in which the purchaser pays for securities at the time of delivery either to the purchaser or his/her custodian.

Derivative Security - Financial instrument created from, or whose value depends upon, one or more underlying assets or indexes of asset values.

Discount - The amount by which the par value of a security exceeds the price paid for the security.

Diversification - A process of investing assets among a range of security types by sector, maturity, and quality rating**.**

Dollar Weighted Average Maturity (WAM) - The average maturity of all the securities that comprise a portfolio.

Fair Market Rate – A documented and verifiable rate of interest which approximates the average rate which could have been earned on similar investments at the time of the transaction.

Federal Agency – A debt instrument, either fully guaranteed or sponsored by the U.S. government. The typical definition of agency includes the government sponsored enterprises of Fannie Mae, Freddie Mac, the Federal Farm Credit Bank (FFCB) and the Federal Home Loan Bank (FHLB).

Federal Deposit Insurance Corporation (FDIC) - A federal agency that insures bank deposits, currently up to $250,000 per account or as adjusted by FDIC. Public deposits that exceed this amount must be properly collateralized with investment securities or insured through a surety bond.

Interest Rate - See "Coupon Rate."

Internal Controls - An internal control structure designed to ensure that the assets of the entity are protected from loss, theft, or misuse. The internal control structure is designed to provide reasonable assurance that these objectives are met.

Interlocal Cooperation Act –Law permitting joint participation by local governments providing one or more government functions within the State. This law (Section 791.001 et seq. of the Texas Government Code ("the Act")) has allowed for the creation of investment pools in Texas.

Investment Advisors Act of 1940- Law which requires all Investment Advisors to be registered with the SEC in order to protect the public from fraud.

Investment Policy - A concise and clear statement of the objectives and parameters formulated by an investor or investment manager for a portfolio of investment securities. The Texas Public Funds Investment Act requires that public entities have a written and approved investment policy.

Investment Pool – An entity created under the Interlocal Cooperation Act to invest public funds jointly on behalf of the entities that participate in the pool.

Liquidity – A liquid investment is one that can be easily and quickly converted to cash without substantial loss of value. Investment pools and money market funds, which allow for same day withdrawal of cash, are considered extremely liquid.

Local Government Investment Pool (LGIP) - An investment by local governments in which their money is pooled as a method for managing local funds.

Market Risk - The risk that the value of a security will rise or decline as a result of changes in market conditions.

Market Value - A security's par amount multiplied by its market price.

Master Repurchase Agreement – A written contract covering all future transactions between the two parties to a repurchase agreement.

Maturity - The date on which payment of a financial obligation is due. The final stated maturity is the date on which the issuer must retire a bond and pay the face value to the bondholder. See "Weighted Average Maturity."

Money Market Mutual Fund - Mutual funds that invest solely in money market instruments (short-term debt instruments, such as Treasury bills, commercial paper, bankers' acceptances, repos and federal funds).

Mortgage-Backed Security (MBS) – Security backed by pools of home loan mortgages.

Financial Industry Regulatory Authority (FINRA) - formerly the National Association of Securities Dealers (NASD) - A self-regulatory organization (SRO) of brokers and dealers in the over-the-counter securities business. Its regulatory mandate includes authority over firms that distribute mutual fund shares as well as other securities.

Net Asset Value (NAV) – The value of a mutual fund or investment pool at the end of the business day. NAV is calculated by adding the market value of all securities in a fund or pool, deducting expenses, and dividing by the number of shares in the fund or pool.

Offer - An indicated price at which market participants are willing to sell a security. Also referred to as the "Ask price."

Par - Face value or principal value of a bond, typically $1,000 per bond. A security's par value is multiplied by its coupon rate to determine coupon payment amount.

Premium - The amount by which the price paid for a security exceeds the security's par value.

Primary Government Securities Dealer (Primary Dealer) – One of 21 (as of 12/2011) large government securities dealers who are required to submit daily reports of market activity and monthly financial statements to the New York Federal Reserve Bank. Primary Dealers are required to continually "make a market" in Treasury securities, buying or selling when asked, thereby creating a liquid secondary market for US debt obligations.

Principal - The face value or par value of a debt instrument. Also may refer to the amount of capital invested in a given security.

Prudent Person Rule - An investment standard outlining the fiduciary responsibilities of public funds investors relating to investment practices.

Regular Way Delivery - Securities settlement that calls for delivery and payment on the third business day following the trade date (T+3); payment on a T+1 basis is currently under consideration. Mutual funds are settled on a same day basis; government securities are settled on the next business day.

Repurchase Agreement (repo or RP) - An agreement by one party to sell securities at a specified price to a second party and a simultaneous agreement of the first party to repurchase the securities at a specified price or at a specified later date.

Reverse Repurchase Agreement (Reverse Repo) - An agreement of one party to purchase securities at a specified price from a second party and a simultaneous agreement by the first party to resell the securities at a specified price to the second party on demand or at a specified date.

Safekeeping - Holding of assets (e.g., securities) by a financial institution.

Swap - Trading one asset for another.

Total Return - The sum of all investment income plus changes in the capital value of the portfolio. For mutual funds, return on an investment is composed of share price appreciation plus any realized dividends or capital gains. This is calculated by taking the following components during a certain time period. (Price Appreciation) + (Dividends paid) + (Capital gains) = Total Return

Treasury Bills - Short-term U.S. government non-interest bearing debt securities with maturities of no longer than one year and issued in minimum denominations of $10,000. Auctions of three- and six-month bills are weekly, while auctions of one-year bills are monthly. The yields on these bills are monitored closely in the money markets for signs of interest rate trends.

Treasury Notes - Intermediate U.S. government debt securities with maturities of two- to 10-years and issued in denominations ranging from $1,000 to $1 million or more.

Uniform Net Capital Rule - SEC Rule 15C3-1 outlining capital requirements for broker/dealers.

Volatility - A degree of fluctuation in the price and valuation of securities.

Yield - The current rate of return on an investment security generally expressed as a percentage of the security's current price.

Yield-to-call (YTC) - The rate of return an investor earns from a bond assuming the bond is redeemed (called) prior to its nominal maturity date.

Yield Curve - A graphic representation that depicts the relationship at a given point in time between yields and maturity for bonds that are identical in every way except maturity. A normal yield curve may be alternatively referred to as a positive yield curve.

Yield-to-maturity - The rate of return yielded by a debt security held to maturity when both interest payments and the investor's potential capital gain or loss are included in the calculation of return.

Z**ero-coupon Securities** – Securities issued at a discount which make no periodic interest payment. The rate of return consists of a gradual accretion of the principal of the security and is payable at par upon maturity.