Investment Policy

City of
West University
Place

October 10, 2022

City of West University Place
Investment Policy
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EXHIBITS

I. Policy

It is the policy of the City of West University Place (the "City") to administer and invest its funds in a manner that will preserve the principal, maintain liquidity, and optimize interest earnings while meeting the daily cash flow requirements of the City. The City will conform to all federal, state and local statutes, rules and regulations governing the investment of the City's funds. The Investment Policy ("Policy") sets forth the investment program of the City and the guidelines to be followed in achieving its objectives.

Annually, City Council shall adopt a resolution stating that it has reviewed the Investment Policy and investment strategies. The resolution so adopted shall record any changes made to the Policy or investment strategies.

II. Purpose

The purpose of the Policy is to comply with Chapter 2256 of the Texas Government Code ("Public Funds Investment Act" or "PFIA" or "Act"), which requires the City to adopt a written investment policy regarding the investment of its funds and funds under its control. The Policy addresses the methods, procedures and practices that must be exercised to ensure effective and judicious fiscal management of the City's funds.

III. Scope

The Policy applies to all funds and investments of the City. These funds are accounted for in the City's Comprehensive Annual Financial Report and include all funds managed by the City, including but not limited to tax revenues, charges for services, bond proceeds, interest income, loans and funds received by the City where the City performs a custodial function. However, the Policy does not apply to the assets administered for the benefit of the City by outside agencies under deferred compensation programs or other retirement programs.

The City will consolidate cash balances from all funds to maximize investment earnings, (except as otherwise required by covenants in bond ordinances, credit agreements as defined in Texas Government Code Section 1371.001 or other applicable regulations). Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

IV. General Objectives

The primary objectives, in priority order, of the City's investment activities shall be safety, liquidity, public trust, and yield:

A. **Safety** – Safety of the principal is the primary objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital for the overall portfolio. The objective will be to minimize credit risk and interest rate risk.

1. **Credit Risk and Concentration of Credit Risk** – The City will minimize credit risk, which is the risk of loss due to the failure of the security issuer or backer, and concentration of credit risk, the risk of loss attributed to the magnitude of investment in a single issuer, by:
   - Limiting investments to the types listed in Section VII ("Suitable and Authorized Investments") of this Policy,
   - Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisers with which the City will do business in accordance to Section VI.A ("Authorized Broker/Dealers") and Section VI.B ("Financial Institutions"), and;
   - Diversifying the investment portfolio so that potential losses on individual securities will be minimized.

2. **Interest Rate Risk** – The City will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates, by:
   - Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity,
   - Investing operating funds primarily in investment pools and money market funds that seek a stable $1.00 net asset value (NAV),
   - Limiting the weighted average maturity of the portfolio in accordance with Section IX ("Investment Strategies"), and;
   - Diversifying maturities to minimize the impact of market movements over time in accordance with Section VIII ("Investment Parameters").

B. **Liquidity** – The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands. Furthermore, since all possible cash demands cannot be anticipated, a portion of the portfolio will be invested in local government investment pools or money market funds, which offer same-day liquidity. Additionally, all authorized securities will have active secondary or resale markets.

C. **Public Trust** – All participants in the City's investment process shall seek to act responsibly as custodians of the public trust. Investment Officer and Investment Officials shall at all times be cognizant of the standard of care and investment objectives and shall avoid any transaction that might impair public confidence in the City's ability to govern effectively.

D. **Yield** – The investment portfolio shall be designed with the objective of attaining a reasonable market yield, throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs of the portfolio. Yield is of least importance compared to the safety, liquidity, and public trust objectives described above. Investments are limited to high credit quality securities earning a fair yield relative to the risk being assumed. Securities shall not be sold prior to maturity with the following exceptions:

- A security with declining credit may be sold early to minimize loss of principal
- Liquidity needs of the portfolio require the security to be sold
- A security that loses its required credit rating must be sold

V. Standards of Care

A. **Prudence** – The standard of prudence to be used by the authorized Investment Officer and Investment Officials shall be the "prudent person" rule. This rule states that "Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived." The determination of whether the Investment Officer or Investment Official has exercised prudence with respect to an investment decision shall be applied in the context of managing an overall portfolio rather than a consideration as to the prudence of a single investment.

Investment Officer and Investment Officials acting in accordance with written procedures and the Policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided that deviations from expectations are reported in a timely fashion and appropriate action is taken to control unfavorable developments.

B. **Ethics and Conflicts of Interest –** Investment Officer and Investment Officials agree to refrain from personal business activity that could conflict with proper execution and management of the investment program, or that could impair their ability to make impartial investment decisions. The Investment Officer and Investment Officials shall agree to disclose to the City Council, with said disclosure held on file within the Finance Department, any conflicts of interests or personal business relationship with financial institutions that conduct business with the City. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. (See Exhibit B.)

A statement required under this subsection must be filed with the Texas Ethics Commission and the City Council if:

a. The Investment Officer or Investment Official has a personal business relationship with a business organization offering to engage in an investment transaction with the City; or
b. An Investment Officer or Investment Official who is related within the second degree by affinity or consanguinity, as determined under Texas Government Code Chapter 573, to an individual seeking to transact investment business with the City.

C. **Delegation of Authority** – Authority to manage the City's investment program is granted to the Finance Director, hereinafter referred to as the Investment Officer, and derived from the following: City Charter Article VII, Section 7.01c. Responsibility for the operation of the investment program is hereby delegated to the Investment Officer, who shall act in accordance with established procedures and internal controls for the operation of the investment program consistent with this investment policy. The Policy includes explicit delegation of authority to persons responsible for investment transactions. (See Exhibit A) No person may engage in an investment transaction except as provided under the terms of the Policy and procedures established by the Investment Officer. The Investment Officer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate activities of subordinate Investment Officials (Finance Manager and Fiscal Services Officer).

D. **Training** – The Investment Officer and Investment Officials must complete at least 10 hours of investment training within 12 months of taking office or assuming duties, and shall attend an investment training session not less than once in a two year period and receive not less than eight (8) hours of training after the initial 10 hours of instruction relating to investment controls, security risks, strategy risks, market risks, diversification of investment portfolio, and compliance with PFIA.

The City shall provide the training through courses and seminars offered by professional organizations and associations in order to insure the quality and capability of the City's investment personnel are in compliance with PFIA.

E. **Internal Controls** – The Finance Director is responsible for establishing and maintaining an internal control structure designed to ensure that public funds of the entity are protected from loss, theft, or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived and the valuation of costs and benefits requires estimates and judgments by management. Therefore, the Finance Director shall establish a process for annual independent review by an external auditor during the annual financial audit to assure compliance with policies and procedures.

VI. Financial Counter-Parties

A. **Authorized Broker/Dealers** –The Investment Officer will maintain a list of security broker/dealers authorized to provide investment services to the City (Exhibit C). This list shall be reviewed, revised as necessary and adopted at least annually by City Council. The Investment Officer and Investment Officials shall not conduct business with any firm not approved by City Council. No public deposit shall be made except in a qualified public depository as established by state laws.

Broker/dealers that request to become qualified for securities transactions will be required to provide 1) information regarding creditworthiness, experience, references and reputation, and 2) a certification stating the firm has received, read and understood the City's investment policy and agree to comply with the Policy. Authorized firms may include primary dealers or regional broker/dealers that qualify under Securities & Exchange Commission Rule 15C3-1 (Uniform Net Capital Rule).

B. **Financial Institutions** – Any financial institution used as a banking services depository shall be a qualified depository by the State Comptroller of Public Accounts. A banking services depository will be chosen by Request for Proposal (RFP) at least every five (5) years. All funds in any depository shall be FDIC insured or collateralized in accordance with the Policy.

Should an approved institution merge with or be acquired by another while on the City's approved list, the new institution must agree to meet the same collateralization and certification requirements before funds are deposited.

C. **Competitive Bids** – The Policy requires that at least three (3) competitive bids or offers must be solicited for all individual security purchases and sales except for:

- Transactions with local government investment pools and money market funds (which are deemed to be made at prevailing market rates),
- Treasury and agency securities purchased at issuance through an approved broker/dealer or financial institution, and
- Fully insured certificates of deposit placed in accordance with the conditions prescribed in Section 2256.010(b) of the PFIA.

In situations where the exact security being offered is not offered by other broker/dealers, offers on the closest comparable investment may be used to establish a fair market price for the security.

D. **Delivery vs. Payment** – All trades with the exception of local government investment pools and money market funds will be executed by delivery vs. payment (DVP) to ensure that securities are deposited in an eligible financial institution prior to the release of funds. Securities and collateral will be held in the City's name by a third-party custodian as evidenced by safekeeping receipts of the institution with which the securities are deposited.

VII. Suitable and Authorized Investments

A. **Eligible Investments** – Funds of the City may be invested only in the following instruments described below. All of these investments are authorized by the PFIA. Only those instruments listed in this section are authorized.

1. Obligations of the United States of America, its agencies and instrumentalities, including letters of credit, with a maximum maturity of three (3) years, excluding mortgage-backed securities.

2. Other Obligations of the United States of America, its agencies and instrumentalities that are fully guaranteed or insured by the FDIC or by the explicit full faith and credit of the United States with a maximum maturity of three (3) years.

3. Obligations of the state of Texas, its agencies, counties, cities, and other political subdivisions rate as to investment quality by a nationally recognized investment rating firm not less than AAA or its equivalent. Individual issuer exposure shall be limited to 5% of the total investment portfolio.

4. Certificates of Deposit issued by a depository institution that has its main office or a branch in Texas and is selected from a list adopted

by the City. The certificate of deposit must be insured by the FDIC or its successor and/or collateralized in accordance with the Policy with a maximum maturity of two (2) years.

5. Money Market Funds that 1) are registered and regulated by the Securities and Exchange Commission, 2) have a dollar weighted average stated maturity of 60 days or less, 3) seek to maintain a stable net asset value (NAV) of $1.00 per share and 4) are rated no lower than AAA or an equivalent rating by at least one nationally recognized rating service.

6. Texas Local Government Investment Pools, authorized by a separate resolution, which meet the requirements of Section 2256.016 of the PFIA and are rated no lower than AAA or an equivalent rating by at least one nationally recognized rating service. To become eligible, investment pools must be approved by City Council action. Investments will be made in a local government investment pool only after a thorough investigation of the pool, which shall be reviewed annually.

7. Interest bearing checking accounts with a bank that is located in Texas and insured by the FDIC and/or collateralized in accordance with the Policy.

B. **Collateralization** – Collateralization will be required for all funds above FDIC coverage on deposit with a depository bank. The collateralization level will be one hundred and two percent (102%) of the total value of principal plus accrued interest on the deposits, less an amount insured by the FDIC.

Securities pledged as collateral will be held in the City’s name by an independent third party with whom the City has a current custodial agreement. The Finance Director is responsible for entering into collateralization agreements with third-party custodians in compliance with the Policy. The collateralization agreements are to specify the acceptable investment securities for collateral, including provisions related to possession of the collateral, the substitution or release of investment securities, ownership of securities, and the method of valuation of securities. A clearly marked evidence of ownership must be supplied to the City and retained.

Collateral shall be reviewed monthly to assure that the market value of the pledged securities is adequate. The depository bank is responsible for monitoring and maintaining the margin on the collateral daily.

Eligible collateral includes a) direct obligations of the United States or other obligations of the United States or other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of the United States, b) direct debt obligations of an agency or instrumentality of the United States, c) direct debt obligations of states, agencies, counties, cities, and other political subdivisions of any state rate as to investment quality by a nationally recognized investment rating firm not less than A or its equivalent. The City's Investment Officer reserves the right to accept or reject any form of collateral or enhancement at their sole discretion.

C. **Existing Investments –** Any investment currently held that does not meet the guidelines of the Policy, but was an authorized investment at the time of purchase, is not required to be liquidated; however, the City shall take all prudent measures consistent with the Policy to liquidate an investment that does not or no longer qualifies as an authorized investment.

VIII. Investment Parameters

A. **Diversification** – The investments shall be diversified by security type and institution. With the exception of U.S. Treasury securities, Government-sponsored enterprises (GSE's), interest-bearing checking accounts that are fully collateralized, and authorized local government investment pools, the City will diversify the entire portfolio to comply with the investment strategy. In no case shall any single investment transaction be more than twenty five-percent (25%) of the entire portfolio at the time of purchase of the security.

B. **Maximum Maturities** – To the extent possible, the City shall attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the City will not directly invest in securities maturing more than three (3) years from the date of purchase. The composite portfolio will have a weighted average maturity of 365 days or less. This dollar weighted average maturity will be calculated using the stated final maturity date(s) of each security.

IX. Investment Strategies

The City maintains separate portfolios for individual funds or groups of funds that are managed according to the terms of this Policy and the corresponding investment strategies listed in Exhibit E. The investment strategy for portfolios is established after the annual Investment Policy review and adoption will be managed in accordance with the terms of this Policy and applicable agreements until the next annual review, when a specific strategy will be adopted.

The City maintains a pooled fund group that is an aggregation of the majority of City funds including tax receipts, enterprise fund revenues, fine and fee

revenues, as well as some, but not all, bond proceeds, and grants. This portfolio is maintained to meet anticipated daily cash needs for City operations, capital projects and debt service. The objectives of this portfolio are to ensure safety of principal; ensure adequate investment liquidity; limit market and credit risk through diversification; and attain a market rate of return in accordance with the objectives and restrictions set forth in the Policy.

X. Reporting

A. **Methods** – The Investment Officer shall prepare an investment report at least quarterly, including a management summary that provides an analysis of the status of the current investment portfolio and transactions made over the last quarter. This management summary will be prepared in a manner consistent with the requirements of Section 2256.023 (Internal Management Reports) of the PFIA, and that will allow the City to ascertain whether investment activities during the reporting period have conformed to the Policy. The report will be provided to City Council and the City Manager.

An independent auditor shall formally review the reports prepared under this section at least annually, and that auditor shall report instances of non-compliance to City Council in the annual audit management letter.

B. **Performance Standards** – The investment portfolio shall be managed in accordance with the objectives specified in the Policy (safety, liquidity, public trust, and yield). The portfolio should obtain a market average rate of return during a market/economic environment of stable interest rates. The Investment Officer shall determine whether market yields are being achieved by comparing the portfolio market yield to the six (6) month and one (1) year U.S. Treasury Bill.

C. **Marking to Market** – The market value of the portfolio shall be calculated at least monthly and a statement of the market value of the portfolio shall be issued at least monthly. The market value of each investment shall be obtained from an independent source such as the Wall Street Journal, reputable brokerage firm, or security pricing service, and reported on the investment reports.

EXHIBIT A

City of West University Place
Authorized Investment Officer and Investment Officials

Finance Director – Investment Officer

Finance Manager – Investment Official

Fiscal Services Officer – Investment Official

EXHIBIT B

City of West University Place
Statement of Ethics and Conflicts of Interest

Investment Officer and Investment Officials for the City of West University Place shall refrain from personal business relationships with business organizations that could conflict with the proper execution of the investment program, or which could impair their ability to make partial investment decisions. This would only apply to personal business relationships with business organizations that have been approved by City Council to conduct investment transactions with the City of West University Place.

An Investment Officer or Investment Official is considered to have a personal business relationship with a business organization if:

(1) The Investment Officer or Investment Official 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.

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

(3) The Investment Officer or Investment Official 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 or Investment Official.

☐ I do hereby certify that I do **not** have a personal business relationship with any business organization approved to conduct investment transactions with the City of West University Place, nor am I related within the second degree by affinity or consanguinity, as determined under Chapter 573 of the Texas Government Code, to an individual seeking to sell an investment to the City of West University Place as of the date of this statement.

☐ I do hereby certify that I **do** have a personal business relationship with a business organization approved to conduct investment transactions with the City of West University Place, and/or I am related within the second degree by affinity or consanguinity, as determined under Chapter 573 of the Texas Government Code, to an individual seeking to sell an investment to the City of West University Place as of the date of this statement, and willfully remove myself from any activities or areas of professional conduct that would cause a perception of ethical conflict and acknowledge that I am required to disclose said relation to the City Council and Texas Ethics Commission.

City of West University Place
Investment Officer/Official(s)

________________________________ __________________
Finance Director/Officer Date

________________________________ __________________
Finance Manager/Official Date

________________________________ __________________
Fiscal Services Officer/Official Date

<u>EXHIBIT C</u>

City of West University Place
Approved Broker/Dealers, Financial Institutions, and Investment Pools

Broker/Dealers

Cantor Fitzgerald & Company

FHN Financial (formerly “Coastal Securities” and “FTN Financial”)

Hilltop Securities (formerly “First Southwest Company”)

Multi-Bank Securities

Wells Fargo Securities LLC

Financial Institutions

JP Morgan Chase, NA (Primary)

Local Government Investment Pools

TexPool

Texas Class

EXHIBIT D

City of West University Place
Certification by Business Organization

(date)

City of West University Place, Texas
(Attn: Designated Investment Official)
3800 University Blvd.
West University Place, TX 77005

Dear Mr/s. *(Investment Official):*

This certification is executed on behalf of the City of West University Place, Texas (the Investor) and ____ (the Business Organization),

pursuant to the Public Funds Investment Act, Chapter 2256, Texas Government Code, (the Act) in connection with investment transactions conducted between the Investor and the Business Organization.

The undersigned Registered Principal or authorized representative of the Business Organization hereby certifies on behalf of the Business Organization that:

1. The undersigned is a Registered Principal or authorized representative of the Business Organization offering to enter an investment transaction with the Investor (Note: as such terms are used in the Public Funds Investment Act, chapter 2256, Texas Local Government Code) and;

2. The Registered Principal or authorized representative of the Business Organization has received and reviewed the Investment Policy furnished by the Investor and;

3. The Registered Principal or authorized representative of the Business Organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the Business Organization and the Investor that are not authorized by the Investor's investment policy, except to the extent that this authorization is dependent on an analysis of the makeup of the investor's entire portfolio or requires and interpretation of the subjective investment standards.

	Registered Principal or Authorized Representative	Broker Assigned to the Account
Signed By:	__________________________	__________________________
Printed Name	__________________________	__________________________
Title	__________________________	__________________________
Date	__________________________	__________________________

EXHIBIT E

Investment Strategies

The City of West University's investment portfolio will be designed and managed to ensure that it will meet all the requirements established by the City of West University's Investment Policy and the Public Funds Investment Act. The overall investment strategy outlined in the Investment Policy has been further refined in this investment strategy statement by the following fund types.

Operating Funds:

Operating Funds generally have greater cash flow needs than other funds types. The operating fund portfolio may consist of any approved investment type with the understanding that the financial requirements of the operating funds will dictate the maturity dates of the investment. Of utmost importance is the preservation and safety of the investment principal.

Additionally, each investment will be viewed for its liquidity and marketability of the investment if the need arises to liquidate the investment before maturity. The final determining factors for the investment strategy will be the diversification of the investment portfolio and the yield of the investment.

To achieve short-term needs of one (1) to one hundred and eighty (180) days, funds will be invested in authorized local government investment pools. For longer-term needs of six (6) months to three (3) years, funds will be invested in approved investments with objectives prioritized as follows:

1) understanding the suitability of the investment to the financial requirements of the City of West University Place;

2) preservation and safety of principal;

3) liquidity;

4) marketability of the investment if the need arises to liquidate the investment before maturity;

5) diversification of the investment portfolio; and

6) yield.

Investment Strategies (Continued)

Debt Service Funds:

The debt service requirements are usually semi-annual, thus allowing the investment strategy to mirror debt obligation payment dates. The strategy for debt service funds allows greater flexibility since the actual requirements are known into the future. Investments will comply with the Investment Policy; however, planning maturity dates to match debt requirement dates will be the primary objective.

The investment instruments will be invested primarily in approved investment types with maturities at six (6) or twelve (12) months established to match debt requirement dates. Shorter-term investment may be used to meet these objectives and longer-term investments may be used when fund balance reserves exceed one year's debt service requirements.

To achieve this strategy the following objectives are prioritized to evaluate investment opportunities:

1) understanding the suitability of the investment to the financial requirements of the City of West University Place;

2) preservation and safety of principal;

3) yield;

4) marketability of the investment if the need arises to liquidate the investment before maturity;

5) diversification of the investment portfolio; and

6) liquidity.

Investment Strategies (Continued)

Capital Improvement Funds:

Bond proceeds can be invested over the life of the project; however, the exact disbursement of the funds is not always known. The investment objective of the capital improvement funds is to schedule maturities to maximize investment earnings while preserving principal and meeting liquidity needs. The key to an effective strategy is to be aware of the project needs and match maturities to the period funds are needed.

The investment objective for capital projects funds is still to match investment maturities with funding needs. As short-term needs are recognized, investment maturities will be moved into authorized local government investment pools to meet financial requirements. Longer-term needs will be invested with the following objectives as prioritized for capital improvement funds:

1) understanding the suitability of the investment to the financial requirements of the City of West University Place;

2) preservation and safety of principal;

3) diversification of the investment portfolio;

4) yield;

5) liquidity; and

6) marketability of the investment if the need arises to liquidate the investment before maturity.

Investment Strategies (Continued)

Reserve Funds:

Certain reserve funds have been established as required by bond covenants. The investment objective is to invest reserve funds to the extent that maturities are established to the limit of the Investment Policy or to the end of the bond requirements whichever is shorter.

The overall investment strategy for reserve funds will use longer-term securities; however, the use of pools is not prohibited. Longer-term investment objectives are prioritized as follows:

1) understanding the suitability of the investment to the financial requirements of the City of West University Place;

2) diversification of the investment portfolio;

3) preservation and safety of principal;

4) yield;

5) liquidity; and

6) marketability of the investment if the need arises to liquidate the investment before maturity

GLOSSARY

ACCRETION OF DISCOUNT: Periodic straight-line increases in the book or carrying value of a security so the amount of the purchase price discount below face value is completely eliminated by the time the bond matures or by the call date, if applicable.

ACCRUED INTEREST: The interest accumulated on a security from its issue date or since the last payment of interest up to but not including the purchase date. The purchaser of the security pays to the seller the market price plus accrued interest.

AMORTIZATION OF PREMIUM: Periodic straight-line decreases in the book or carrying value of a security so the premium paid for a bond above its face value or call price is completely eliminated.

ASK: The price at which securities are offered by sellers.

BARBELL MATURITY STRATEGY: A maturity pattern within a portfolio in which maturities of the assets in the portfolio are concentrated in both the short and long ends of the maturity spectrum.

BASIS POINT: One one-hundredth (1/100) of one percent; 0.0001 in decimal form.

BENCHMARK: A comparative base for performance evaluation. A benchmark can be a broad-based bond index, a customized bond index, or a specific objective.

BID: The price offered for securities by purchasers. (When selling securities, one asks for a bid.)

BOND EQUIVALENT YIELD: Used to compare yields available from discounted securities that pay interest at maturity with yields available from securities that pay interest semi-annually.

BOOK ENTRY SECURITIES: Stocks, bonds, other securities, and some certificates of deposit that are purchased, sold, and held as electronic computer entries on the records of a central holder. These securities are not available for purchase in physical form; buyers get a receipt or confirmation as evidence of ownership.

BOOK VALUE: The original cost of the security as adjusted for amortization of any premium paid or accretion of discount since the date of purchase.

BROKER: A party who brings buyers and sellers together. Brokers do not take ownership of the property being traded. They are compensated by commissions. They are not the same as dealers; however, the same firms that act as brokers in some transactions may act as dealers in other transactions.

CALLABLE BOND: A bond that the issuer has the right to redeem prior to maturity at a specified price. Some callable bonds may be redeemed on one call date while others may have multiple call dates. Some callable bonds may be redeemed at par while others can be redeemed only at a premium. Some callable bonds are step-up bonds that pay an initial coupon rate for the first period, and then the coupon rate increases for the following periods if the bonds are not called by the issuer.

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination (over $100,000) CD's are typically negotiable.

CODE: The Internal Revenue Code of 1986, as amended.

COLLATERAL: Securities, evidence of deposit or other property which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.

COLLATERALIZED MORTGAGE OBLIGATION (CMO): A type of mortgage-backed security created by dividing the rights to receive the principal and interest cash flows from an underlying pool of mortgages in separate classes or tiers.

COMMERCIAL PAPER: Short-term unsecured promissory notes issued by corporations for a maturity specified by the buyer. It is used primarily by corporations for short-term financing needs at a rate which is generally lower than the prime rate.

CONFIRMATION: The document used to state in writing the terms of the trade which had previously been agreed to verbally.

COUPON RATE: The stated annual rate of interest payable on a coupon bond expressed as a percentage of the bond's face value.

CREDIT RISK: The risk that (1) the issuer is downgraded to a lower quality category and/or (2) the issuer fails to make timely payments of interest or principal.

CUSIP NUMBER: A nine-digit number established by the Committee on Uniform Securities Identification Procedures that is used to identify publicly traded securities. Each publicly traded security receives a unique CUSIP number when the security is issued.

CUSTODY: The service of an organization, usually a financial institution, of holding (and reporting) a customer's securities for safekeeping. The financial institution is known as the custodian.

DEALER: A firm which buys and sells for its own account. Dealers have ownership, even if only for an instant, between a purchase from one party and a sale to another party. They are compensated by the spread between the price they pay and the price they receive. Dealers are not the same as brokers; however, the same firms which act as dealers in some transactions may act as brokers in other transactions.

DELIVERY VERSUS PAYMENT (DVP): The safest method of settling a trade involving a book entry security. In a DVP settlement, the funds are wired from the buyer's account and the security is delivered from the seller's account in simultaneous, interdependent wires.

DEPOSITORY TRUST COMPANY (DTC): An organization that holds physical certificates for stocks and bonds and issues receipts to owners. Securities held by DTC are immobilized so that they can be traded on a book entry basis.

DERIVATIVE: A security that derives its value from an underlying asset, group of assets, reference rate, or an index value. Some derivatives can be highly volatile and result in a loss of principal in changing interest rate environments.

DISCOUNT: The amount by which the price paid for a security is less than its face value.

DISCOUNT SECURITIES: Securities that do not pay periodic interest. Investors earn the difference between the discount issue price and the full face value paid at maturity.

DIVERSIFICATION: Dividing investment funds among a variety of securities offering independent returns, to reduce risk inherent in particular securities.

DURATION: A sophisticated measure of the weighted average maturity of a bond's cash flow stream, where the present values of the cash flows serve as the weights.

ECONOMIC CYCLE (BUSINESS CYCLE): As the economy moves through the business cycle, interest rates tend to follow the levels of production, output, and consumption - rising as the economy expands and moves out of recession and declining after the economy peaks, contracts, and heads once again into recession.

EFFECTIVE MATURITY: The average maturity of a bond, given the potential for early call. For a non-callable bond, the final maturity date serves as the effective maturity. For a callable bond, the effective maturity is bounded by the first call date and the final maturity date; the position within this continuum is a function of the call price, the current market price, and the reinvestment rate assumed.

FACE VALUE: The principal amount due and payable to a bondholder at maturity; par value. Also, the amount on which coupon interest is computed.

FAIL: The event of a securities purchase or sale transaction not settling as intended by the parties.

FAIR VALUE: The amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits.

FEDERAL FARM CREDIT BANKS (FFCB): A government-sponsored corporation that was created in 1916 and is a nationwide system of banks and associations providing mortgage loans, credit, and related services to farmers, rural homeowners, and agricultural and rural cooperatives. The banks and associations are cooperatively owned, directly or indirectly, by their respective borrowers. The Federal Farm Credit System is supervised by the Farm Credit Administration, an independent agency of the U.S. government. (See Government Sponsored Enterprise)

FEDERAL FUNDS: Monies within the Federal Reserve System representing a member bank's surplus reserve funds. Banks with excess funds may sell their surplus to other banks whose funds are below required reserve levels. Normally, Federal funds are employed in settling all government securities transactions. The Federal Funds Rate is the rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

FEDERAL HOME LOAN BANKS (FHLB): Government-sponsored wholesale banks (currently twelve regional banks) which lend funds and provide correspondent banking services to member commercial bank, thrift institutions, credit unions and insurance companies. The mission of the FHLBs is to liquefy the housing related assets of its members who must purchase stock in their district Bank. (See Government Sponsored Enterprises)

FEDERAL HOME LOAN MORTGAGE CORPORATION (FHLMC or "Freddie Mac"): A government-sponsored corporation that was created in July 1970, by the enactment of Title III of the Emergency Home Finance Act of 1970. Freddie Mac was established to help maintain the availability of mortgage credit for residential housing, primarily through developing and maintaining an active, nationwide secondary market in conventional residential mortgages. (See Government Sponsored Enterprises)

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA or Fannie Mae): FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae is a private stockholder-owned corporation. FNMA securities are highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest. (See Government Sponsored Enterprises)

FEDERAL OPEN MARKET COMMITTEE (FOMC): Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank presidents. The president of the New York Federal Reserve Bank is a permanent member while the other presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of government securities in the open market as a means of influencing the volume of bank credit and money.

FEDERAL RESERVE SYSTEM: The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C., twelve regional banks and about 5700 commercial banks that are members of the system.

FIXED-INCOME SECURITY: A financial instrument promising a fixed amount of periodic income over a specified future time span.

GOVERNMENT-SPONSORED ENTERPRISES (GSE's): Payment of principal and interest on securities issued by these corporations is not guaranteed explicitly by the U.S. government, however, most investors consider these securities to carry an implicit U.S. government guarantee. The debt is fully guaranteed by the issuing corporations. GSE's include: Farm Credit System, Federal Home Loan Bank System, Federal Home Loan Mortgage Corporation, and Federal National Mortgage Association.

INSTRUMENTALITIES: See Government-Sponsored Enterprises

INTEREST RATE RISK: The risk that the general level of interest rates will change, causing unexpected price appreciations or depreciations.

LADDERED MATURITY STRATEGY: A maturity pattern within a portfolio in which maturities of the assets in the portfolio are equally spaced. Over time, the shortening of the remaining lives of the assets provides a steady source of liquidity or cash flow. Given a normal yield curve with a positive slope this passive strategy provides the benefit of being able to take advantage of the higher, longer-term yields without sacrificing safety or liquidity.

LIQUIDITY: An entity's capacity to meet future monetary outflows (whether they are required or optional) from available resources. Liquidity is often obtained from reductions of cash or by converting assets into cash.

LIQUIDITY RISK: The risk that an investment will be difficult to sell at a fair market price in a timely fashion.

MARKET RISK: The risk that the value of a security will rise or decline as a result of changes in market conditions. It is that part of a security's risk that is common to all securities of the same general class (stocks and bonds) and thus cannot be eliminated by diversification; also known as systematic risk.

MARKET VALUE: The price at which a security is trading and could presumably be purchased or sold.

MARKING-TO-MARKET: The practice of valuing a security or portfolio according to its market value, rather than its cost or book value.

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer to liquidate the underlying securities in the event of default by the seller.

MATURITY DATE: The date on which the principal or face value of an investment becomes due and payable.

MONEY MARKET INSTRUMENT: Generally, a short-term debt instrument that is purchased from a broker, dealer, or bank. Sometimes the term "money market" with "short-term", defines an instrument with no more than 12 months remaining from the purchase date until the maturity date. Sometimes the term "money market" is used more restrictively to mean only those instruments that have active secondary markets.

MORTGAGE-BACKED SECURITIES (MBS): Securities composed of, or collateralized by, loans that are themselves collateralized by liens on real property.

OFFER: The price asked by a seller of securities. (When purchasing securities, one asks for an offer.)

OPEN MARKET OPERATIONS: Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

OPPORTUNITY COST: The cost of pursuing one course of action measured in terms of the foregone return that could have been earned on an alternative course of action that was not undertaken.

PAR: See Face Value

PFIA OR ACT: The Public Funds Investment Act, Chapter 2256, Texas Government Code, as amended.

POOLED FUND GROUP: An internally created fund of an investing entity in which one or more institutional accounts of the investing entity are invested (as defined by the Public Funds Investment Act).

PREMIUM: The amount by which the price paid for a security exceeds its face value.

PRIMARY DEALER: A group of government securities dealers that submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC)-registered securities broker-dealers, banks, and a few unregulated firms.

PRINCIPAL: The face or par value of an instrument, exclusive of accrued interest.

PRUDENT PERSON RULE: An investment standard. In some states the law requires that a fiduciary, such as a trustee, may invest money only in a list of securities selected by the state. In other states the trustee may invest in a security if it is one which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

QUALIFIED REPRESENTATIVE: A person who holds a position with - and is authorized to act on behalf of - a business organization (as defined by the Public Funds Investment Act).

RATE OF RETURN: The amount of income received from an investment, expressed as a percentage. A market rate of return is the yield that an investor can expect to receive in the current interest-rate environment utilizing a buy-and-hold to maturity investment strategy.

REINVESTMENT RATE: The interest rate earned on the reinvestment of coupon payments.

REINVESTMENT RATE RISK: The risk that the actual reinvestment rate falls short of the expected or assumed reinvestment rate.

REPURCHASE AGREEMENT (RP or REPO): An agreement of 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 on demand or at a specified later date. The difference between the selling price and the repurchase price provides the interest income to the party that provided the funds. Every transaction where a security is sold under an agreement to be repurchased is a repo from the seller/borrower’s point of view and a reverse repo from the buyer/lender’s point of view.

REVERSE REPURCHASE AGREEMENT: (See Repurchase Agreement)

SAFEKEEPING: A procedure where securities are held by a third party acting as custodian for a fee.

SECONDARY MARKET: A market made for the purchase and sale of outstanding issues following the initial distribution.

SECURITIES AND EXCHANGE COMMISSION (SEC): Agency created by Congress to protect investors in securities transactions by administering securities legislation.

SECURITIES LENDING: The temporary transfer of securities by one party, the lender, to another, the borrower. The securities borrower is required to provide acceptable assets as collateral to the securities lender in the form of cash or other securities. If the borrower provides securities as collateral to the lender, it pays a fee to borrow the lent securities. If it provides cash as collateral, the lender pays interest to the borrower and reinvests the cash at a higher rate.

SEC RULE 15C3-1: See Uniform Net Capital Rule

STRUCTURED NOTES: Debt obligations whose principal or interest payments are determined by an index or formula.

SEPARATELY INVESTED ASSET: An account or fund of a state agency or local government that is not invested in a pooled fund group (as defined by the Public Funds Investment Act).

SPREAD: Most commonly used when referring to the difference between the bid and asked prices in a quote. Additionally, it may also refer to additional basis points that a non-Treasury security earns over and above a Treasury with a comparable maturity date.

STRIPS: Separation of the principal and interest cash flows due from any interest-bearing securities into different financial instruments. Each coupon payment is separated from the underlying investment to create a separate security. Each individual cash flow is sold at a discount. The amount of the discount and the time until the cash flow is paid determine the investor's return.

SWAP: The trading of one asset for another. Sometimes used in active portfolio management to increase investment returns by "swapping" one type of security for another.

TOTAL RETURN: Interest income plus capital gains (or minus losses) on an investment.

TREASURY BILLS: A non-interest bearing discount security issued by the U.S. Treasury, generally having initial maturities of 3 months, 6 months, or 1 year.

TREASURY BONDS: Long-term, coupon bearing U.S. Treasury securities having initial maturities of more than 10 years.

TREASURY NOTES: Intermediate-term, coupon bearing U.S. Treasury securities having initial maturities of 2 - 10 years.

UNIFORM NET CAPITAL RULE: Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called *net capital rule* and *net capital ratio*. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

YIELD TO MATURITY (YTM): The promised return assuming all interest and principal payments are made and reinvested at the same rate taking into account price appreciation (if priced below par) or depreciation (if priced above par).