

JEFF DAVIS COUNTY UNDERGROUND WATER CONSERVATION DISTRICT INVESTMENT POLICY and STRATEGY STATEMENT

(Adopted March 22, 2022)

PREFACE

The purpose of this document is to set forth specific investment policy and strategy guidelines for the Jeff Davis County Underground Water Conservation District in order to achieve the goals of safety, liquidity, yield, and public trust for all investment activity. The Board of Directors of the Jeff Davis County Underground Water Conservation District shall review its investment strategies and policy not less than annually. This policy serves to satisfy the statutory requirement of the Texas Water Code Chapter 36 and the Public Funds Investment Act (the “Act”) to define, adopt and review a formal investment strategy and policy.

It is the policy of the Jeff Davis County Underground Water Conservation District 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 Resolution Requirements and the adopted Investment Policy. Maturity selections shall be based on cash flow and market conditions to take advantage of interest earnings. The Jeff Davis County Water District’s portfolio shall be designed and managed in a manner responsive to the public trust and consistent with the Investment Policy.

Each major fund type has varying cash flow requirements and liquidity needs. Therefore specific strategies shall be implemented considering the fund’s unique requirements.

INVESTMENT STRATEGY [PFIA 2256.005(d)]

The Jeff Davis County Underground Water Conservation District maintains a conservative investment portfolio that utilizes specific investment strategy considerations designed to address the unique characteristics of the fund groups represented in the portfolio. While it is recognized that at this time there is no debt service required of the District, the Board of Directors felt it prudent to establish appropriate guidelines and procedures to accommodate any future demands. 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. The composite portfolio will have a dollar weighted average maturity of 365 days or less. This dollar weighted average maturity will be calculated using the stated final maturity dates of each security. Investment guidelines by fund-type are as follows:

- Investment strategies for general 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 that will experience minimal volatility during economic cycles. This may be accomplished by purchasing high quality, short- to medium-term securities that will complement each other in a laddered structure. Diversification of the portfolio will not be circumvented by convinces.
- Investment strategies for debt service funds shall have as the primary objective the assurance of investment liquidity adequate to cover the debt service obligations on the required payment date. Securities purchased shall not have a stated final maturity date which exceeds the debt service payment date, or funds shall be maintained in an investment pool or money market mutual fund to be available for debt service payments.
- Investment strategies for bond funds and for debt service reserve funds shall have as the primary objective the ability to generate a dependable revenue source to the appropriate fund from securities with a low degree of volatility. Except as may be required by the bond ordinance specific to an individual issue, securities should be of high quality, with short to medium term maturities.

JEFF DAVIS COUNTY UNDERGROUND WATER CONSERVATION DISTRICT INVESTMENT POLICY

I. POLICY

It is the policy of the Jeff Davis County Underground Water Conservation District (“District”) that after allowing for the anticipated cash flow requirements of the District and giving due consideration to the safety and risk of investment, all available funds shall be invested in conformance with these legal and administrative guidelines and to the maximum extent possible.

Effective cash management is recognized as essential to good fiscal management. Investment interest is NOT a viable and material source of revenue to District funds. The District’s investment portfolio shall be designed and managed in a manner which will maximize this revenue source, be responsive to public trust, and will be in compliance with legal requirements and limitations.

Investments shall be made with the primary objectives of:

- * **Safety** and preservation of principal
- * Maintenance of sufficient **liquidity** to meet operating needs
- * **Diversification** of the portfolio
- * Maximization of **yield** on the portfolio – optimize interest earnings
- * **Public trust** from prudent investment activities

II. PURPOSE

The purpose of this investment policy is to comply with Chapter 36 of the Texas Water Code and Chapter 2256 of the Government Code (“Public Funds Investment Act”) which requires the District to adopt a written investment policy regarding the investment of its funds and funds under its control. The Investment Policy addresses the methods, procedures and practices that must be exercised to ensure effective and judicious fiscal management of the District’s funds.

III. SCOPE

This Investment Policy shall govern the investment of all financial assets of the Jeff Davis County Underground Water Conservation District. These funds are accounted for in the District’s Comprehensive Annual Financial Report (CAFR) and may include:

- General Fund
- Special Revenue Funds

- Capital Projects Funds
- Enterprise Funds
- Trust and Agency Funds, to the extent not required by law or existing contract to be kept segregated and managed separately
- Debt Service Funds, including reserves and sinking funds, to the extent not required by law or existing contract to be kept segregated and managed separately
- Any new fund created by the District, unless specifically exempted from this Policy by the Board of Directors (Board) or by law

The District will consolidate cash balances from all funds to maximize investment earnings. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

This Investment Policy shall apply to all transactions involving the financial assets and related activity for all the foregoing funds. However, this policy does not apply to the assets administered for the benefit of the District by outside agencies under deferred compensation programs.

IV. INVESTMENT OBJECTIVES

The District shall manage and invest its cash with four primary objectives, listed in order of priority: **safety, liquidity, yield, and public trust**. The safety of the principal invested always remains the primary objective. All investments shall be designed and managed in a manner responsive to the public trust and consistent with state and local law.

The District shall maintain a comprehensive cash management program, which includes collection of accounts receivable, vendor payments in accordance with invoice terms, and prudent investment of available cash. Cash management is defined as the process of managing monies in order to insure maximum cash availability and maximum yield on short-term investment of idle cash.

Safety [PFIA 2256.005 (b) (2)]

Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate credit and interest rate risk.

- Credit Risk – The District will minimize credit risk, the risk of loss due to the failure of the issuer or backer of the investment, by:
 - Limiting investments to the safest types of investments
 - Pre-qualifying the financial institutions and broker/dealers with which the District will do business
 - Diversifying the investment portfolio so that potential losses on individual investments will be minimized.

- ❑ Interest Rate Risk – the District will minimize the risk that the market value of investments in the portfolio will fall due to changes in general interest rates, by:
 - Structuring the investment portfolio so that investments mature to meet cash requirements for ongoing operations, thereby avoiding the need to liquidate investments prior to maturity
 - Investing operating funds primarily in certificates of deposit, shorter-term securities, money market mutual funds, or local government investment pools functioning as money market funds.

Liquidity [PFIA 2256.005(b) (2)]

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. Because all possible cash demands cannot be anticipated, a portion of the portfolio should consist of either securities with active secondary or resale markets, or shares in money market mutual funds or local government investment pools that offer same day liquidity.

Yield [PFIA 2256.005(b) (3)]

The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. Return on investment is of secondary importance compared to the safety and liquidity objectives described above.

Public Trust

All participants in the District's investment process shall seek to act responsibly as custodians of the public trust. Investment Officers shall avoid any transaction that might impair public confidence in the District's ability to govern effectively.

V. RESPONSIBILITY AND CONTROL

Delegation of Authority [PFIA 2256.005(f)]

In accordance with Chapter 36.156, Water Code, and the Public Funds Investment Act, the Board designates the General Manager as the District's Investment Officer. An Investment Officer is authorized to execute investment transactions on behalf of the District. No person may engage in an investment transaction or the management of District funds except as provided under the terms of this Investment Policy as approved by the Board. The investment authority granted to the investing officers is effective until rescinded by the Board.

Quality and Capability of Investment Management [PFIA 2256.005(b) (3)]

The District shall provide periodic training in investments for the designated investment officers and other investment personnel through courses and seminars offered by professional organizations, associations, and other independent sources in order to insure the quality and capability of investment management in compliance with the Public Funds Investment Act.

Training Requirement [PFIA 2256.008]

In accordance with Chapter 36.1561 and the Public Funds Investment Act, designated Investment Officers shall attend an investment training session no less often than once every two years commencing September 1, 1997 and shall receive not less than 4 hours of instruction relating to investment responsibilities. A newly appointed Investment Officer must attend a training session of at least 6 hours of instruction within twelve months of the date the officer took office or assumed the officer's duties. The investment training session shall be provided by an independent source approved by the Board (Note: a designated investment committee may approve the independent source of training.) For purposes of this policy, an "independent source" from which investment training shall be obtained shall include a professional organization, an institution of higher learning or any other sponsor other than a business organization with whom the District may engage in an investment transaction.

The Investment Officer is required to complete Cybersecurity Awareness Training each year.

Internal Controls (Best Practice)

The General Manager and the Board of Directors are responsible for establishing and maintaining an internal control structure designed to ensure that the assets 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 (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

Accordingly, the General Manager shall establish a process for annual independent review by an external auditor to assure compliance with policies and procedures. The internal controls shall address the following points:

- Control of collusion.
- Separation of transactions authority from accounting and record keeping.
- Custodial safekeeping.
- Avoidance of physical delivery securities.
- Clear delegation of authority to subordinate staff members.

- Written confirmation for telephone (voice) transactions for investments and wire transfers.
- Development of a wire transfer agreement with the depository bank or third party custodian.

Prudence [PFIA 2256.006]

The standard of prudence to be applied by the Investment Officer shall be the “prudent investor “rule which states: “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.” In determining whether an Investment Officer has exercised prudence with respect to an investment decision, the determination shall be made taking into consideration:

- The investment of all funds, or funds under the District’s control, over which the officer had responsibility rather than a consideration as to the prudence of a single investment.
- Whether the investment decision was consistent with the written approved investment policy of the District.

Indemnification (Best Practice)

The Investment Officer, acting in accordance with written procedures and exercising due diligence, shall not be held personally responsible for a specific investment’s credit risk or market price changes, provided that these deviations are reported immediately and the appropriate action is taken to control adverse developments.

Ethics and Conflicts of Interest [PFIA 2256.005(i)] & [Water Code 36.061(a) (1)]

Officers and employees involved in the investment process shall refrain from personal business activity that would conflict with the proper execution and management of the investment program, or that would impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and Officers shall refrain from undertaking personal investment transactions with the same individual with which business is conducted on behalf of the District.

An Investment Officer of the District who has a personal business relationship with an organization seeking to sell an investment to the District shall file a statement disclosing that personal business interest. An Investment Officer who is related within the second degree by affinity or consanguinity to an individual seeking to sell an investment to the District shall file a statement disclosing that relationship. A statement required under this

subsection must be filed with the Texas Ethics Commission and the governing body of the entity.

VI. SUITABLE AND AUTHORIZED INVESTMENTS

Portfolio Management

The District currently has a “buy and hold” portfolio strategy. Maturity dates are matched with cash flow requirements and investments are purchased with the intent to be held until maturity. However, investments may be liquidated before maturity for the following reasons:

- An investment with declining credit may be liquidated early to minimize loss of principal.
- Cash flow needs of the District require that the investment be liquidated.

Investments [PFIA 2256.005(b) (4) (A)]

District funds governed by this policy may be invested in the instruments described below, all of which are authorized by Chapter 2256 of the Government Code (Public Funds Investment Act). Investment of District funds in any instrument or security not authorized for investment under the Act is prohibited.

I. Authorized

1. Obligations of the United States of America, its agencies and instrumentalities.
2. Certificates of Deposit issued by a bank organized under Texas law, the laws of another state, or federal law that has its main office or a branch office in Texas a savings and loan association or savings bank organized under Texas law, the laws of another state, or federal law, that has its main office or a branch office in Texas, and that is guaranteed or insured by the Federal Deposit Insurance or its successor or secured by obligations in a manner and amount provided by law for deposits of the District.
3. Fully collateralized direct repurchase agreements with a defined termination date secured by obligations of the United States or its agencies and instrumentalities. These shall be pledged to the District, held in the District’s name, and deposited at the time the investment is made with the District or with a third party selected and approved by the District. Repurchase agreements must be purchased through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in Texas. A Master Repurchase Agreement must be signed by the bank/dealer prior to investment in a repurchase agreement. All repurchase agreement transactions will be on a delivery vs. payment basis. Securities received for repurchase agreements must have a market value greater than or

equal to 102 percent at the time funds are disbursed. (Sweep accounts and/or Bond Proceeds)

4. Money Market Mutual funds that are 1) registered and regulated by the Securities and Exchange Commission, 2) have a dollar weighted average stated maturity of 90 days or less, 3) rated AAA by at least one Nationally recognized rating service and 4) maintain a net asset value of \$1 per share.
5. Local government investment pools which 1) meet the requirements of Chapter 2256.016 of the Public Funds Investment Act 2) are rated no lower than AAA or an equivalent rating by at least one nationally recognized rating service 3) seek to maintain a \$1.00 net asset value and 4) are authorized by resolution or ordinance by the Board of Directors.

All prudent measure will be taken to liquidate an investment that is downgraded to less than the required minimum rating. [PFIA 2256.021]

II. Not Authorized [PFIA 2256.009(b) (1-4)]

Investments included in interest-only or principal-only strips of obligations with underlying mortgage-backed security collateral, or in collateralized mortgage obligations with an inverse floating interest rate or a maturity date of over 10 years are strictly prohibited.

VII. INVESTMENT PARAMETERS

Maximum Maturities [PFIA 2256.005(b) (4) (B)]

The longer the maturity of investments, the greater their price volatility. Therefore, it is the District's policy to concentrate its investment portfolio in shorter-term securities in order to limit principal risk caused by changes in interest rates.

The District attempts to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the District will not directly invest in securities maturity more than one (1) year from the date of purchase; however, the above described obligations, certificates, or agreements may be collateralized using longer dated investments.

Because no secondary market exists for repurchase agreements, the maximum maturity shall be 120 days except in the case of flexible repurchase agreements for bond proceeds. The maximum maturity for such an investment shall be determined in accordance with project cash flow projections and the requirements of the governing bond ordinance.

The composite portfolio will have a weighted average maturity of 180 days or less. This dollar weighted average maturity will be calculated using the stated final maturity dates of each security.

[PFIA 2256.005(b) (4) (C)]

Diversification [PFIA 2256.005(b) (3)]

The District recognizes that investment risks can result from issuer defaults, market price changes or various technical complications leading to temporary illiquidity. Risk is controlled through portfolio diversification which shall be achieved by the following general guidelines:

- Limiting investments to avoid overconcentration in investments from a specific issuer or business sector (excluding U.S. Treasury securities and certificates of deposits that are fully insured and collateralized in accordance with state and federal law example)
- Limiting investment in securities that have higher credit risks, (example commercial paper)
- Investing in investments with varying maturities, and
- Continuously investing a portion of the portfolio in readily available funds such as local government investment pools (LGIPs), money market funds or overnight repurchase agreements to ensure that appropriate liquidity is maintained in order to meet ongoing obligations.

The following maximum limits, by instrument, are established for the District's total portfolio:

1.	U.S. Treasury Securities	100%
2.	Agencies and Instrumentalities	85%
3.	Certificates of Deposits	100%
4.	Repurchase Agreements*	20%
5.	Money Market Mutual Funds	50%
6.	Authorized Pools	50%

*Excluding flexible repurchase agreements for bond proceeds investments.

VIII. SELECTION OF BANKS AND DEALERS

Depository (Water Code 36.155)

At least every five years a Depository shall be selected through the District's banking services procurement process, which shall include a formal request for proposal (RFP). The selection of a depository will be determined by competitive bid and evaluation of bids will be based on the following selection criteria:

- The ability to qualify as a depository for public funds in accordance with state and local laws.
- The ability to provide requested information or financial statements for the periods specified.
- The ability to meet all requirements in the banking RFP.
- Complete response to all required items on the bid form
- Lowest net banking service cost, consistent with the ability to provide an appropriate level of service.
- The credit worthiness and financial stability of the bank.

Authorized Brokers/Dealers [PFIA 2256.025]

The District shall, at least annually, review, revise, and adopt a list of qualified broker/dealers and financial institutions authorized to engage in securities transactions with the District (Note: a designated investment committee may adopt and annually review the list of qualified broker/dealers.) Those firms that request to become qualified bidders for securities transactions will be required to provide a completed broker/dealer questionnaire that provides information regarding creditworthiness, experience and reputation, and 2) a certification stating the firm has received, read and understood the District investment policy and agree to comply with the policy. Authorized firms may include primary dealers or regional dealers that qualify under Securities & Exchange Commission Rule 15C3-1 (Uniform Net Capital Rule), and qualified depositories. All investment providers, including financial institutions, banks, money market mutual funds, and local government investment pools, must sign a certification acknowledging that the organization has received and reviewed the District's investment policy and that reasonable procedures and controls have been implemented to preclude investment transactions that are not authorized by the Districts' Policy. [PFIA 2256.005(k-l)]

Competitive Bids (Best Practice)

It is the policy of the District to require competitive bidding for all individual security purchases and sales except for: a) transactions with money market funds and local government investment pools and b) treasury and agency securities purchased at issue through an approved broker/dealer or financial institution. At least three bids or offers must be solicited for all other transactions involving individual securities. Certificates of deposit may be solicited orally, in writing, electronically, or in any combination of those methods.

Delivery vs. Payment [PFIA 2256.005(b) (4) (E)]

Securities shall be purchased using the **delivery vs. payment** method with the exception of investment pools and mutual funds. Funds will be released after notification that the purchased security has been received.

IX. SAFEKEEPING OF SECURITIES AND COLLATERAL

Safekeeping and Custodian Agreements (Best Practice)

The District shall contract with a bank or banks for the safekeeping of securities either owned by the District as part of its investment portfolio or held as collateral to secure demand or time deposits. Securities owned by the District shall be held in the District's name as evidenced by safekeeping receipts of the institution holding the securities.

Collateral for deposits will be held by a third party custodian designated by the District and pledged to the District as evidenced by safekeeping receipts of the institution with which the collateral is deposited. Original safekeeping receipts shall be obtained. Collateral may be held by the depository bank's trust department, a Federal Reserve Bank or branch of a Federal Reserve Bank, a Federal Home Loan Bank, or a third party bank approved by the District.

Collateral Policy [PFCA 2257.023]

Consistent with the requirements of the Public Funds Collateral Act, it is the policy of the District to require full collateralization of all District investments and funds on deposit with a depository bank, other than investments which are obligations of the U.S. government and its agencies and instrumentalities. In order to anticipate market changes and provide a level of security for all funds, the collateralization level will be 102% of market value of principal and accrued interest on the deposits or investments less an amount insured by the FDIC. At its discretion, the District may require a higher level of collateralization for certain investment securities. Securities pledged as collateral shall be held by an independent third party with whom the Depository bank has a current custodial agreement. The General Manager is responsible for entering into collateralization agreements with third party custodians in compliance with this policy. The agreements are to specify the acceptable investment securities for collateral, including provisions relating 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 (safekeeping receipt) must be supplied to the District and retained. Collateral shall be reviewed at least monthly to assure that the market value of the pledged securities is adequate.

Collateral Defined

The District shall accept only the following securities as collateral:

- Obligations of the United States or its agencies and instrumentalities

- Direct obligations of the state of Texas or its agencies or instrumentalities
- Collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States
- Obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized rating firm not less than A or it's equivalent with a remaining maturity of ten (10) years or less.
- A surety bond issued by an insurance company rated as to investment quality by a nationally recognized rating firm not less than A
- A letter of credit issued to the District by the Federal Home Loan Bank.

Subject to Audit

All collateral shall be subject to inspection and audit by the General Manager or the District's independent auditors.

X. PERFORMANCE

Performance Standards [Water Code 36.061(a) (3) (B)]

The District's investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio shall be designed with the objective of obtaining a rate of return through budgetary and economic cycles, commensurate with the investment risk constraints and the cash flow requirements of the District.

Performance Benchmark (Best Practice)

It is the policy of the District to purchase investments with maturity dates coinciding with cash flow needs. Through this strategy, the District attempts to purchase the highest yielding allowable investments available on the market at that time. Market value will be calculated on a quarterly basis on all securities owned and compared to current book value of those securities to determine portfolio performance during that period of time. The District's portfolio shall be designed with the objective of regularly meeting or exceeding the average rate of return on U.S. Treasury Bills at a maturity level comparable to the District's weighted average maturity in days.

XI. REPORTING [PFIA 2256.023]

Methods

The Investment Officer shall prepare an investment report on a quarterly basis that summarizes investment strategies employed in the most recent quarter and describes the

portfolio in terms of investment securities, maturities, and shall explain the total investment return for the quarter.

The quarterly investment report shall include a summary statement of investment activity prepared in compliance with generally accepted accounting principals. This summary will be prepared in a manner which will allow the District to ascertain whether investment activities during the reporting period have conformed to the Investment Policy. The report will be provided to the Board of Directors. The report will include the following:

- A listing of individual securities held at the end of the reporting period.
- Unrealized gains or losses resulting from appreciation or depreciation by listing the beginning and ending book and market value of securities for the period.
- Additions and changes to the market value during the period.
- Average weighted yield to maturity of portfolio as compared to applicable benchmark.
- Listing of investments by maturity date.
- Fully accrued interest for the reporting period
- The percentage of the total portfolio which each type of investment represents.
- Statement of compliance of the District's investment portfolio with state law and the investment strategy and policy approved by the Board of Directors.

A review of the quarterly reports will be performed by an independent auditor in association with the annual financial audit and the results reported to the board. [PFIA 2256.023(d)]

Marking to Market [PFIA 2256.005 (b) (4) (D)]

Market value of all securities in the portfolio will be determined on a quarterly basis. These values will be obtained from a reputable and independent source and disclosed to the governing body quarterly in a written report.

XII. INVESTMENT POLICY ADOPTION [PFIA 2256.005(e)]

The District's investment policy shall be adopted by resolution of the Board of Directors. It is the District's intent to comply with state laws and regulations. The District's investments policies shall be subject to revisions to stay current with changing laws, regulations, and needs of the District. The Board shall review the Policy annually and approve any changes or modifications.

GLOSSARY OF COMMON TREASURY TERMINOLOGY

Accrued Interest: The accumulated interest due on a bond as of the last interest payment made by the issuer.

Agency: A debt security issued by a federal or federally sponsored agency. Federal agencies are backed by the full faith and credit of the U.S. Government. Federally sponsored agencies (FSAs) are backed by each particular agency with a market perception that there is an implicit government guarantee. An example of federal agency is the Government National Mortgage Association (GNMA). An example of a FSA is the Federal National Mortgage Association (FNMA).

Amortization: The systematic reduction of the amount owed on a debt issue through periodic payments of principal.

Annual Financial Report: The official annual report for the Hemphill County Water District. It includes combined statements and basic financial statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provision, extensive introductory material, and a detailed statistical section.

Asked: The price at which securities are offered.

Average Life: The average length of time that an issue of serial bonds and/or term bonds with a mandatory sinking fund features is expected to be outstanding.

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

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

Book Value: The value at which a security is carried on the inventory lists or other financial records of an investor. The book value may differ significantly from the security’s current value in the market.

Broker: A broker brings buyers and sellers together for a commission paid by the initiator of the transaction or by both sides; he does not position. In the money market, brokers are active in markets in which banks buy and sell money and in interdealer markets.

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.

Call Price: The price at which an issuer may redeem a bond prior to maturity. The price is usually at a slight premium to the bond's original issue price to compensate the holder for loss of income and ownership.

Call Risk: The risk to a bondholder that a bond may be redeemed prior to maturity.

Cash Sale/Purchase: A transaction which calls for delivery and payment of securities on the same day that the transaction is initiated.

Certificate of Deposit (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination CD's are typically negotiable.

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.

Commercial Paper: An unsecured short-term promissory note issued by corporations, with maturities ranging from 2 to 270 days.

Convexity: A measure of a bond's price sensitivity to changing interest rates. A high convexity indicates greater sensitivity of a bond's price to interest rate changes.

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 Quality: The measurement of the financial strength of a bond issuer. This measurement helps an investor to understand an issuer's ability to make timely interest payments and repay the loan principal upon maturity. Generally, the higher the credit quality of a bond issuer, the lower the interest rate paid by the issuer because the risk of default is lower. Credit quality ratings are provided by nationally recognized rating agencies.

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

Current Yield (Current Return): A yield calculation determined by dividing the annual interest received on a security by the current market price of that security.

Dealer: A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his own account.

Debenture: A bond secured only by the general credit of the issuer.

Delivery versus Payment: There are two methods of delivery of securities: delivery versus payment and delivery versus receipt (also called free). Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is the delivery of securities with an exchange of a signed receipt for the securities.

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.

Discount Securities: Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value, e.g., U.S. Treasury Bills.

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

Duration: A measure of the timing of the cash flows, such as the interest payments and the principal repayment, to be received from a given fixed-income security. This calculation is based on three variables: term to maturity, coupon rate, and yield to maturity. The duration of a security is a useful indicator of its price volatility for given changes in interest rates.

Fair Value: The amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Federal Funds (Fed Funds): Funds placed in Federal Reserve banks by depository institutions in excess of current reserve requirements. These depository institutions may lend fed funds to each other overnight or on a longer basis. They may also transfer funds among each other on a same-day basis through the Federal Reserve banking system. Fed funds are considered to be immediately available funds.

Federal Funds Rate: Interest rate charged by one institution lending federal funds to the other.

Federal Credit Agencies: Agencies of the Federal government set up to supply credit to various classes of institutions and individuals, e.g. S&L's, small business firms, students, farmers, farm cooperatives, and exporters.

Federal Deposit Insurance Corporation (FDIC): A federal agency that insures bank deposits, currently up to \$100,000 per deposit.

Federal Home Loan Banks (FHLB): The institutions that regulate and lend to savings and loan associations. The Federal Home Loan Banks play a role analogous to that played by the Federal Reserve Banks vis-à-vis member commercial banks.

Federal National Mortgage Association (FNMA): 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, H.U.D. It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned

corporation. The corporation's purchases include a variety of adjustable mortgages and second loans in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

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., 12 regional banks and about 5,700 commercial banks that are members of the system.

Government National Mortgage Association (GNMA or Ginnie Mae): Securities guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. Security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by FHA, VA or FMHM mortgages. The term pass through is often used to describe Ginnie Maes.

Government Securities: An obligation of the U.S. government, backed by the full faith and credit of the government. These securities are regarded as the highest quality of investment securities available in the U.S. securities market. See "Treasury Bills, Notes, and Bonds."

Interest Rate: See "Coupon Rate."

Interest Rate Risk: The risk associated with declines or rises in interest rates which cause an investment in a fixed-income security to increase or decrease in value.

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. The concept of reasonable assurance recognized that 1) the cost of a control should not exceed the benefits likely to be derived and 2) the valuation of costs and benefits requires estimates and judgments by management. Internal controls should address the following points:

- **Control of collusion** – Collusion is a situation where two or more employees are working in conjunction to defraud their employer.
- **Separation of transaction authority from accounting and record keeping** – By separating the person who authorizes or performs the transaction from the people who record or otherwise account for the transaction, a separation of duties is achieved.

- **Custodial safekeeping** – Securities purchased from any bank or dealer including appropriate collateral (as defined by state law) shall be placed with an independent third party for custodial safekeeping.

Inverted Yield Curve: A chart formation that illustrates long-term securities having lower yields than short-term securities. This configuration usually occurs during periods of high inflation coupled with low levels of confidence in the economy and a restrictive monetary policy.

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.

Investment-grade Obligations: An investment instrument suitable for purchase by institutional investors under the prudent person rule. Investment-grade is restricted to those obligations rated BBB or higher by a rating agency.

Liquidity: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

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

Mark-to-market: The process whereby the book value or collateral value of a security is adjusted to reflect its current market value.

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

Market Value: Current market price of a security.

Master Repurchase Agreement: To protect investors, many public investors will request that repurchase agreements be preceded by a master repurchase agreement between the investor and the financial institution or dealer. The master agreement should define the nature of the transaction, identify the relationship between the parties, establish normal practices regarding ownership and custody of the collateral securities during the term of the investment, provide remedies in the case of default by either party and clarify issues of ownership. The master repurchase agreement protects the investor by eliminating the uncertainty of ownership and hence, allowing investors to liquidate collateral if a bank or dealer defaults during the term of the 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: The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

Money Market Mutual Fund: Mutual funds that invest solely in money market instruments.

Mutual Fund: An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments. Mutual funds are regulated by the Investment Company Act of 1940.

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: The market value of one share of an investment company, such as a mutual fund. This figure is calculated by totaling a fund's assets which includes securities, cash, and any accrued earnings, subtracting this from the fund's liabilities and dividing this total by the number of shares outstanding. This is calculated once a day based on the closing price for each security in the fund's portfolio.

No Load Mutual Fund: A mutual fund which does not levy a sales charge on the purchase of its shares.

Nominal Yield: the stated rate of interest that a bond pays its current owner, based on par value of the security. It is also known as the "coupon," coupon rate," or "interest rate."

Offer: An indicated price at which market participants are willing to sell a security or commodity. Also referred to as the "ask price."

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.

Par: Face value or principal value of a bond, typically \$1,000 per bond.

Portfolio: Collection of securities held by an investor.

Positive Yield Curve: A chart formation that illustrates short-term securities having lower yields than long-term securities.

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

Prime Rate: A preferred interest rate charged by commercial banks to their most creditworthy customers. Many interest rates are keyed to this rate.

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

Prospectus: A legal document that must be provided to any prospective purchaser of a new securities offering registered with the SEC. This can include information on the issuer, the issuer's business, the proposed use of proceeds, the experience of the issuer's management, and certain certified financial statements.

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

Qualified Public Depositories: A financial institution which does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of the state, which has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability and which has been approved by the Public Deposit Protection Commission to hold public deposits.

Rate of Return: The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond or the current income return.

Reinvestment Risk: The risk that a fixed income investor will be unable to reinvest income proceeds from a security holding at the same rate of return currently generated by that holding.

Repurchase Agreement (RP or 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.

SEC Rule 15C3-1: See uniform net capital rule.

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

Securities & Exchange Commission: Agency created by Congress to protect investors in securities transactions by administering securities legislation.

Serial Bond: A bond issue, usually of a municipality, with various maturity dates scheduled at regular intervals until the entire issue is retired.

Sinking Fund: Money accumulated on a regular basis in a separate custodial account that is used to redeem debt securities or preferred stock issues.

Swap: Trading one asset for another.

Term Bond: Bonds comprising a large part of all of a particular issue which come due in a single maturity. The issuer usually agrees to make periodic payments into a sinking fund for mandatory redemption of term bonds before maturity.

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. $(\text{Price Appreciation}) + (\text{Dividends paid}) + (\text{Capital gains}) = \text{Total Return}$

Treasury Bills: A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months or one year in minimum denominations of \$10,000.00. The yields on bills are monitored closely in the money markets for signs of interest rate trends.

Treasury Bond: Long-term U.S. Treasury securities having initial maturities of more than ten years.

Treasury Notes: Intermediate term coupon bearing U.S. Treasury securities having initial maturities from one to ten years. Currently, the longest outstanding maturity for such securities is 30 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. This is one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

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

Volatility Risk Rating: A rating system to clearly indicate the level of volatility and other non-credit risks associated with securities and certain bond funds. The ratings for

bond funds range from those that have extremely low sensitivity to changing market conditions and offer the greatest stability of the return (“aaa” by S&P; “V-1” by Fitch) to those that are highly sensitive with currently identifiable market volatility risk (“ccc” by S&P, “V-10” by Fitch).

Weighted Average Maturity (WAM): The average maturity of all the securities that comprise a portfolio. According to SEC rule 2A-7, the WAM for SEC registered money market mutual funds may not exceed 90 days and no one security may have a maturity that exceeds 397 days.

When Issued (WI): A conditional transaction in which an authorized new security has not been issued. All “when issued” transactions are settled when the actual security is issued.

Yield: The rate of annual income return on an investment, expressed as a percentage. (a) Income Yield is obtained by dividing the current dollar income by the current market price of the security. (b) Net Yield or Yield to Maturity is the current income yield minus any premium above par or plus any discount from par on purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.

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 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.

Zero-coupon Securities: Security that is issued at a discount and makes no periodic interest payments. The rate of return consists of a gradual accretion of the principal of the security and is payable at par upon maturity.