City of Lubbock, TX
Finance Department
Investment Policy and Investment Strategy for 2016

Policy

The Executive Director of Finance, or Designee, of the City of Lubbock, Texas, is charged with the responsibility to prudently and properly manage any and all funds of the City. Time and demand deposits must be fully collateralized and all transactions appropriately authorized. The following investment policy addresses the procedures, controls, and practices, which must be exercised to ensure sound fiscal management. The statutory foundation for this Policy is the Public Funds Investment Act (the "Act", Texas Government Code 2256) and the Public Funds Collateral Act, (Texas Government Code 2257.)

Scope

This policy shall apply to the investment of all financial assets and all funds of the City of Lubbock (hereinafter referred to as the "City") over which it exercises financial control. In order to effectively make use of the City's cash resources, all moneys, with the exception of certain bond proceeds which must be segregated and accounted for separately ("Bond Funds"), shall be pooled into one investment account ("Operating Funds"). The investment income derived from this account shall be distributed to the various City funds in accordance with the existing City Policy.

These funds are accounted for in the City of Lubbock Comprehensive Annual Financial Report (CAFR) and include:

General Fund
Special Revenue Funds
Debt Service Funds
Capital Projects Funds
Enterprise Funds (excluding WTMPA)
Internal Service Funds
Agency Funds

The Bond Funds Portfolio includes bond proceeds recorded in Capital Projects, Enterprise, and Internal Service Funds, while the Operating Portfolio includes all other resources in the other funds listed.

Objectives

The City's principal investment objectives are listed in order of priority:

A. **Compliance** with all Federal, State, and other legal requirements (includes but is not limited to Chapter 2256 Public Funds Investment Act, as amended and Chapter 2257 Public Funds Collateral Act, as amended, of the Texas Government Code)
B. **Safety:** Preservation of capital and the protection of investment principal.
C. **Liquidity:** Maintenance of sufficient liquidity to meet anticipated disbursements and cash flows.
D. **Diversification:** Maintenance of diversity in market sector and maturity to minimize market risk in a particular sector.
E. **Marketability:** Ability to liquidate investments before maturity if the need arises.
F. **Yield:** Attainment of a market rate of return equal to or higher than the performance measure established by the Executive Director of Finance, or Designee.

Responsibility and Control

Delegation of Authority

The ultimate responsibility and authority for investment transactions involving the City resides with the Executive Director of Finance, or Designee. The Executive Director of Finance, or Designee, has delegated the investment function to the Debt and Investment Analyst, or Designee, and all are designated as Investment Officers. (2256.005(f)) The Debt and Investment Analyst, or Designee is charged with executing the day-to-day investment functions for the City following the guidance and recommendations of the City's Audit and Investment Committee.

Audit and Investment Committee

The City will utilize the Audit and Investment Committee to assist in monitoring the performance and structure of the City's investments. The Audit and Investment Committee shall be responsible for the investment strategy decisions, activities, and the establishment of written procedures for the investment operations consistent with this policy. Monitoring of the portfolio shall be performed by the Audit and Investment Committee no less than quarterly and verified by the City's independent auditor at least annually. The Audit and Investment Committee shall discuss investment reports, investment strategies, and investment and banking procedures.

Investment Advisors

The Executive Director of Finance, or Designee, may in his/her discretion, with Council approval, appoint one or more investment advisors, registered with the Securities and Exchange Commission under the Investment Advisors Act of 1940 (15 U.S.C. Section 80b-1 et seq.), to assist in the management of a portion of the City's assets. To be eligible for consideration, an investment advisor shall demonstrate to the Audit and Investment Committee knowledge of cash management and experience in managing public funds. Selection of any investment advisor shall be based upon their expertise in public cash management. An appointed investment advisor may be granted investment discretion within the guidelines of this Investment Policy with regard to the City's assets placed under its management. A contract made under authority of the Act may not be for a term longer than two years on the original contract term. A renewal or extension of the contract must be made by the City Council by resolution. (2256.003)

Standard of Care

The standard of care is to be used for managing the City's assets (2256.006), which states, "Investments shall be made with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived." Investment officers acting in accordance with written procedures and exercising due diligence, shall not be held personally liable for a specific security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments. The City’s independent auditor will perform a compliance audit of management controls on investments and adherence to investment policies annually.

In accordance with the Act (2256.005 and 2256.008), the Investment Officers shall attend 10 hours of investment training within 12 months of assuming duties and 8 hours not less than once in a two-year period that begins on the first day of the City’s fiscal year and consists of the two consecutive fiscal years after that date. The investment training session shall be provided by an independent source approved by the Audit and Investment Committee. Training must include education in investment controls, security risks, strategy risks, market risks, and diversification of investment portfolio in order to ensure the quality and capability of investment management in compliance with the Act.

Investment Portfolio

Authorized Investments

The following are authorized investments for the City and all are authorized and further defined by the Act:

- Obligations of the United States or its agencies and instrumentalities, which have a liquid market with a readily determinable market value but excluding mortgage backed securities. (2256.009(1))
- Direct obligations of this state or its agencies and instrumentalities (2256.009(2)) rated not less than A or its equivalent by at least one nationally recognized investment rating firm. (2256.009(a)(5))
- Other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, this state or the United States or their respective agencies and instrumentalities, including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation or by the explicit full faith and credit of the United States. (2256.009(a)4))
- Obligations of states (other than Texas), agencies, counties, cities, and other political subdivisions of any state rated not less than A or its equivalent by at least one nationally recognized investment rating firm. (2256.009(a)(5))
- Fully collateralized certificates of deposit issued by a state or national bank that has its main office or a branch office in Texas and guaranteed, or insured by the Federal Deposit Insurance Corporation or its successor, secured by obligations authorized by this subchapter, or secured in any other manner and amount provided by law for deposits of the City (2256.0010)
- Constant dollar, investment pools rated not less than AAA or an equivalent rating by at least one nationally recognized rating service and authorized by the City Council and as further defined by the Act**,** which invests in eligible securities as authorized by this subchapter (2256.016).

The following investments are prohibited by the Act (2256.009(b)):

- An obligation whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal, i.e. interest-only collateralized mortgage obligations (IO's).
- Obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest, i.e. principal-only collateralized mortgage obligations (PO's).
- Collateralized mortgage obligations that have a stated final maturity date of greater than 10 years.
- Collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index, i.e. CMO inverse floaters.
- Investment in the aggregate of more than 80 percent of the entity's monthly average fund balance, excluding bond proceeds and reserves and other funds held for debt service, in money market mutual funds or mutual funds; investment in the aggregate of more than 15 percent of its monthly average fund balance, excluding bond proceeds and reserves and other funds held for debt service, in mutual funds; investment of any portion of bond proceeds, reserves, and funds held for debt service, in mutual funds; and investment of its funds or funds under its control, including bond proceeds and reserves and other funds held for debt service, in any one mutual fund in an amount that exceeds 10 percent of the total assets of the mutual fund (2256.014).

Existing Investments

The Investment Officer is not required to liquidate investments that were authorized investments at the time of purchase (2256.017).

Effect of Loss of Required Rating

An investment that requires a minimum rating does not qualify as an authorized investment during the period the investment does not have a minimum rating. The Investment Officer shall take all prudent measures that are consistent with the City's investment policy to liquidate the investment(s) that does not have the minimum rating

(2256.021). In accordance with Section (2256.005(b)), the Investment Officer shall monitor rating changes in current investments by keeping a monthly record of ratings issued by three nationally recognized rating agencies.

Investment Diversification

It is the intent of the City to diversify the investment instruments within the portfolio to avoid incurring unreasonable risks inherent in over-investing in specific instruments, individual financial institutions or maturities. The asset allocation in the portfolio should, however, be flexible depending upon the outlook for the economy and the securities markets. When conditions warrant, the guidelines below may be exceeded by approval of the Audit and Investment Committee.

The City may invest to the following limits as a percentage of its total investment portfolio, these limitations do not apply to Bond Funds:

100% in United States Treasury Obligations
100% in Investment Pools
80% in Federal Instrumentalities or Agencies
50% in Certificates of Deposit
30% in Municipal Bonds

Investment Pools

In accordance with the Act (2256.016) investment pools must be continuously rated no lower than AAA or equivalent, with a weighted average maturity of less than 60 days. The pool must have an advisory board. A thorough investigation of the pool is required prior to investing, and on a continual basis, as due diligence, and shall include but is not limited to, the following topics:

- A description of eligible investment securities, and a written statement of investment policy and objectives.
- A description of interest calculations, method of distribution, and treatment of gains and losses.
- A description of the method used to safeguard securities (including the settlement processes), and the frequency and method by which securities are priced.
- An annual audited financial statement.
- The yield and expense ratio of the pool, including a statement regarding how yield is calculated.
- The frequency of audit of the program.
- A description of eligible participants along with allowable frequency and size of deposits and withdrawals.
- A schedule for receiving statements and portfolio listings.
- The policy under which reserves, retained earnings, etc. may be utilized by the pool.
- A fee schedule, and when and how it is assessed.
- Information related to the fund’s eligibility for accepting bond proceeds.
- Investments in a qualifying Investment Pool should be limited to no more than 5% of the total assets in the pool.

Investment Strategy

The City of Lubbock maintains portfolios, which utilize four specific investment strategy considerations, designed to address the unique characteristics of the fund groups represented in the investment portfolios. The policies detailed below are subject to an annual review to occur prior to the annual City Council action regarding the Investment Policy. (2256.005(d))

(1) Operating Funds and Commingled Pools Containing Operating Funds

The investment strategy for the portfolio containing operating funds, the Operating Portfolio, has as its primary objective to assure that anticipated cash flows are matched with adequate investment liquidity. Investment maturities shall be matched against liabilities including debt service requirements.

The secondary objective of the Operating Portfolio is to create a portfolio structure, which will experience minimal volatility during economic cycles. This will be accomplished by purchasing high quality, short- to medium-term securities, which will complement each other in a laddered maturity structure.

The City shall maintain a dollar-weighted average maturity of two (2) years or less based on the stated final maturity dates of each security in its Operating Portfolio. The City shall at all times maintain at least 10% of its operating investment portfolio in instruments maturing in 120 days or less.

(2) Debt Service Funds

The investment strategy for debt service funds shall have as the primary objective the assurance of investment liquidity adequate to cover each succeeding debt service obligation on the required payment date. Securities purchased shall not have a stated final maturity date which exceeds any unfunded debt service payment date. The maximum weighted average maturity shall not exceed one (1) year.

(3) Debt Service Reserve Funds

The investment strategies for debt service reserve funds shall have as the primary objective the ability to generate a dependable revenue stream to the appropriate debt service 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 intermediate-term maturities. The maximum weighted average maturity shall not exceed one (1) year. Volatility shall be further controlled through the purchase of securities carrying the highest coupon available within the desired maturity and quality range using a laddered maturity structure. Such securities will tend to hold their value during economic cycles.

(4) Bond Funds

The investment strategy for bond funds will have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity. These portfolios should include at least 10% in highly liquid securities to allow for flexibility and unanticipated project outlays. The stated final maturity dates of securities held shall not exceed the estimated project completion date. The maximum weighted average maturity shall not exceed two (2) years.

Cash Flow

A cash flow analysis shall be reviewed and updated no less than semi-annually. This cash flow analysis is the basis for matching liabilities or obligations with security maturities as outlined in the strategies previously listed.

Maximum Maturity

The maximum maturity of any individual security the City may invest in shall be 5 years.

Derivatives

A derivative is any security whose cash flow characteristics (coupon, redemption amount, or stated and estimated maturity) depend upon one or more indices or that has embedded futures or options. They can be linked to different market sectors or interest rate scenarios including: 1) increasing or decreasing interest rates, 2) U.S. Treasury yield curve, 3) foreign yield curves, 4) relationship between two different yield curves, 5) foreign exchange rates 6) equity price movements, and 7) commodity price movements.

The City shall define a derivative for purposes of investment as any mortgaged backed security to eliminate possible extension, volatility and reinvestment risk. The City will not invest in any mortgage-backed securities (MBS) whether a straight pass-through mortgage backed or further derived mortgage backed security (CMO).

The City shall not define United States Agency and Instrumentality debentures as derivatives. Debentures have a defined maturity date, which cannot extend regardless of their structure. These will be restricted to a maximum maturity of three (3) years. Floating rate debentures may only float on the U.S. Treasury rates and not exceed one (1) year in maturity.

The Investment Officers will monitor the development of new financial instruments and may present to the Audit and Investment Committee amendments to the above definition. The Investment Officers will not invest in derivatives without approval from either the Committee or City Council.

Management Style

The City seeks an active, rather than passive, management of its portfolio assets. Assets may be sold at a loss only if the Investment Officers feel that the sale of the security is in the best long-term interest of the City. Supporting documentation shall be maintained by the Investment Officer for all sales of securities in which there is a book loss or where a security is sold in order to simultaneously purchase another security.

Authorized Financial Broker/Dealers and Institutions

The City shall maintain a list of authorized broker/dealers and financial institutions, which are approved by the Audit and Investment Committee for investment purposes. It shall be the policy of the City to purchase securities only from those authorized institutions and firms. The Committee will review and approve the list at least annually.

To be eligible for authorization, each broker/dealer or financial institution shall:

1. Complete and submit to the City a Broker/Dealer Questionnaire, which includes the firm's most recent financial statements.
2. Provide a written instrument certifying that they have received and thoroughly reviewed the City’s investment policy and have implemented reasonable procedures and controls and understand the parameters set by the City of Lubbock.
3. Be a member of the FDIC (Financial Institutions only)
4. Be a “primary” dealer or regional dealer that qualifies under Securities & Exchange Commission Rule 15C3-1 (uniform net capital rule). All broker/dealers must submit: (a) audited financial reports (b) proof of National Association of Security Dealers certification, and (c) proof of state registration (Broker/Dealers only).
5. Provide competitive offers, resulting in the sale of a security, to the City. If there are no sales from a particular broker/dealer over a 12-month period, this broker/dealer will be removed from the approved broker/dealer listing (Broker/Dealers only).

The Investment Officer, or investment advisor, shall maintain a file of all Broker/Dealer Questionnaires. Broker/dealers and other financial institutions will be selected on the basis of their expertise in cash management and their ability to provide service to the City's account.

The Investment Officers shall exercise due diligence in monitoring the activities of other officers and subordinate staff members engaged in transactions with the City. Employees of any firm or financial institution offering securities or investments to the City of Lubbock shall be trained in the precautions appropriate to public-sector investments and shall be required to familiarize themselves with the City's investment objectives, policies and constraints. In the advent of a material adverse change in the financial condition of the firm or financial institution, the City will be informed immediately by telephone and in writing.

All investment transactions must be competitively transacted and executed with broker/dealers or financial institutions that have been authorized by the City. The City will obtain at least 3 competitive offers. Exception: New issues will not be required to be competitively transacted as all broker/dealers would show the same price and yield.

Selection of Financial Institutions

Depositories shall be selected through the City's banking services procurement process, which shall include a formal request for application. In selecting depositories, the services available, service costs, and credit-worthiness of institutions shall be considered, and the Investment Officers, shall conduct a comprehensive review of prospective depositories' credit characteristics and financial history.

The City shall select financial institutions from which the City may purchase certificates of deposit in accordance with the Act and this Policy. The City of Lubbock will have a written depository agreement with any financial institution with whom the City of Lubbock has time or demand deposits. The Investment Officer shall monitor the financial condition of financial institutions where certificates of deposit are held and report quarterly to the Audit and Investment Committee.

Collateralization of Public Deposits

Collateralization requirements are governed by Texas Government Code Chapter 2257 Public Funds Collateral Act. Collateralization will be required on three types of investments: time deposits, demand deposits, and repurchase agreements. In order to anticipate market changes and provide a level of security for all funds, the required minimum collateral level will be 102% of market value of principal and accrued interest monitored and maintained by the financial institution. The City of Lubbock chooses to limit collateral to the following:

Underlying collateral shall be composed of those investments approved in this policy and mortgage-backed securities as defined in Texas Government Code Chapter 2257.002. The maturity of the collateral security shall be no longer than a 30-year stated final maturity. Market value of the collateral shall be priced at least daily for repurchase agreements and monthly for time and demand deposits (including mortgage-backed securities).[A,E]

Collateral shall always be held by an independent third party with whom the City of Lubbock has a current custodial agreement. This should be evidenced by a written agreement in an effort to satisfy the Uniform Commercial Code (UCC) requirement for control. A safekeeping receipt must be supplied to the City of Lubbock for any transaction involving sales/purchases/maturities of securities and/or underlying collateral, which the City of Lubbock will retain. The right of collateral substitution is granted provided the substitution has prior approval of the City and is followed by the delivery of an original safekeeping receipt to the City of Lubbock, and the replacement collateral is received prior to the release of original collateral.

The collateral agreement must be:

- In writing
- Approved by the board of directors of the depository or its loan committee; and,
- Continuously, for the time of its execution, an official record of the depository institution.

Safekeeping of Securities

All securities owned by the City shall be held in City designated third party safekeeping. All trades executed by a dealer will settle Delivery vs. Payment through the City's safekeeping agent.

Securities purchased by the City shall be held in a segregated account. Collateral pledged to the City securing Certificates of Deposit shall be held in joint custody at the Federal Reserve Bank. It is the intent of the City that all securities be perfected in the name of the City.

Securities held in custody for the City shall be independently audited on an annual basis to verify investment holdings.

Delivery versus Payment

All security transactions, including collateral for repurchase agreements, entered into by the City of Lubbock shall be conducted on a delivery-versus-payment (DVP) basis. That is, funds shall not be wired or paid until verification has been made that the collateral was received by the Trustee. The collateral shall be held in the name of the City. The Trustee's records shall assure the notation of the City's ownership of or explicit claim on the securities. The original copy of all safekeeping receipts shall be delivered to the City.

Same Day Funds Settlement Procedures

All new issues will be made depository book-entry eligible, and principal and interest will be paid to the depository by fiscal agents in same-day funds on the payment date. For all existing issues, payments of principal and interest will be made to depositories by the fiscal agents in same-day funds on the payment date.

Each depository should pay bondholders in same-day funds on the payment date. On, or prior to the morning of the payment date, CUSIP number identification and dollar amount notifications will be sent to each depository using automated communications.

Reporting

Investment reports shall be prepared monthly and be signed and submitted by the Investment Officers, in a timely manner. These reports will be submitted to the City Manager and City Council. This report shall describe in detail the investment position of the City, disclose the market value and book value of each fund group as well as each separate investment, and state the maturity date of each security and accrued interest for the reporting period. It must also express the compliance of the portfolio to the investment strategy contained in the City's Investment Policy, the Act, and Generally Accepted Accounting Principles (GAAP). Market pricing information is obtained through the use of appropriate software available either externally such as through investment advisors, or internally. A written record shall be maintained of all bids and offerings for securities transactions in order to insure that the City receives competitive pricing. An independent auditor will review monthly investment reports on an annual basis, as required by the Act.

Changes in Statutes, Ordinances or Procedures

This policy is designed to operate within the restrictions set forth in applicable State of Texas and Federal laws and statutes, but it does not permit all activity allowed by those laws. Changes to state or federal laws, which restrict a permitted activity under this policy, shall be incorporated into this policy immediately upon becoming law. Changes to state or federal laws, which do not further restrict this policy, shall be reviewed by the Audit and Investment Committee and recommended to the City Council when appropriate.

Performance Review

The Audit and Investment Committee shall meet no less than quarterly to review the portfolio's adherence to appropriate risk levels and to compare the portfolio's total return to the established investment objectives and goals.

The Investment Officers shall periodically establish a benchmark yield for the City's investments, which shall be equal to the average yield on the United States Treasury security, which most closely corresponds to the portfolio's actual weighted average maturity, or other benchmark as approved by the Audit and Investment Committee. When comparing the performance of the City's portfolio, all fees and expenses involved with managing the portfolio should be included in the computation of the portfolio's rate of return.

Ethics and Conflicts of Interest

Investment Officers, employees, and Audit and Investment Committee Members involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the City Manager and the Texas Ethics Commission, any material financial interests in financial institutions that conduct business within this City, and they shall further disclose any large personal financial/investment positions that could be related to the performance of this City's portfolio. A disclosure statement with the Texas Ethics Commission and the City Manager will also be filed if an Investment Officer, employee, or Audit and Investment Committee Member is related within the third degree by consanguinity or within the second degree by affinity, as determined under Chapter 573, to an individual seeking to sell an investment to the City. Employees and officers shall subordinate their personal investment transactions to those of the City particularly with regard to the timing of purchases and sales.

Internal Controls

The Investment Officers shall establish a system of internal controls, which shall be documented in writing. The internal controls shall be reviewed by the Audit and Investment Committee and with the independent auditor on an annual basis. The controls shall be designed to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, unanticipated market changes, or imprudent actions by employees and officers of the City.

Policy Revisions

The City Council shall adopt a written instrument by rule, order, ordinance, or resolution stating that it has reviewed the investment policy and investment strategies and that the written instrument so adopted shall record any changes made to either the investment policy or investment strategies (2256.005(e)). The Audit and Investment Committee will review the Investment Policy and Investment Strategies annually. The Audit and Investment Committee shall forward modifications to the Policy or a resolution stating there are no changes to the City Council annually for City Council action.

Authority/Date Issued:

City Council Resolution # 5728/December 18, 1997
City Council Resolution # 5867/May 28, 1998
City Council Resolution #6600/November 4, 1999
City Council Resolution #2000-R0418/November 27, 2000
City Council Resolution #2001-R0471/November 8, 2001
City Council Resolution #2003-R0065/February 13, 2003
City Council Resolution #2003-R0474/October 23, 2003
City Council Resolution #2004- R0560/November 18, 2004
City Council Resolution #2005- R0478/October 13, 2005
City Council Resolution #2007- R0242/June 14, 2007
City Council Resolution #2007- R0402/August, 23, 2007
City Council Resolution #2008-R0113/April 10, 2008
City Council Resolution #2009-R0138/April 9, 2009
City Council Resolution #2010-R0159/April 8, 2010
City Council Resolution #2011-R0135/April 14, 2011
City Council Resolution #2012-R0033/January 26, 2012
City Council Resolution #2013-R0050/January 31, 2013
City Council Resolution #2014-R0002/January 9, 2014
City Council Resolution #2014-R0002/January 8, 2015

Glossary

AGENCIES: Federal agency securities and/or Government-sponsored enterprises.

ASKED: The price at which securities are offered.

BANKERS' ACCEPTANCE (BA): A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

BROKER: A broker brings buyers and sellers together for a commission.

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

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.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report for the City of Lubbock, Texas. It includes combined financial statements for all fund types and account groups as well as combining financial statements, as applicable, and footnotes prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical and Supplemental Information Section.

COUPON: (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. (b) A certificate attached to a bond evidencing interest due on a payment date.

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. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

DERIVATIVES: (1) Financial instruments whose return profile is linked to, or derived from the movement of one or more underlying index or security, and may include a leveraging factor, or (2) financial contracts based upon notional amounts whose value is derived from an underlying index or security (interest rates, foreign exchange rates, equities or commodities).

DISCOUNT: The difference between the cost price of a security and its maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

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

DIVERSIFICATION: Dividing investment funds among securities offering independent returns.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits, currently up to $250,000 per depositor, per insured bank, for each account ownership category..

FEDERAL FUNDS RATE: The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open market operations.

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.

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): The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment.

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

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase—reverse 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-lender to liquidate the underlying securities in the event of default by the seller-borrower.

MATURITY: The date upon which the principal or stated value of an investment becomes due and payable.

MONEY MARKET: The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

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.

PORTFOLIO: Collection of securities held by an investor.

PRIMARY DEALER: A group of government securities dealers who 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.

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 custody state—the so-called legal list. 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 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 this 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 the current income return.

REPURCHASE AGREEMENT (RP OR REPO): A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money, that is, increasing bank reserves.

SAFEKEEPING: A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

SECURITIES & EXCHANGE COMMISSION: Agency created by Congress to protect investors in securities transactions by administering securities legislation.

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

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.

TREASURY BONDS: Long-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of more than 10 years.

TREASURY NOTES: Medium-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from two to 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: 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 for 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 in the purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.