

Investment Policy



Approved on: December 17, 2013

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Investment Policy City of Rowlett, Texas

I. PURPOSE

The purpose of this Investment Policy (hereinafter "Policy") is to set forth the investment objectives and parameters for the management of public funds of the City of Rowlett, Texas (hereinafter "City"). This Policy is designed to safeguard the City's funds, the availability of operating and capital funds when needed, and an investment return competitive with comparable funds and financial market indices. In order to execute this framework this Policy contains an Investment Strategy Statement.

II. SCOPE

This Policy is authorized by the City Council of the City in accordance with Chapter 2256, Texas Government Code, the Public Funds Investment Act. The Policy addresses the methods, procedures and practices which must be exercised to insure effective and judicious fiscal management of City funds. All City funds will be managed within the guidelines of this Policy with the exception of the Deferred Compensation Agency Fund. Bond funds, in addition to this Policy, shall be managed in accordance with their issuing documentation and all applicable State and Federal Law.

In addition to the Policy, the Investment Strategy Statement, also approved by the City Council, provides a separate written investment strategy for each of the City's funds. Each investment strategy describes the investment objectives for each particular fund. Cash and investment balances as defined in this Section are entirely known as "Available Fund".

III. INVESTMENT OBJECTIVES

Safety of Principal

The foremost objective of this investment program is the safety of the principal of those funds within the portfolios. Investment transactions shall seek to keep capital losses at a minimum, whether they are from securities defaults or erosion of market value. To attain this objective, diversification is required in order that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio.

From time to time, securities may be traded for other similar securities to improve yield, maturity or credit risk. For these transactions, a loss may be incurred for accounting purposes, provided any of the following occurs with respect to the replacement security:

- A. Yield has been increased, or
- B. Maturity has been adjusted in anticipation of interest rate changes
- C. Quality of the investment has been improved.

Maintenance of Liquidity

The portfolios shall be managed in such a manner that funds are available to meet reasonably anticipated cash flow requirements in an orderly manner. Periodical cash

flow analyses will be completed in order to ensure that the portfolios are positioned to provide sufficient liquidity.

Return on Investment

Investment portfolios shall be designed with the objective of attaining a market rate within an acceptable range of the rate of return of the established benchmarks taking into account the investment risk constraints and liquidity needs. Return on investment is of least importance compared to the safety and liquidity objectives described above. The core of investments is limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed.

IV. DELEGATION OF AUTHORITY

As designated by the City Council, management responsibility for the investment program is assigned to the Director of Financial Services and Assistant Director of Financial Services. The Director of Financial Services and Assistant Director of Financial Services and other persons granted investment authority shall be considered and referred to as "Investment Officers" for the purpose of this Policy. As such, the Investment Officers are authorized to deposit, withdraw, invest, transfer, execute documentation, and otherwise manage City funds according to this Policy. The Investment Officers may grant, in writing, investment authority to other persons within the Finance Division. Any limitations placed on this authority will be specifically stated. No person may engage in an investment transaction or the management of funds except as provided under the terms of the Investment Policy, Investment Strategy Statement and other operational procedures established by the Investment Officers. The Investment Officers shall establish written procedures for the operation of the investment portfolio and a system of internal accounting and administrative controls to regulate the activities of employees. Any new requirements from policy will be in compliance within one year of this adoption.

V. INVESTMENT ADVISORS AND PROVIDERS

The City Council may appoint an investment advisor to assist the City's financial staff with the management of its funds and other responsibilities including but not limited to competitive bidding, reporting requirements and security documentation. The investment advisor must be registered with the Securities and Exchange Commission (SEC) under the Investment Advisor's Act of 1940 as well as with the Texas State Securities Board. The term of contract shall be limited under the Texas Public Funds Investment Act to a two-year period. A renewal or extension of the contract must be made by the City Council by order, ordinance or resolution.

Investment Advisors shall adhere to the spirit, philosophy and specific term of this Policy and shall invest within the standard of "Prudent Expert".

Investment Providers shall adhere to the spirit and philosophy of this Policy and shall avoid recommending or suggesting transactions outside the standard of "Prudent Expert."

The following criteria will be established in the selection of Investment Advisors and Investment Providers, including:

- 1) Adherence to the City's policies and strategies
- 2) Investment performance and transaction pricing within accepted risk constraints,
- 3) Responsiveness to the City's request for services, information and open communication,
- 4) Understanding of the inherent fiduciary responsibility of investing public funds,
- 5) Similarity in philosophy and strategy with the City's objectives.

Selected Investment Advisors and Investment Providers shall provide timely transaction confirmations and monthly activity reports.

Businesses eligible to transact investment business with the City shall be presented a written copy of this Policy. Additionally, the qualified representative of the business seeking to transact investment business shall execute a written instrument stating substantially to the effect that the registered principal has:

- 1) Received and thoroughly reviewed this Policy
- 2) Acknowledged that the organization has implemented reasonable procedures and controls in an effort to preclude imprudent investment activities with the City, except to the extent that this authorization is dependent on an analysis of the makeup of the City's entire portfolio or requires an interpretation of subjective investment standards.

The City will not enter into an investment transaction with a financial institution prior to receiving the written instrument described above.

If brokerage services are utilized, the Investment Officer will present annually to the governing body a list of qualified brokers. The governing body must review and approve qualified brokers authorized to engage in investment transactions with the City.

VI. STANDARDS OF PRUDENCE

The standard of prudence to be used by Investment Officers shall be the "Prudent Person" standard and shall be applied in the context of managing the overall investment program. Investment officers acting in accordance with written procedures and this Policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectation are reported to the City Council in a timely fashion and the liquidity and the sale of securities are carried out in accordance with the terms of this Policy. The "Prudent Person" rule states the following:

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 from the investment.

While the standard of prudence to be used by investment officials who are officers or employees is the Prudent Person standard, any person or firm hired or retained to invest, monitor, or advise concerning these assets shall be held to the higher standard of "Prudent Expert". The standard shall be that in investing and reinvesting moneys and in acquiring, retaining, managing, and disposing of investments of these funds, the contractor shall exercise: the judgment, care, skill, prudence, and diligence under the circumstances then prevailing, which persons of prudence, discretion, and intelligence, acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims by diversifying the investments of the funds, so as to minimize the risk, considering the probable income as well as the probable safety of their capital.

VII. ETHICS AND CONFLICTS OF INTEREST

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

An officer or employee involved in the investment process has a *personal business relationship* with a business organization if:

- 1) The Investment Officer or employee owns 10 percent or more of the voting stock or shares of the business organization or owns \$5,000 or more of the fair market value of the business organization;
- 2) Funds received by the Investment Officer or employee from the business organization exceed 10 percent of his/her gross income for the previous year; or
- 3) The Investment Officer or employee has acquired from the business organization during the previous year investments with a book value of \$2,500 or more for his/her personal account.

VIII. INTERNAL CONTROLS AND INVESTMENT PROCEDURES

The Investment Officers shall establish a system of internal controls and operational procedures that are in writing and made a part of the City's financial operational procedures. The internal controls should be designed to prevent losses of funds, which might arise from fraud, employee error, and misrepresentation by third parties, or

imprudent actions by employees. The written procedures should include reference to safekeeping, repurchase agreements, separation of transaction authority from accounting and recordkeeping, wire transfer agreements, banking service contracts, collateral/depository agreements, and "delivery-vs-payment" procedures. No person may engage in an investment transaction except as authorized under the terms of this Policy.

Independent auditors, as a normal part of the annual financial audit to the City, shall conduct a review of the system of internal controls to ensure compliance with policies and procedures.

IX. CONTINUING EDUCATION

Within 12 months after taking office or assuming duties, each Investment Officer shall attend a training session relating to their investment responsibilities and receive not less than 10 hours of instruction. On an ongoing basis, all Investment Officers shall receive not less than 10 hours of instruction- not less than once in a two year period that begins on the first day of the City of Rowlett's fiscal year (October 1) and consists of the two consecutive fiscal years after that date. Training must include education in investment controls, security risks, strategy risks, market risks and compliance with the Public Funds Investment Act. Training must be provided by an independent source approved by the City Council. Possible training sources include Government Treasurer's of Texas, TML (Texas Municipal League), PFM Asset Management LLC, TexPool (on-line) and First Public.

X. AUTHORIZED INVESTMENT INSTITUTIONS AND DEALERS

The Investment Officers or designee and/or the City's Investment Advisor/s shall only purchase securities from Qualified Financial Institutions and investment institutions which are designated as Primary Securities Dealers by the Federal Reserve Bank of New York. The Investment Officers and/or the City's Investment Advisor/s shall only enter into repurchase agreements with financial institutions that are Qualified Institutions and Primary Securities Dealers as designated by the Federal Reserve Bank of New York.

The City's Investment Advisor(s) shall utilize and maintain its own list of approved primary and non-primary securities dealers.

The Investment Officers or designee shall maintain a list of financial institutions and broker/dealers that are approved for investment purposes and only firms meeting the following requirements will be eligible to serve as Qualified Institutions:

- 1) Regional dealers that qualify under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule);
- 2) Capital of no less than \$10,000,000;
- 3) Registered as a dealer under the Securities Exchange Act of 1934;
- 4) Member of the National Association of Dealers (NASD);
- 5) Registered to sell securities in Texas;
- 6) The firm and assigned broker have been engaged in the business of effecting transactions in U.S. government and agency obligations for at least five (5) consecutive years;

All brokers, dealers and other financial institutions deemed to be Qualified Institutions shall be provided with current copies of the City's Investment Policy and sign the Broker/Dealer Certification. This requirement is for the City's Investment Officer or designee. The City's Investment Advisor will adhere to its own internal due diligence procedures. A current audited financial statement is required to be on file for each financial institution and broker/dealer with which the City transacts business.

XI. INVESTMENT STRATEGY STATEMENT

The City maintains Short-Term Portfolios for operating, debt service funds and bond construction funds and Long-Term Portfolio for core funds (operating reserve funds) and debt service reserve funds.

Short -Term Portfolios:

Operating Funds

Investment strategies for operating funds have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity.

Debt Service Funds

Investment strategies for debt service funds shall have as the primary objective the assurance of investment liquidity adequate to cover the debt service obligation on the required payment date. Securities purchased shall not have a stated final maturity date that exceeds the debt service payment date.

Bond Construction or Special Purpose Funds

Investment strategies for bond construction or special purpose fund portfolios will have as their primary objective to ensure that anticipated cash flows are matched with adequate investment liquidity. These fund 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 should not exceed the estimated project completion date.

Long -Term Portfolios:

Core Funds

The objective is to create a portfolio structure for the City's Core Funds, as determined by the cash flow analysis report, which will experience minimal market value volatility during economic cycles. This may be accomplished by purchasing quality, short- to medium-term securities that will complement each other in a laddered or barbell maturity structure. The overall weighted average duration of principal return for the Core Fund portfolio shall be less than two (2) years. Securities may not be purchased that have a final stated maturity date which exceeds five (5) years.

Debt Service Reserve Funds

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.

XII. MATURITY AND LIQUIDITY REQUIREMENTS

To the extent possible, an attempt will be made to match investment maturities with known cash needs and anticipated cash flow requirements.

A. Maturity Guidelines

Securities purchased by or on behalf of the City shall have a final maturity of five (5) years or less from the date of purchase. The overall weighted average duration of principal return for the entire portfolio shall be less than two (2) years. The maturities of the underlying securities of a repurchase agreement will follow the requirements of the Master Repurchase Agreement.

B. Liquidity Requirements

The Investment Officers or designee shall determine the approximate amount of funds required to meet the day-to-day expenditure needs of the City. A goal of the next depository agreement is that all funds in the depository bank will be "swept" each night into a fully collateralized repurchase agreement or money market fund. In order to have an available source of funds to meet unexpected cash requirements, a minimum of two months operating expenses will be invested in authorized money market funds or state or local investment pools. The balance of the City's funds will be available for investment according to the guidelines incorporated within this Policy.

XIII. PERFORMANCE MEASUREMENTS

In order to assist in the evaluation of the portfolios' performance, the City will use performance benchmarks for short-term and long-term portfolios. The use of benchmarks will allow the City to measure its returns against other investors in the same markets.

A. The short-term investment portfolios shall be designed with the annual objective of exceeding the weighted average return (net book value rate of return) of a Local Government Investment Pool.

B. The long-term investment portfolio (Core Funds) shall be designed with the objective of exceeding the return of the Merrill Lynch 1-3 Year U.S. Treasury Index (or a comparable benchmark) compared to the portfolio's total rate of return. The Merrill Lynch 1-3 Year Treasury Index represents U.S. Treasury

securities maturing over one year, but less than three years. This maturity range is an appropriate benchmark based on the objectives of the City.

XIV. COMPETITIVE SELECTION OF INVESTMENT INSTRUMENTS

After the Investment Officers and/or the City's Investment Advisor/s has determined the approximate maturity date based on cash flow needs and market conditions and has analyzed and selected one or more optimal types of investments, a minimum of three (3) qualified banks and/or approved broker/dealers must be contacted and asked to provide bids/offers on securities in questions. Bids will be held in confidence until the bid deemed to best meet the investment objectives is determined and selected.

However, if obtaining bids/offers are not feasible and appropriate, securities may be purchased/sold utilizing the comparison to current market price method on an exception basis. Acceptable current market price providers include, but are not limited to:

- A. Telerate Information System
- B. Bloomberg Information Systems
- C. Wall Street Journal or a comparable nationally recognized financial publication providing daily market pricing
- D. Daily market pricing provided by the City's custodian or their correspondent institutions

The Investment Officers or designee and/or the City's Investment Advisor/s shall utilize the competitive bid process to select the securities to be purchased or sold. Selection by comparison to a current market price, as indicated above, shall only be utilized when, in judgment of the Investment Officers or the City's Investment Advisor/s, competitive bidding would inhibit the selection process.

Examples of when this method may be used include:

- A. When time constraints due to unusual circumstances preclude the use of the competitive bidding process
- B. When no active market exists for the issue being traded due to the age or depth of the issue
- C. When a security is unique to a single dealer, for example, a private placement
- D. When the transaction involves new issues or issues in the "when issued" market

Overnight sweep investment instruments will not be bid, but may be placed with the City's depository bank relating to the demand account for which the investment instrument was purchased.

XV. AUTHORIZED INVESTMENTS AND PORTFOLIO COMPOSITION

Investments should be made subject to the cash flow needs and such cash flows are subject to revisions as market conditions and the City's needs change. However, when the invested funds are needed in whole or in part for the purpose originally intended or for more optimal investments, the Investment Officers or designee and/or the City's Investment Advisor/s may sell the investment at the then-prevailing market price and place the proceeds into the proper account at the City's custodian.

The following are the investment requirements and allocation limits on security types, issuers, and maturities as established by the City. Diversification strategies within the established guidelines shall be reviewed and revised periodically as necessary by the Investment Officers. The Investment Officers, and/or City's Investment Advisor/s shall have the option to further restrict investment percentages from time to time based on market conditions, risk and diversification investment strategies. The percentage allocations requirements for investment types and issuers are calculated based on the original cost of each investment. Investments not listed in this Policy are prohibited. The following requirements do not apply to funds derived from the sale of debt.

Investments described below are those authorized by the Public Funds Investment Act (Chapter 2256, Texas Government Code), as amended, which is included and made a part of this Policy as Appendix A. The following list may not contain all of those securities that are authorized by state statutes, but only those that the City Council wish to include in the City's portfolios. The purchase of specific issues may at times be further restricted or prohibited because of current market conditions. The City funds governed by this Policy may be invested in the following investments:

Security Type	Minimum Rating Requirement	Maturity Limits	Maximum Allocation Limit	Maximum Issuer Limit
Local Government Investment Pools	AAA/AAAm	N/A	75%	N/A
United States Government Securities	N/A	5 Years	100%	N/A
United States Government Agencies (full faith and credit of the United States Government)	N/A	5 Years	75%	25%
Federal Instrumentalities (United States Government Sponsored Enterprises ("GSE") which are non-full faith and credit).*	N/A	5 Years	80%	40%
Mortgage-Backed Securities ("MBS")*	N/A	5 Years	20%	15%
Interest Bearing Time Deposit or Saving Accounts	N/A	1 Years	20%	10%
Repurchase Agreements	N/A	90 Days	20%	10%
Commercial Paper	P-1/A-1	270 Days	25%	5%
Bankers' Acceptances	P-1/A-1	180 Days	25%	5%
State and/or Local Government Taxable and/or Tax-Exempt Debt	Single "A" category by two NRSROs	5 Years	25%	10%
Registered Investment Companies (Money Market Mutual Funds)	AAAm	N/A	50%	25%

A. Local Government Investment Pools

1. Investment Authorization

Local government investment pools organized in accordance with the Interlocal Cooperation Act (Chapter 791, Texas Government Act) as amended, whose assets consist exclusively of the obligations that are allowed as a direct investment for funds subject to the Public Funds Investment Act (Chapter 2256, Texas Government Code). A public funds investment pool must be continuously rated no lower than "AAA", "AAA-m" or at an equivalent rating by at least one Nationally Recognized Statistical Rating Organization ("NRSRO").

2. Portfolio Composition

A maximum of 75% of available funds may be invested in the Local Government Pools.

3. Due Diligence Requirements

A thorough review of any local government investment pool is required prior to investing, and on a continual basis. There shall be a questionnaire developed by the Investment Officers or designee and/or the City's Investment Advisor/s that will contain a list of questions that covers the major aspects of any investment pool/fund.

B. United States Government Securities

1. Purchase Authorization

Negotiable direct obligations or obligations the principal and interest of which are unconditionally guaranteed by the United States Government. Such securities will include, but not be limited to the following:

Cash Management Bills
Treasury Securities – State and Local Government Series ("SLGS")
Treasury Bills
Treasury Notes
Treasury Bonds
Treasury Strips

2. Portfolio Composition

A maximum of 100% of available funds may be invested in the United States Government Securities with the exception of Treasury Strips are limited to 10% of available funds.

3. Maturity Limitations

The maximum length to maturity of any direct investment in the United States Government Securities is five (5) years from the date of purchase.

C. United States Government Agencies (full faith and credit of the United States Government)

1. Purchase Authorization

Bonds, debentures, notes or callables issued or guaranteed by the United States Governments agencies, provided such obligations are backed by the full faith and credit of the United States Government. This includes fixed rate mortgage-backed securities. Such securities will include, but not be limited to the following:

United States Export – Import Bank

-Direct obligations or fully guaranteed certificates of beneficial ownership

Farmer Home Administration

-Certificates of beneficial ownership

Federal Financing Bank

-Discount notes, notes and bonds

Federal Housing Administration Debentures

Government National Mortgage Association (GNMA)

-GNMA guaranteed mortgage-backed bonds

-GNMA guaranteed pass-through obligations

General Services Administration

United States Maritime Administration Guaranteed

-Title XI Financing

New Communities Debentures

-United States Government guaranteed debentures

United States Public Housing Notes and Bonds

-United States Government guaranteed public housing notes and bonds

United States Department of Housing and Urban Development

-Project notes and local authority bonds

2. Portfolio Composition

A maximum of 75% of available funds may be invested in United States Government agencies.

3. Limits on Individual Issuers

A maximum of 25% of available funds may be invested in individual United States Government agencies.

4. Maturity Limitations

The maximum length to maturity for an investment in any United States Government agency security is five (5) years from the date of purchase.

D. Federal Instrumentalities (United States Government Sponsored Enterprises (“GSE”) which are non-full faith and credit)

1. Purchase Authorization

Bonds, debentures, notes or callables issued or guaranteed by United States Government Sponsored Enterprises (Federal Instrumentalities), which are non-full faith and credit agencies. These are limited to the following:

Federal Farm Credit Bank (FFCB)
Federal Home Loan Bank or its District banks (FHLB)
Federal National Mortgage Association (FNMA)
Federal Home Loan Mortgage Corporation (Freddie-Macs) including Federal -Home Loan Mortgage Corporation participation certificates

2. Portfolio Composition

A maximum of 80% of available funds may be invested in Federal Instrumentalities.

3. Limits on Individual Issuers

A maximum of 40% of available funds may be invested in any one issuer.

4. Maturity Limitations

The maximum length to maturity for an investment in any Federal Instrumentality security is five (5) years from the date of purchase.

E. Mortgage-Backed Securities (MBS)

1. Purchase Authorization

Authorized Staff may invest in mortgage-backed securities (MBS) which are based on mortgages that are guaranteed by a government agency or GSE for payment of principal and a guarantee of timely payment.

2. Portfolio Composition

A maximum of 20% of available funds may be invested in MBS. The combined total of available funds invested in Federal Instrumentalities and Mortgage Backed Securities cannot be more than 80%.

3. Limits of Individual Issuers

A maximum of 15% of available funds may be invested with any one issuer.

4. Maturity Limitations

A maximum length to maturity for an investment in any MBS is five (5) years from the date of purchase.

The maturity of mortgage securities shall be considered the date corresponding to its average life. This date reflects the point at which an investor will have received back half of the original principal (face) amount. The average life may be different from the stated legal maturity included in a security's description.

F. Interest Bearing Time Deposit or Saving Accounts

1. Purchase Authorization

Certificates of deposit or savings accounts issued by state and national banks that has a main office or branch in Texas that are: guaranteed or insured by the Federal Deposit Insurance Corporation, or its successor; or secured by obligations of any direct federal agency or instrumentality issues that have a market value of not less than the principal amount of the certificates or Certificate of Deposit balances exceeding FDIC insurance limits will be fully collateralized by securities listed in sections B, C or D above. Collateral will be held by the City's third party custodian.

2. Portfolio Composition

A maximum of 20% of available funds may be invested in non-negotiable interest bearing time certificates of deposit.

3. Limits on Individual Issuers

A maximum of 10% of available funds may be deposited with any one issuer.

4. The maximum maturity on any certificate shall be no greater than one (1) year from the date of purchase.

G. Repurchase Agreements

1. Purchase Authorization

a. Repurchase agreements composed of only those investments authorized in sections B, C, or D above. All firms are required

to sign the City's Master Repurchase Agreement prior to the execution of a repurchase agreement transaction.

- b. A third party custodian with whom the City has a current custodial agreement shall hold the collateral for all repurchase agreements with a term longer than one (1) business day. A clearly marked receipt that shows evidence of ownership must be supplied to the Investment Officers or designee and retained.
- c. Securities authorized for collateral must have maturities less than ten (10) years and with market value for the principal and accrued interest of 102 percent of the value and for the term of the repurchase agreement. Immaterial short-term deviations from 102 percent requirement are permissible only upon the approval of the Investment Officers and/or the City's Investment Advisor/s.
- d. The overnight sweep arrangement shall adhere to the agreement between the City and the City's depository bank.

2. Portfolio Composition

A maximum of 20% of available funds may be invested in repurchase agreements excluding one (1)-business day agreements and overnight sweep agreements.

3. Limits on Individual Issuers

A maximum of 10% of available funds may be invested with any one institution excluding one (1)-business day agreements and overnight sweep agreements.

4. Limits on Maturities

The maximum length to maturity of any repurchase agreement is 90 days from the date of purchase.

H. Commercial Paper

1. Purchase Authorization

Commercial paper of any United States company that is rated, at the time of purchase, "Prime-1" by Moody's and "A-1" by Standard & Poor's (prime commercial paper).

2. Portfolio Composition

A maximum of 25% of available funds may be directly invested in prime commercial paper.

3. Limits on Individual Issuers

A maximum of 5% of available funds may be invested with any one issuer.

4. Maturity Limitations

The maximum length to maturity for prime commercial paper shall be 270 days from the date of purchase.

I. Bankers' Acceptances

1. Purchase Authorization

Bankers' Acceptances issued by a domestic bank or a federally chartered domestic office of a foreign bank, which are eligible for purchase by the Federal Reserve System, at the time of purchase, the short-term paper is rated, at a minimum, "P-1" by Moody's Investors Services and "A-1" Standard & Poor's.

2. Portfolio Composition

A maximum of 25% of available funds may be directly invested in Bankers' Acceptances.

3. Limits on Individual Issuers

A maximum of 5% of available funds may be invested with any one issuer.

4. Maturity Limitations

The maximum length to maturity for Bankers' Acceptances shall be 180 days from the date of purchase.

J. State and/or Local Government Taxable and/or Tax-Exempt Debt

1. Purchase Authorization

State and/or local government taxable and/or tax-exempt debt, general obligation and/or revenue bonds, at the time of purchases, at a minimum single "A" category by any two NRSROs, or rated at least "MIG-2" by Moody's and "SP-2" by Standard & Poor's for short-term debt.

2. Portfolio Composition

A maximum of 25% of available funds may be invested in taxable and tax-exempt General Obligation bonds.

3. Limits on Individual Issuers

A maximum of 10% of available funds may be invested with any one issuer.

4. Maturity Limitations

A maximum length to maturity for an investment in any state or local government debt security is five (5) years from the date of purchase.

K. Registered Investment Companies (Money Market Mutual Funds)

1. Investment Authorization

Shares in open-end and no-load money market funds provided such funds are registered under the Federal Investment Company Act of 1940 and operate in accordance with 17 C.F.R. § 270.2a-7, which stipulates that money market funds must have an average weighted maturity of 60 days or less. In addition, the share value of the money market funds must equal to \$1.00.

2. Portfolio Composition

A maximum of 50% of available funds may be invested in money market funds.

3. Limits of Individual Issuers

A maximum of 25% of available funds may be invested with any one money market fund.

4. Rating Requirements

The money market funds shall be rated "AAAm" by Standard & Poor's or the equivalent by another NRSRO.

5. Due Diligence Requirements

A thorough review of any money market fund is required prior to investing, and on a continual basis. There shall be a questionnaire developed by the Investment Officers or designee and/or the City's Investment Advisor/s that will contain a list of questions that covers the major aspects of any investment pool/fund.

XVI. DOWNGRADE PROVISION FOR INVESTMENT RATINGS

In the event any security in the portfolio, subsequent to purchase, is downgraded to a level below the minimum required rating, the Investment Advisor(s) shall notify the City or its representatives as soon as practical of such ratings change along with any

contemplated actions to sell or hold the security. The City, independently or in concert with the Investment Advisor(s), shall confirm the decision to sell or hold the security. If it is determined the position should be sold, then it should be traded in a timely basis, consistent with market liquidity.

XVII. DERIVATIVES AND REVERSE REPURCHASE AGREEMENTS

The City may not invest in investment products that include the use of derivatives. A "derivative" is defined as a financial instrument the value of which depends on, or is derived from, the value of one or more underlying assets or indices or asset values. Reverse repurchase agreements are not permitted by this Policy.

XVIII. REPORTING

The Investment performance will be monitored and evaluated by the Investment Officers. In conjunction with the Investment Officers, the City's Investment Advisor/s shall provide quarterly investment reports on the City's short-term and long-term core investments to City Council as required by the Public Funds Investment Act (Chapter 2256, Texas Government Code), Section 2256.023. Schedules in the quarterly report should include the following:

- 1) describe in detail the investment position of the City,
- 2) contain a summary statement prepared in compliance with generally accepted accounting principals stating the reporting period beginning market value, additions or changes to the market value during the period and ending market value for the period, and fully accrued interest for the period for each pooled fund group,
- 3) state the reporting period beginning book and market value and reporting period ending book and market value of each investment security by asset type and fund type,
- 4) state the maturity date of each investment security,
- 5) state the fund for which each investment security was purchased, and
- 6) state the compliance of the investment portfolio with the City's Investment Policy and Investment Strategy Statement and the Public Funds Investment Act, and
- 7) be prepared jointly and signed by each Investment Officer.

XIX. DEPOSITORY AGREEMENTS

The City will select and designate a qualified bank depository for a minimum three year period. Consistent with the Requirements of State law, the City will require that all deposits be federally insured or collateralized with eligible securities. If deposits are collateralized, they will be held at the City's custodial agent. The depository will be required to sign a Custodial Agreement with the City and the City's Custodial agent. The

Agreement shall define the City's rights to the collateral in case of default, bankruptcy, or closing and shall establish a perfected security interest in compliance with Federal and State regulations. It shall further address any concerns in relation to acceptable collateral, levels of collateral, substitution and addition of collateral, and reporting and monitoring of collateral.

XX. THIRD-PARTY CUSTODIAL AGREEMENTS

Securities, with the exception of certificates of deposits, shall be held with a third party custodian; and all securities purchase by, and all collateral obtained by the City should be properly designated as an asset of the City. The securities must be held in an account separate and apart from the assets of the financial institution. A third party custodian is defined as any bank depository chartered by the Federal Government, the State of Texas, or any other state or territory of the United States which has a branch or principal place of business in the State of Texas or by a national association organized and existing under the laws of the United States which is authorized to accept and execute trusts and which is doing business in the State of Texas. Certificates of deposits will be placed in the provider's safekeeping department for the term of the deposit.

The custodian shall accept transaction instructions only from those persons who have been duly authorized by the Investment Officers and which authorization has been provided, in writing, to the custodian. No withdrawal of securities, in whole or in part, shall be made from safekeeping, shall be permitted unless by such a duly authorized person.

Monthly, the custodian shall provide the Investment Officers or designee and/or the City's Investment Advisor/s with detail information on the securities held by the custodian. Security transactions between a broker/dealer and the custodian involving the purchase or sale of securities by transfer of money or securities must be made on a "delivery vs. payment" basis, if applicable, to ensure that the custodian will have the security or money, as appropriate, in hand at the conclusion of the transaction. Only after receiving written authorization from the Investment Officers shall authorized securities be delivered "free". Securities held as collateral shall be held free and clear of any liens.

XXI. RESERVATION OF AUTHORITY

The Investment Policy and the Statement of Investment Strategy will be reviewed on an annual basis by the City Council. Revisions and or amendments will be approved and documented by the City Council.

Mayor City of Rowlett

A. Glossary of Cash and Investment Management Terms

Attachment A
Glossary of Cash and Investment Management Terms

Accrued Interest. Interest earned but which has not yet been paid or received.

Agency. See "Federal Agency Securities."

Ask Price. Price at which a broker/dealer offers to sell a security to an investor. Also known as "offered price."

Asset Backed Securities (ABS). A fixed-income security backed by notes or receivables against assets other than real estate. Generally issued by special purpose companies that "own" the assets and issue the ABS. Examples include securities backed by auto loans, credit card receivables, home equity loans, manufactured housing loans, farm equipment loans and aircraft leases.

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

Bankers' Acceptance (BA's). A draft or bill of exchange drawn upon and accepted by a bank. Frequently used to finance shipping of international goods. Used as a short-term credit instrument, bankers' acceptances are traded at a discount from face value as a money market instrument in the secondary market on the basis of the credit quality of the guaranteeing bank.

Basis Point. One hundredth of one percent, or 0.01%. Thus 1% equals 100 basis points.

Bearer Security. A security whose ownership is determined by the holder of the physical security. Typically, there is no registration on the issuer's books. Title to bearer securities is transferred by delivery of the physical security or certificate. Also known as "physical securities."

Benchmark Bills: In November 1999, FNMA introduced its Benchmark Bills program, a short-term debt securities issuance program to supplement its existing discount note program. The program includes a schedule of larger, weekly issues in three- and six-month maturities and biweekly issues in one-year for Benchmark Bills. Each issue is brought to market via a Dutch (single price) auction. FNMA conducts a weekly auction for each Benchmark Bill maturity and accepts both competitive and non-competitive bids through a web based auction system. This program is in addition to the variety of other discount note maturities, with rates posted on a daily basis, which FNMA offers. FNMA's Benchmark Bills are unsecured general obligations that are issued in book-entry form through the Federal Reserve Banks. There are no periodic payments of interest on Benchmark Bills, which are sold at a discount from the principal amount and payable at par at maturity. Issues under the Benchmark program constitute the same credit standing as other FNMA discount notes; they simply add organization and liquidity to the short-term Agency discount note market.

Benchmark Notes/Bonds: Benchmark Notes and Bonds are a series of FNMA "bullet" maturities (non-callable) issued according to a pre-announced calendar. Under its Benchmark Notes/Bonds program, 2, 3, 5, 10 and 30-year maturities are issued each quarter. Each Benchmark Notes new issue has a minimum size of \$4 billion, 30-year new issues having a minimum size of \$1 billion, with re-openings based on investor demand to further enhance liquidity. The amount of non-callable issuance has allowed FNMA to build a yield curve in

Benchmark Notes and Bonds in maturities ranging from 2 to 30 years. The liquidity emanating from these large size issues has facilitated favorable financing opportunities through the development of a liquid overnight and term repo market. Issues under the Benchmark program constitute the same credit standing as other FNMA issues; they simply add organization and liquidity to the intermediate- and long-term Agency market.

Benchmark. A market index used as a comparative basis for measuring the performance of an investment portfolio. A performance benchmark should represent a close correlation to investment guidelines, risk tolerance and duration of the actual portfolio's investments.

Bid Price. Price at which a broker/dealer offers to purchase a security from an investor.

Bond Market Association (BMA). The bond market trade association representing the largest securities markets in the world. In addition to publishing a Master Repurchase Agreement, widely accepted as the industry standard document for Repurchase Agreements, the BMA also recommends bond market closures and early closes due to holidays.

Bond. Financial obligation for which the issuer promises to pay the bondholder (the purchaser or owner of the bond) a specified stream of future cash flows, including periodic interest payments and a principal repayment.

Book Entry Securities. Securities that are recorded in a customer's account electronically through one of the financial markets electronic delivery and custody systems, such as the Fed Securities wire, DTC and PTC

(as opposed to bearer or physical securities). The trend is toward a certificate-free society in order to cut down on paperwork and to diminish investors' concerns about the certificates themselves. The vast majority of securities are now book entry securities.

Book Value. The value at which a debt security is reflected on the holder's records at any point in time. Book value is also called "amortized cost" as it represents the original cost of an investment adjusted for amortization of premium or accretion of discount. Also called "carrying value." Book value can vary over time as an investment approaches maturity and differs from "market value" in that it is not affected by changes in market interest rates.

Broker/Dealer. A person or firm transacting securities business with customers. A "broker" acts as an agent between buyers and sellers, and receives a commission for these services. A "dealer" buys and sells financial assets from its own portfolio. A dealer takes risk by owning inventory of securities, whereas a broker merely matches up buyers and sellers. See also "Primary Dealer."

Bullet Notes/Bonds. Notes or bonds that have a single maturity date and are non-callable.

Call Date. Date at which a call option may be or is exercised.

Call Option. The right, but not the obligation, of an issuer of a security to redeem a security at a specified value and at a specified date or dates prior to its stated maturity date. Most fixed-income calls are a par, but can be at any previously established price. Securities issued with a call provision typically carry a higher yield than similar securities issued without a call feature. There are three primary types of call options (1) European - one-time calls, (2) Bermudan - periodically on a predetermined schedule (quarterly, semi-annual, annual), and (3) American -

continuously callable at any time on or after the call date. There is usually a notice period of at least 5 business days prior to a call date.

Callable Bonds/Notes. Securities, which contain an imbedded call option giving the issuer, the right to redeem the securities prior to maturity at a predetermined price and time.

Certificate of Deposit (CD). Bank obligation issued by a financial institution generally offering a fixed rate of return (coupon) for a specified period of time (maturity). Can be as long as 10 years to maturity, but most CDs purchased by public agencies are one year and under.

Collateral. Investment securities or other property that a borrower pledges to secure repayment of a loan, secure deposits of public monies, or provide security for a repurchase agreement.

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

Collateralized Mortgage Obligation (CMO). A security that pools together mortgages and separates them into short, medium, and long-term positions (called tranches). Tranches are set up to pay different rates of interest depending upon their maturity. Interest payments are usually paid monthly. In "plain vanilla" CMOs, principal is not paid on a tranche until all shorter tranches have been paid off. This system provides interest and principal in a more predictable manner. A single pool of mortgages can be carved up into numerous tranches each with its own payment and risk characteristics.

Commercial Paper. Short term unsecured promissory note issued by a company or financial institution. Issued at a discount and matures for par or face value. Usually a maximum maturity of 270 days, and given a short-term debt rating by one or more NRSROs.

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.

Corporate Note. A debt instrument issued by a corporation with a maturity of greater than one year and less than ten years.

Counterparty. The other party in a two party financial transaction. "Counterparty risk" refers to the risk that the other party, to a transaction, will fail in its related obligations. For example, the bank or broker/dealer in a repurchase agreement.

Coupon Rate. Annual rate of interest on a debt security, expressed as a percentage of the bond's face value.

Current Yield. Annual rate of return on a bond based on its price. Calculated as (coupon rate / price), but does not accurately reflect a bond's true yield level.

Custody. Safekeeping services offered by a bank, financial institution or trust company, referred to as the "custodian." Service normally includes the holding and reporting of the customer's securities, the collection and disbursement of income, securities settlement and market values.

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

Delivery Versus Payment (DVP). Settlement procedure in which securities are delivered versus payment of cash, but only after cash has been received. Most security transactions, including those through the Fed Securities Wire system and DTC, are done DVP as a protection for both the buyer and seller of securities.

Depository Trust Company (DTC). A firm through which members can use a computer to arrange for securities to be delivered to other members without physical delivery of certificates. A member of the Federal Reserve System and owned mostly by the New York Stock Exchange, the Depository Trust Company uses computerized debit and credit entries. Most corporate securities, commercial paper, CDs and BAs clear through DTC.

Derivatives. For hedging purposes, common derivatives are options, futures, swaps and swaptions. All Collateralized Mortgage Obligations ("CMOs") are 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).

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

Designated Bond. FFCB's regularly issued, liquid, non-callable securities that generally have a 2 or 3 year original maturity. New issues of Designated Bonds are \$1 billion or larger. Re-openings of existing Designated Bond issues are generally a minimum of \$100 million. Designated Bonds are offered through a syndicate of two to six dealers. Twice each month the Funding Corporation announces its intention to issue a new Designated Bond, reopen an existing issue, or to not issue or reopen a Designated Bond. Issues under the Designated Bond program constitute the same credit standing as other FFCB issues; they simply add organization and liquidity to the intermediate- and long-term Agency market.

Discount Notes. Unsecured general obligations issued by Federal Agencies at a discount. Discount notes mature at par and can range in maturity from overnight to one year. Very large primary (new issue) and secondary markets.

Discount Rate. Rate charged by the system of Federal Reserve Banks on overnight loans to member banks. Changes to this rate are administered by the Federal Reserve and closely mirror changes to the "fed funds rate."

Discount Securities. Non-interest bearing money market instruments that are issued at discount and redeemed at maturity for full face value. Examples include: U.S. Treasury Bills, Federal Agency Discount Notes, Bankers' Acceptances and Commercial Paper.

Discount. The amount by which a bond or other financial instrument sells below its face value. See also "Premium."

Diversification. Dividing investment funds among a variety of security types, maturities, industries and issuers offering potentially independent returns.

Dollar Price. A bond's cost expressed as a percentage of its face value. For example, a bond quoted at a dollar price of 95 ½, would have a principal cost of \$955 per \$1,000 of face value.

Duff & Phelps. One of several NRSROs that provide credit ratings on corporate and bank debt issues.

Duration. The weighted average maturity of a security's or portfolio's cash flows, where the present values of the cash flows serve as the weights. The greater the duration of a security/portfolio, the greater its percentage price volatility with respect to changes in interest rates. Used as a measure of risk and a key tool for managing a portfolio versus a benchmark and for hedging risk. There are also different kinds of duration used for different purposes (e.g. MacAuley Duration, Modified Duration).

Fannie Mae. See "Federal National Mortgage Association."

Fed Money Wire. A computerized communications system that connects the Federal Reserve System with its member banks, certain U. S. Treasury offices, and the Washington D.C. office of the Commodity Credit Corporation. The Fed Money Wire is the book entry system used to transfer cash balances between banks for themselves and for customer accounts.

Fed Securities Wire. A computerized communications system that facilitates book entry transfer of securities between banks, brokers and customer accounts, used primarily for settlement of U.S. Treasury and Federal Agency securities.

Fed. See "Federal Reserve System."

Federal Agency Security. A debt instrument issued by one of the Federal Agencies. Federal Agencies are considered second in credit quality and liquidity only to U.S. Treasuries.

Federal Agency. Government sponsored/owned entity created by the U.S. Congress, generally for the purpose of acting as a financial intermediary by borrowing in the marketplace and directing proceeds to specific areas of the economy considered to otherwise have restricted access to credit markets. The largest Federal Agencies are GNMA, FNMA, FHLMC, FHLB, FFCB, SLMA, and TVA.

Federal Deposit Insurance Corporation (FDIC). Federal agency that insures deposits at commercial banks, currently to a limit of \$250,000 per depositor per bank.

Federal Farm Credit Bank (FFCB). One of the large Federal Agencies. A government sponsored enterprise (GSE) system that is a network of cooperatively-owned lending institutions that provides credit services to farmers, agricultural cooperatives and rural utilities. The FFCBs act as financial intermediaries that borrow money in the capital markets and use the proceeds to make loans and provide other assistance to farmers and farm-affiliated businesses. Consists of the consolidated operations of the Banks for Cooperatives, Federal Intermediate Credit Banks, and Federal Land Banks. Frequent issuer of discount notes, agency notes and callable agency securities. FFCB debt is not an obligation of, nor is it guaranteed by the U.S. government, although it is considered to have minimal credit risk due to its importance to the U.S. financial system and agricultural industry. Also issues notes under its "designated note" program.

Federal Funds (Fed Funds). Funds placed in Federal Reserve Banks by depository institutions in excess of current reserve requirements, and frequently loaned or borrowed on an overnight basis between depository institutions.

Federal Funds Rate (Fed Funds Rate). The interest rate charged by a depository institution lending Federal Funds to another depository institution. The Federal Reserve influences this rate

by establishing a "target" Fed Funds rate associated with the Fed's management of monetary policy.

Federal Home Loan Bank System (FHLB). One of the large Federal Agencies. A government sponsored enterprise (GSE) system, consisting of wholesale banks (currently twelve district banks) owned by their member banks, which provides correspondent banking services and credit to various financial institutions, financed by the issuance of securities. The principal purpose of the FHLB is to add liquidity to the mortgage markets. Although FHLB does not directly fund mortgages, it provides a stable supply of credit to thrift institutions that make new mortgage loans. FHLB debt is not an obligation of, nor is it guaranteed by the U.S. government, although it is considered to have minimal credit risk due to its importance to the U.S. financial system and housing market. Frequent issuer of discount notes, agency notes and callable agency securities. Also issues notes under its "global note" and "TAP" programs.

Federal Home Loan Mortgage Corporation (FHLMC or "Freddie Mac"). One of the large Federal Agencies. A government sponsored public corporation (GSE) that provides stability and assistance to the secondary market for home mortgages by purchasing first mortgages and participation interests financed by the sale of debt and guaranteed mortgage backed securities. FHLMC debt is not an obligation of, nor is it guaranteed by the U.S. government, although it is considered to have minimal credit risk due to its importance to the U.S. financial system and housing market. Frequent issuer of discount notes, agency notes, callable agency securities and MBS. Also issues notes under its "reference note" program.

Federal National Mortgage Association (FNMA or "Fannie Mae"). One of the large Federal Agencies. A government sponsored public corporation (GSE) that provides liquidity to the residential mortgage market by purchasing mortgage loans from lenders, financed by the issuance of debt securities and MBS (pools of mortgages packaged together as a security). FNMA debt is not an obligation of, nor is it guaranteed by the U.S. government, although it is considered to have minimal credit risk due to its importance to the U.S. financial system and housing market. Frequent issuer of discount notes, agency notes, callable agency securities and MBS. Also issues notes under its "benchmark note" program.

Federal Reserve Bank. One of the 12 distinct banks of the Federal Reserve System.

Federal Reserve System (the Fed). The independent central bank system of the United States that establishes and conducts the nation's monetary policy. This is accomplished in three major ways: (1) raising or lowering bank reserve requirements, (2) raising or lowering the target Fed Funds Rate and Discount Rate, and (3) in open market operations by buying and selling government securities. The Federal Reserve System is made up of twelve Federal Reserve District Banks, their branches, and many national and state banks throughout the nation. It is headed by the seven member Board of Governors known as the "Federal Reserve Board" and headed by its Chairman.

Financial Industry Regulatory Authority, Inc (FINRA). is a private corporation that acts as a self-regulatory organization (SRO). FINRA is the successor to the National Association of Securities Dealers, Inc. (NASD). Though sometimes mistaken for a government agency, it is a non-governmental organization that performs financial regulation of member brokerage firms and exchange markets. The government also has a regulatory arm for investments, the Securities and Exchange Commission.

Fiscal Agent/Paying Agent. A bank or trust company that acts, under a trust agreement with a corporation or municipality, in the capacity of general treasurer. The agent performs such duties as making coupon payments, paying rents, redeeming bonds, and handling taxes relating to the issuance of bonds.

Fitch Investors Service, Inc. One of several NRSROs that provide credit ratings on corporate and municipal debt issues.

Floating Rate Security (FRN or "floater"). A bond with an interest rate that is adjusted according to changes in an interest rate or index. Differs from variable-rate debt in that the changes to the rate take place immediately when the index changes, rather than on a predetermined schedule. See also "Variable Rate Security."

Freddie Mac. See "Federal Home Loan Mortgage Corporation".

Ginnie Mae. See "Government National Mortgage Association".

Global Notes: Notes designed to qualify for immediate trading in both the domestic U.S. capital market and in foreign markets around the globe. Usually large issues that are sold to investors worldwide and therefore have excellent liquidity. Despite their global sales, global notes sold in the U.S. are typically denominated in U.S. dollars.

Government National Mortgage Association (GNMA or "Ginnie Mae"). One of the large Federal Agencies. Government-owned Federal Agency that acquires, packages, and resells mortgages and mortgage purchase commitments in the form of mortgage-backed securities. Largest issuer of mortgage pass-through securities. GNMA debt is guaranteed by the full faith and credit of the U.S. government (one of the few agencies that is actually full faith and credit of the U.S.).

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, Bonds, and SLGS."

Government Sponsored Enterprise (GSE). Privately owned entity subject to federal regulation and supervision, created by the U.S. Congress to reduce the cost of capital for certain borrowing sectors of the economy such as students, farmers, and homeowners. GSEs carry the implicit backing of the U.S. Government, but they are not direct obligations of the U.S. Government. For this reason, these securities will offer a yield premium over U.S. Treasuries. Some consider GSEs to be stealth recipients of corporate welfare. Examples of GSEs include: FHLB, FHLMC, FNMA and SLMA.

Government Sponsored Enterprise Security. A security issued by a Government Sponsored Enterprise. Considered Federal Agency Securities.

Index. A compilation of statistical data that tracks changes in the economy or in financial markets.

Interest-Only (IO) STRIP. A security based solely on the interest payments from the bond. After the principal has been repaid, interest payments stop and the value of the security falls to nothing. Therefore, IOs are considered risky investments. Usually associated with mortgage-backed securities.

Internal Controls. An internal control structure ensures 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 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. Internal controls should address the following points:

1. **Control of collusion** - Collusion is a situation where two or more employees are working in conjunction to defraud their employer.
2. **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.
3. **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.
4. **Avoidance of physical delivery securities** - Book-entry securities are much easier to transfer and account for since actual delivery of a document never takes place. Delivered securities must be properly safeguarded against loss or destruction. The potential for fraud and loss increases with physically delivered securities.
5. **Clear delegation of authority to subordinate staff members** - Subordinate staff members must have a clear understanding of their authority and responsibilities to avoid improper actions. Clear delegation of authority also preserves the internal control structure that is contingent on the various staff positions and their respective responsibilities.
6. **Written confirmation of transactions for investments and wire transfers** - Due to the potential for error and improprieties arising from telephone and electronic transactions, all transactions should be supported by written communications and approved by the appropriate person. Written communications may be via fax if on letterhead and if the safekeeping institution has a list of authorized signatures.
7. **Development of a wire transfer agreement with the lead bank and third-party custodian** - The designated official should ensure that an agreement will be entered into and will address the following points: controls, security provisions, and responsibilities of each party making and receiving wire transfers.

Inverse Floater. A floating rate security structured in such a way that it reacts inversely to the direction of interest rates. Considered risky as their value moves in the opposite direction of normal fixed-income investments and whose interest rate can fall to zero.

Investment Advisor. A company that provides professional advice managing portfolios, investment recommendations and/or research in exchange for a management fee.

Investment Adviser Act of 1940. Federal legislation that sets the standards by which investment companies, such as mutual funds, are regulated in the areas of advertising, promotion, performance reporting requirements, and securities valuations.

Investment Grade. Bonds considered suitable for preservation of invested capital; bonds rated a minimum of Baa3 by Moody's, BBB- by Standard & Poor's, or BBB- by Fitch. Although "BBB" rated bonds are considered investment grade, most public agencies cannot invest in securities rated below "A."

Liquidity. Relative ease of converting an asset into cash without significant loss of value. Also, a relative measure of cash and near-cash items in a portfolio of assets. Also, a term describing the marketability of a money market security correlating to the narrowness of the spread between the bid and ask prices.

Local Government Investment Pool (LGIP). An investment by local governments in which their money is pooled as a method for managing local funds, (i.e., Florida State Board of Administration's Florida Prime Fund).

Long-Term Core Investment Program. Funds that are not needed within a one year period.

Market Value. The fair market value of a security or commodity. The price at which a willing buyer and seller would pay for a security.

Mark-to-market. Adjusting the value of an asset to its market value, reflecting in the process unrealized gains or losses.

Master Repurchase Agreement. A widely accepted standard agreement form published by the Bond Market Association (BMA) that is used to govern and document Repurchase Agreements and protect the interest of parties in a repo transaction.

Maturity Date. Date on which principal payment of a financial obligation is to be paid.

Medium Term Notes (MTN's). Used frequently to refer to corporate notes of medium maturity (5-years and under). Technically, any debt security issued by a corporate or depository institution with a maturity from 1 to 10 years and issued under an MTN shelf registration. Usually issued in smaller issues with varying coupons and maturities, and underwritten by a variety of broker/dealers (as opposed to large corporate deals issued and underwritten all at once in large size and with a fixed coupon and maturity).

Money Market. The market in which short-term debt instruments (bills, commercial paper, bankers' acceptance, etc.) are issued and traded.

Money Market Mutual Fund (MMF). A type of mutual fund that invests solely in money market instruments, such as: U.S. Treasury bills, commercial paper, bankers' acceptances, and repurchase agreements. Money market mutual funds are registered with the SEC under the Investment Company Act of 1940 and are subject "rule 2a-7" which significantly limits average maturity and credit quality of holdings. MMF's are managed to maintain a stable net asset value (NAV) of \$1.00. Many MMFs carry ratings by a NRSRO.

Moody's Investors Service. One of several NRSROs that provide credit ratings on corporate and municipal debt issues.

Mortgage Backed Securities (MBS). Mortgage-backed securities represent an ownership interest in a pool of mortgage loans made by financial institutions, such as savings and loans, commercial banks, or mortgage companies, to finance the borrower's purchase of a home or other real estate. The majority of MBS are issued and/or guaranteed by GNMA, FNMA and FHLMC.

There are a variety of MBS structures, some of which can be very risky and complicated. All MBS have reinvestment risk as actual principal and interest payments are dependent on the payment of the underlying mortgages which can be prepaid by mortgage holders to refinance and lower rates or simply because the underlying property was sold.

Mortgage Pass-Through Securities. A pool of residential mortgage loans with the monthly interest and principal distributed to investors on a pro-rata basis. Largest issuer is GNMA.

Municipal Note/Bond. A debt instrument issued by a state or local government unit or public agency. The vast majority of municipals are exempt from state and federal income tax, although some non-qualified issues are taxable.

Mutual Fund. Portfolio of securities professionally managed by a registered investment company that issues shares to investors. Many different types of mutual funds exist (bond, equity, money fund); all except money market funds operate on a variable net asset value (NAV).

Negotiable Certificate of Deposit (Negotiable CD). Large denomination CDs (\$100,000 and larger) that are issued in bearer form and can be traded in the secondary market.

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. (See below.)

$$[(\text{Total assets}) - (\text{Liabilities})]/(\text{Number of shares outstanding})$$

NRSRO. A "Nationally Recognized Statistical Rating Organization." A designated rating organization that the SEC has deemed a strong national presence in the U.S. NRSROs provide credit ratings on corporate and bank debt issues. Only ratings of a NRSRO may be used for the regulatory purposes of rating. Includes Moody's, S&P, Fitch and Duff & Phelps.

Offered Price. See also "Ask Price."

Open Market Operations. Federal Reserve monetary policy tactic entailing the purchase or sale of government securities in the open market by the Federal Reserve System from and to primary dealers in order to influence the money supply, credit conditions, and interest rates.

Par Value. Face value, stated value or maturity value of a security.

Physical Delivery. Delivery of readily available underlying assets at contract maturity.

Portfolio. Collection of securities and investments held by an investor.

Premium. The amount by which a bond or other financial instrument sells above its face value. See also "Discount."

Primary Dealer. Any of a group of designated government securities dealers designated by to the Federal Reserve Bank of New York. Primary dealers can buy and sell government securities directly with the Fed. Primary dealers also submit daily reports of market activity and security positions held to the Fed and are subject to its informal oversight. Primary dealers are considered the largest players in the U.S. Treasury securities market.

Prime Paper. Commercial paper of high quality. Highest rated paper is A-1+/A-1 by S&P and P-1 by Moody's.

Principal. Face value of a financial instrument on which interest accrues. May be less than par value if some principal has been repaid or retired. For a transaction, principal is par value times price and includes any premium or discount.

Prudent Investor Standard. Standard that requires that when investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency. More stringent than the "prudent person" standard as it implies a level of knowledge commensurate with the responsibility at hand.

Qualified Public Depository - Per Florida Statute 280, means any bank, saving bank or savings association that:

1. Is organized and exists under the laws of the United States, the laws of this state or any other state or territory of the United States;
2. Has its principal place of business in this state or has a branch office in this state which is authorized under the laws of this state or of the United States to receive deposits in this state.
3. Has deposit insurance under the provision of the Federal Deposit Insurance Act, as amended, 12 U.S.C. ss.1811 seq.
4. Meets all requirements of F.S. 280
5. Has been designed by the Treasurer as a qualified public depository.

Range Note. A type of structured note that accrues interest daily at a set coupon rate that is tied to an index. Most range notes have two coupon levels; a higher accrual rate for the period the index is within a designated range, the lower accrual rate for the period that the index falls outside the designated range. This lower rate may be zero and may result in zero earnings.

Rate of Return. Amount of income received from an investment, expressed as a percentage of the amount invested.

Realized Gains (Losses). The difference between the sale price of an investment and its book value. Gains/losses are "realized" when the security is actually sold, as compared to "unrealized" gains/losses which are based on current market value. See "Unrealized Gains (Losses)."

Reference Bills: FHLMC's short-term debt program created to supplement its existing discount note program by offering issues from one month through one year, auctioned on a weekly or on an alternating four-week basis (depending upon maturity) offered in sizeable volumes (\$1 billion and up) on a cycle of regular, standardized issuance. Globally sponsored and distributed, Reference Bill issues are intended to encourage active trading and market-making and facilitate

the development of a term repo market. The program was designed to offer predictable supply, pricing transparency and liquidity, thereby providing alternatives to U.S. Treasury bills. FHLMC's Reference Bills are unsecured general corporate obligations. This program supplements the corporation's existing discount note program. Issues under the Reference program constitute the same credit standing as other FHLMC discount notes; they simply add organization and liquidity to the short-term Agency discount note market.

Reference Notes: FHLMC's intermediate-term debt program with issuances of 2, 3, 5, 10 and 30-year maturities. Initial issuances range from \$2 - \$6 billion with re-openings ranging \$1 - \$4 billion.

The notes are high-quality bullet structures securities that pay interest semiannually. Issues under the Reference program constitute the same credit standing as other FHLMC notes; they simply add organization and liquidity to the intermediate- and long-term Agency market.

Repurchase Agreement (Repo). A short-term investment vehicle where an investor agrees to buy securities from a counterparty and simultaneously agrees to resell the securities back to the counterparty at an agreed upon time and for an agreed upon price. The difference between the purchase price and the sale price represents interest earned on the agreement. In effect, it represents a collateralized loan to the investor, where the securities are the collateral. Can be DVP, where securities are delivered to the investor's custodial bank, or "tri-party" where the securities are delivered to a third party intermediary. Any type of security can be used as "collateral," but only some types provide the investor with special bankruptcy protection under the law. Repos should be undertaken only when an appropriate BMA approved master repurchase agreement is in place.

Reverse Repurchase Agreement (Reverse Repo). A repo from the point of view of the original seller of securities. Used by dealers to finance their inventory of securities by essentially borrowing at short-term rates. Can also be used to leverage a portfolio and in this sense, can be considered risky if used improperly.

Safekeeping. Service offered for a fee, usually by financial institutions, for the holding of securities and other valuables. Safekeeping is a component of custody services.

Secondary Market. Markets for the purchase and sale of any previously issued financial instrument.

Securities Lending. An arrangement between an investor and a custody bank that allows the custody bank to "loan" the investor's investment holdings, reinvest the proceeds in permitted investments, and share any profits with the investor. Should be governed by a securities lending agreement. Can increase the risk of a portfolio in that the investor takes on the default risk on the reinvestment at the discretion of the custodian.

Sinking Fund. A separate accumulation of cash or investments (including earnings on investments) in a fund in accordance with the terms of a trust agreement or indenture, funded by periodic deposits by the issuer (or other entity responsible for debt service), for the purpose of assuring timely availability of moneys for payment of debt service. Usually used in connection with term bonds.

Spread. The difference between the price of a security and similar maturity U.S. Treasury investments, expressed in percentage terms or basis points. A spread can also be the absolute

difference in yield between two securities. The securities can be in different markets or within the same securities market between different credits, sectors, or other relevant factors.

Standard & Poor's. One of several NRSROs that provide credit ratings on corporate and municipal debt issues.

STRIPS (Separate Trading of Registered Interest and Principal of Securities). Acronym applied to U.S. Treasury securities that have had their coupons and principal repayments separated into individual zero-coupon Treasury securities. The same technique and "strips" description can be applied to non-Treasury securities (e.g. FNMA strips).

Structured Notes. Notes that have imbedded into their structure options such as step-up coupons or derivative-based returns.

Swap. Trading one asset for another.

TAP Notes: Federal Agency notes issued under the FHLB TAP program. Launched in 6/99 as a refinement to the FHLB bullet bond auction process. In a break from the FHLB's traditional practice of bringing numerous small issues to market with similar maturities, the TAP Issue Program uses the four most common maturities and reopens them up regularly through a competitive auction. These maturities (2, 3, 5 and 10 year) will remain open for the calendar quarter, after which they will be closed and a new series of TAP issues will be opened to replace them. This reduces the number of separate bullet bonds issued, but generates enhanced awareness and liquidity in the marketplace through increased issue size and secondary market volume.

Tennessee Valley Authority (TVA). One of the large Federal Agencies. A wholly owned corporation of the United States government that was established in 1933 to develop the resources of the Tennessee Valley region in order to strengthen the regional and national economy and the national defense. Power operations are separated from non-power operations. TVA securities represent obligations of TVA, payable solely from TVA's net power proceeds, and are neither obligations of nor guaranteed by the United States. TVA is currently authorized to issue debt up to \$30 billion. Under this authorization, TVA may also obtain advances from the U.S. Treasury of up to \$150 million. Frequent issuer of discount notes, agency notes and callable agency securities.

Total Return. Investment performance measured over a period of time that includes coupon interest, interest on interest, and both realized and unrealized gains or losses. Total return includes, therefore, any market value appreciation/depreciation on investments held at period end.

Treasuries. Collective term used to describe debt instruments backed by the U.S. Government and issued through the U.S. Department of the Treasury. Includes Treasury bills, Treasury notes, and Treasury bonds. Also a benchmark term used as a basis by which the yields of non-Treasury securities are compared (e.g., "trading at 50 basis points over Treasuries").

Treasury Bills (T-Bills). Short-term direct obligations of the United States Government issued with an original term of one year or less. Treasury bills are sold at a discount from face value and do not pay interest before maturity. The difference between the purchase price of the bill and the

maturity value is the interest earned on the bill. Currently, the U.S. Treasury issues 4-week, 13-week and 26-week T-Bills

Treasury Bonds. Long-term interest-bearing debt securities backed by the U.S. Government and issued with maturities of ten years and longer by the U.S. Department of the Treasury. The Treasury stopped issuing Treasury Bonds in August 2001.

Treasury Notes. Intermediate interest-bearing debt securities backed by the U.S. Government and issued with maturities ranging from one to ten years by the U.S. Department of the Treasury. The Treasury currently issues 2-year, 5-year and 10-year Treasury Notes.

Trustee. A bank designated by an issuer of securities as the custodian of funds and official representative of bondholders. Trustees are appointed to insure compliance with the bond documents and to represent bondholders in enforcing their contract with the issuer.

Uniform Net Capital Rule. SEC regulation 15C3-1 that outlines the minimum net capital ratio (ratio of indebtedness to net liquid capital) of member firms and non-member broker/dealers.

Unrealized Gains (Losses). The difference between the market value of an investment and its book value. Gains/losses are "realized" when the security is actually sold, as compared to "unrealized" gains/losses which are based on current market value. See also "Realized Gains (Losses)."

Variable-Rate Security. A bond that bears interest at a rate that varies over time based on a specified schedule of adjustment (e.g., daily, weekly, monthly, semi-annually or annually). See also "Floating Rate Note."

Weighted Average Maturity (or just "Average Maturity"). The average maturity of all securities and investments of a portfolio, determined by multiplying the par or principal value of each security or investment by its maturity (days or years), summing the products, and dividing the sum by the total principal value of the portfolio. A simple measure of risk of a fixed-income portfolio.

Weighted Average Maturity to Call. The average maturity of all securities and investments of a portfolio, adjusted to substitute the first call date per security for maturity date for those securities with call provisions.

Yield Curve. A graphic depiction of yields on like securities in relation to remaining maturities spread over a time line. The traditional yield curve depicts yields on U.S. Treasuries, although yield curves exist for Federal Agencies and various credit quality corporates as well. Yield curves can be positively sloped (normal) where longer-term investments have higher yields, or "inverted" (uncommon) where longer-term investments have lower yields than shorter ones.

Yield to Call (YTC). Same as "Yield to Maturity," except the return is measured to the first call date rather than the maturity date. Yield to call can be significantly higher or lower than a security's yield to maturity.

Yield to Maturity (YTM). Calculated return on an investment, assuming all cash flows from the security are reinvested at the same original yield. Can be higher or lower than the coupon rate depending on market rates and whether the security was purchased at a premium or discount. There are different conventions for calculating YTM for various types of securities.

Yield. There are numerous methods of yield determination. In this glossary, see also "Current Yield," "Yield Curve," "Yield to Call" and "Yield to Maturity."

B. Government Code

GOVERNMENT CODE
CHAPTER 2256. PUBLIC FUNDS INVESTMENT

SUBCHAPTER A. AUTHORIZED INVESTMENTS FOR GOVERNMENTAL ENTITIES

Sec. 2256.001. SHORT TITLE. This chapter may be cited as the Public Funds Investment Act.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.002. DEFINITIONS. In this chapter:

- (1) "Bond proceeds" means the proceeds from the sale of bonds, notes, and other obligations issued by an entity, and reserves and funds maintained by an entity for debt service purposes.
- (2) "Book value" means the original acquisition cost of an investment plus or minus the accrued amortization or accretion.
- (3) "Funds" means public funds in the custody of a state agency or local government that:
 - (A) are not required by law to be deposited in the state treasury; and
 - (B) the investing entity has authority to invest.
- (4) "Institution of higher education" has the meaning assigned by Section 61.003, Education Code.
- (5) "Investing entity" and "entity" mean an entity subject to this chapter and described by Section 2256.003.
- (6) "Investment pool" means an entity created under this code to invest public funds jointly on behalf of the entities that participate in the pool and whose investment objectives in order of priority are:
 - (A) preservation and safety of principal;
 - (B) liquidity; and
 - (C) yield.
- (7) "Local government" means a municipality, a county, a school district, a district or authority created under Section 52(b)(1) or (2), Article III, or Section 59, Article XVI, Texas Constitution, a fresh water supply district, a hospital district, and any political subdivision, authority, public corporation, body politic, or instrumentality of the State of Texas, and any nonprofit corporation acting on behalf of any of those entities.
- (8) "Market value" means the current face or par value of an investment multiplied by the net selling price of the security as quoted by a recognized market pricing source quoted on the valuation date.
- (9) "Pooled fund group" means an internally created fund of an investing entity in which one or more institutional accounts of the investing entity are invested.
- (10) "Qualified representative" means a person who holds a position with a business organization, who is authorized to act on behalf of the business organization, and who is one of the following:
 - (A) for a business organization doing business that is regulated by or registered with a securities commission, a person who is registered under the rules of the National Association of Securities Dealers;
 - (B) for a state or federal bank, a savings bank, or a state or federal credit union, a member of the loan committee for the bank or branch of the bank or a person authorized by corporate resolution to act on behalf of and bind the banking institution;

- (C) for an investment pool, the person authorized by the elected official or board with authority to administer the activities of the investment pool to sign the written instrument on behalf of the investment pool; or
 - (D) for an investment management firm registered under the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-1 et seq.) or, if not subject to registration under that Act, registered with the State Securities Board, a person who is an officer or principal of the investment management firm.
- (11) "School district" means a public school district.
 - (12) "Separately invested asset" means an account or fund of a state agency or local government that is not invested in a pooled fund group.
 - (13) "State agency" means an office, department, commission, board, or other agency that is part of any branch of state government, an institution of higher education, and any nonprofit corporation acting on behalf of any of those entities.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1421, Sec. 1, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 1454, Sec. 1, eff. Sept. 1, 1999.

Sec. 2256.003. AUTHORITY TO INVEST FUNDS; ENTITIES SUBJECT TO THIS CHAPTER.

- (a) Each governing body of the following entities may purchase, sell, and invest its funds and funds under its control in investments authorized under this subchapter in compliance with investment policies approved by the governing body and according to the standard of care prescribed by Section 2256.006:
 - (1) a local government;
 - (2) a state agency;
 - (3) a nonprofit corporation acting on behalf of a local government or a state agency; or
 - (4) an investment pool acting on behalf of two or more local governments, state agencies, or a combination of those entities.
- (b) In the exercise of its powers under Subsection (a), the governing body of an investing entity may contract with an investment management firm registered under the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-1 et seq.) or with the State Securities Board to provide for the investment and management of its public funds or other funds under its control. A contract made under authority of this subsection may not be for a term longer than two years. A renewal or extension of the contract must be made by the governing body of the investing entity by order, ordinance, or resolution.
- (c) This chapter does not prohibit an investing entity or investment officer from using the entity's employees or the services of a contractor of the entity to aid the investment officer in the execution of the officer's duties under this chapter.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1999, 76th Leg., ch. 1454, Sec. 2, eff. Sept. 1, 1999.

Sec. 2256.004. APPLICABILITY.

- (a) This subchapter does not apply to:
 - (1) a public retirement system as defined by Section 802.001;
 - (2) state funds invested as authorized by Section 404.024;
 - (3) an institution of higher education having total endowments of at least \$95 million in book value on May 1, 1995;

- (4) funds invested by the Veterans' Land Board as authorized by Chapter 161, 162, or 164, Natural Resources Code;
 - (5) registry funds deposited with the county or district clerk under Chapter 117, Local Government Code; or
 - (6) a deferred compensation plan that qualifies under either Section 401(k) or 457 of the Internal Revenue Code of 1986 (26 U.S.C. Section 1 et seq.), as amended.
- (b) This subchapter does not apply to an investment donated to an investing entity for a particular purpose or under terms of use specified by the donor.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 505, Sec. 24, eff. Sept. 1, 1997; Acts 1997, 75th Leg., ch. 1421, Sec. 2, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 62, Sec. 8.21, eff. Sept. 1, 1999; Acts 1999, 76th Leg., ch. 1454, Sec. 3, eff. Sept. 1, 1999.

Sec. 2256.005. INVESTMENT POLICIES; INVESTMENT STRATEGIES; INVESTMENT OFFICER.

- (a) The governing body of an investing entity shall adopt by rule, order, ordinance, or resolution, as appropriate, a written investment policy regarding the investment of its funds and funds under its control.
- (b) The investment policies must:
 - (1) be written;
 - (2) primarily emphasize safety of principal and liquidity;
 - (3) address investment diversification, yield, and maturity and the quality and capability of investment management; and
 - (4) include:
 - (A) a list of the types of authorized investments in which the investing entity's funds may be invested;
 - (B) the maximum allowable stated maturity of any individual investment owned by the entity;
 - (C) for pooled fund groups, the maximum dollar-weighted average maturity allowed based on the stated maturity date for the portfolio;
 - (D) methods to monitor the market price of investments acquired with public funds; and
 - (E) a requirement for settlement of all transactions, except investment pool funds and mutual funds, on a delivery versus payment basis.
- (c) The investment policies may provide that bids for certificates of deposit be solicited:
 - (1) orally;
 - (2) in writing;
 - (3) electronically; or
 - (4) in any combination of those methods.
- (d) As an integral part of an investment policy, the governing body shall adopt a separate written investment strategy for each of the funds or group of funds under its control. Each investment strategy must describe the investment objectives for the particular fund using the following priorities in order of importance:
 - (1) understanding of the suitability of the investment to the financial requirements of the entity;
 - (2) preservation and safety of principal;
 - (3) liquidity;
 - (4) marketability of the investment if the need arises to liquidate the investment before maturity;
 - (5) diversification of the investment portfolio; and

- (6) yield.
- (e) The governing body of an investing entity shall review its investment policy and investment strategies not less than annually. The governing body 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.
- (f) Each investing entity shall designate, by rule, order, ordinance, or resolution, as appropriate, one or more officers or employees of the state agency, local government, or investment pool as investment officer to be responsible for the investment of its funds consistent with the investment policy adopted by the entity. If the governing body of an investing entity has contracted with another investing entity to invest its funds, the investment officer of the other investing entity is considered to be the investment officer of the first investing entity for purposes of this chapter. Authority granted to a person to invest an entity's funds is effective until rescinded by the investing entity, until the expiration of the officer's term or the termination of the person's employment by the investing entity, or if an investment management firm, until the expiration of the contract with the investing entity. In the administration of the duties of an investment officer, the person designated as investment officer shall exercise the judgment and care, under prevailing circumstances, that a prudent person would exercise in the management of the person's own affairs, but the governing body of the investing entity retains ultimate responsibility as fiduciaries of the assets of the entity. Unless authorized by law, a person may not deposit, withdraw, transfer, or manage in any other manner the funds of the investing entity.
- (g) Subsection (f) does not apply to a state agency, local government, or investment pool for which an officer of the entity is assigned by law the function of investing its funds.
Text of subsec. (h) as amended by Acts 1997, 75th Leg., ch. 685, Sec. 1
- (h) An officer or employee of a commission created under Chapter 391, Local Government Code, is ineligible to be an investment officer for the commission under Subsection (f) if the officer or employee is an investment officer designated under Subsection (f) for another local government.
Text of subsec. (h) as amended by Acts 1997, 75th Leg., ch. 1421, Sec. 3
- (h) An officer or employee of a commission created under Chapter 391, Local Government Code, is ineligible to be designated as an investment officer under Subsection (f) for any investing entity other than for that commission.
- (i) An investment officer of an entity who has a personal business relationship with a business organization offering to engage in an investment transaction with the entity shall file a statement disclosing that personal business interest. An investment officer who is related within the second degree by affinity or consanguinity, as determined under Chapter 573, to an individual seeking to sell an investment to the investment officer's entity 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. For purposes of this subsection, an investment officer has a personal business relationship with a business organization if:
- (1) the investment officer owns 10 percent or more of the voting stock or shares of the business organization or owns \$5,000 or more of the fair market value of the business organization;
 - (2) funds received by the investment officer from the business organization exceed 10 percent of the investment officer's gross income for the previous year; or

- (3) the investment officer has acquired from the business organization during the previous year investments with a book value of \$2,500 or more for the personal account of the investment officer.
- (j) The governing body of an investing entity may specify in its investment policy that any investment authorized by this chapter is not suitable.
- (k) A written copy of the investment policy shall be presented to any person offering to engage in an investment transaction with an investing entity or to an investment management firm under contract with an investing entity to invest or manage the entity's investment portfolio. For purposes of this subsection, a business organization includes investment pools and an investment management firm under contract with an investing entity to invest or manage the entity's investment portfolio. Nothing in this subsection relieves the investing entity of the responsibility for monitoring the investments made by the investing entity to determine that they are in compliance with the investment policy. The qualified representative of the business organization offering to engage in an investment transaction with an investing entity shall execute a written instrument in a form acceptable to the investing entity and the business organization substantially to the effect that the business organization has:
- (1) received and reviewed the investment policy of the entity; and
 - (2) acknowledged that the business organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the entity and the organization that are not authorized by the entity's investment policy, except to the extent that this authorization is dependent on an analysis of the makeup of the entity's entire portfolio or requires an interpretation of subjective investment standards.
- (l) The investment officer of an entity may not acquire or otherwise obtain any authorized investment described in the investment policy of the investing entity from a person who has not delivered to the entity the instrument required by Subsection (k).
- (m) An investing entity other than a state agency, in conjunction with its annual financial audit, shall perform a compliance audit of management controls on investments and adherence to the entity's established investment policies.
- (n) Except as provided by Subsection (o), at least once every two years a state agency shall arrange for a compliance audit of management controls on investments and adherence to the agency's established investment policies. The compliance audit shall be performed by the agency's internal auditor or by a private auditor employed in the manner provided by Section 321.020. Not later than January 1 of each even-numbered year a state agency shall report the results of the most recent audit performed under this subsection to the state auditor. Subject to a risk assessment and to the legislative audit committee's approval of including a review by the state auditor in the audit plan under Section 321.013, the state auditor may review information provided under this section. If review by the state auditor is approved by the legislative audit committee, the state auditor may, based on its review, require a state agency to also report to the state auditor other information the state auditor determines necessary to assess compliance with laws and policies applicable to state agency investments. A report under this subsection shall be prepared in a manner the state auditor prescribes.
- (o) The audit requirements of Subsection (n) do not apply to assets of a state agency that are invested by the comptroller under Section 404.024.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 685, Sec. 1, eff. Sept. 1, 1997; Acts 1997, 75th Leg., ch. 1421, Sec. 3, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch.

1454, Sec. 4, eff. Sept. 1, 1999; Acts 2003, 78th Leg., ch. 785, Sec. 41, eff. Sept. 1, 2003.

Sec. 2256.006. STANDARD OF CARE.

- (a) 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 of funds shall be governed by the following investment objectives, in order of priority:
- (1) preservation and safety of principal;
 - (2) liquidity; and
 - (3) yield.
- (b) In determining whether an investment officer has exercised prudence with respect to an investment decision, the determination shall be made taking into consideration:
- (1) the investment of all funds, or funds under the entity's control, over which the officer had responsibility rather than a consideration as to the prudence of a single investment; and
 - (2) whether the investment decision was consistent with the written investment policy of the entity.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.007. INVESTMENT TRAINING; STATE AGENCY BOARD MEMBERS AND OFFICERS.

- (a) Each member of the governing board of a state agency and its investment officer shall attend at least one training session relating to the person's responsibilities under this chapter within six months after taking office or assuming duties.
- (b) The Texas Higher Education Coordinating Board shall provide the training under this section.
- (c) Training under this section must include education in investment controls, security risks, strategy risks, market risks, diversification of investment portfolio, and compliance with this chapter.
- (d) An investment officer shall attend a training session not less than once in a two-year period and may receive training from any independent source approved by the governing body of the state agency. The investment officer shall prepare a report on this subchapter and deliver the report to the governing body of the state agency not later than the 180th day after the last day of each regular session of the legislature.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 73, Sec. 1, eff. May 9, 1997; Acts 1997, 75th Leg., ch. 1421, Sec. 4, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 1454, Sec. 5, eff. Sept. 1, 1999.

Sec. 2256.008. INVESTMENT TRAINING; LOCAL GOVERNMENTS.

- (a) Except as provided by Subsections (b) and (e), the treasurer, the chief financial officer if the treasurer is not the chief financial officer, and the investment officer of a local government shall:
- (1) attend at least one training session from an independent source approved by the governing body of the local government or a designated investment committee advising the investment officer as provided for in the investment policy of the local government and containing at least 10 hours of instruction relating to the

treasurer's or officer's responsibilities under this subchapter within 12 months after taking office or assuming duties; and

- (2) except as provided by Subsections (b) and (e), attend an investment training session not less than once in a two-year period and receive not less than 10 hours of instruction relating to investment responsibilities under this subchapter from an independent source approved by the governing body of the local government or a designated investment committee advising the investment officer as provided for in the investment policy of the local government.
- (b) An investing entity created under authority of Section 52(b), Article III, or Section 59, Article XVI, Texas Constitution, that has contracted with an investment management firm under Section 2256.003(b) and has fewer than five full-time employees or an investing entity that has contracted with another investing entity to invest the entity's funds may satisfy the training requirement provided by Subsection (a)(2) by having an officer of the governing body attend four hours of appropriate instruction in a two-year period. The treasurer or chief financial officer of an investing entity created under authority of Section 52(b), Article III, or Section 59, Article XVI, Texas Constitution, and that has fewer than five full-time employees is not required to attend training required by this section unless the person is also the investment officer of the entity.
- (c) Training under this section must include education in investment controls, security risks, strategy risks, market risks, diversification of investment portfolio, and compliance with this chapter.
- (d) Not later than December 31 each year, each individual, association, business, organization, governmental entity, or other person that provides training under this section shall report to the comptroller a list of the governmental entities for which the person provided required training under this section during that calendar year. An individual's reporting requirements under this subsection are satisfied by a report of the individual's employer or the sponsoring or organizing entity of a training program or seminar.
- (e) This section does not apply to a district governed by Chapter 36 or 49, Water Code.
Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1421, Sec. 5, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 1454, Sec. 6, eff. Sept. 1, 1999; Acts 2001, 77th Leg., ch. 69, Sec. 4, eff. May 14, 2001.

Sec. 2256.009. AUTHORIZED INVESTMENTS: OBLIGATIONS OF, OR GUARANTEED BY GOVERNMENTAL ENTITIES.

- (a) Except as provided by Subsection (b), the following are authorized investments under this subchapter:
 - (1) obligations, including letters of credit, of the United States or its agencies and instrumentalities;
 - (2) direct obligations of this state or its agencies and instrumentalities;
 - (3) 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;
 - (4) 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;
 - (5) obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized investment rating firm not less than A or its equivalent; and
 - (6) bonds issued, assumed, or guaranteed by the State of Israel.

- (b) The following are not authorized investments under this section:
- (1) obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal;
 - (2) obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest;
 - (3) collateralized mortgage obligations that have a stated final maturity date of greater than 10 years; and
 - (4) collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1999, 76th Leg., ch. 1454, Sec. 7, eff. Sept. 1, 1999; Acts 2001, 77th Leg., ch. 558, Sec. 1, eff. Sept. 1, 2001.

Sec. 2256.010. AUTHORIZED INVESTMENTS: CERTIFICATES OF DEPOSIT AND SHARE CERTIFICATES. A certificate of deposit or share certificate is an authorized investment under this subchapter if the certificate is issued by a state or national bank domiciled in this state, a savings bank domiciled in this state, or a state or federal credit union domiciled in this state and is:

- (1) guaranteed or insured by the Federal Deposit Insurance Corporation or its successor or the National Credit Union Share Insurance Fund or its successor;
- (2) secured by obligations that are described by Section 2256.009(a), including mortgage backed securities directly issued by a federal agency or instrumentality that have a market value of not less than the principal amount of the certificates, but excluding those mortgage backed securities of the nature described by Section 2256.009(b); or
- (3) secured in any other manner and amount provided by law for deposits of the investing entity.

Amended by Acts 1995, 74th Leg., ch. 32, Sec. 1, eff. April 28, 1995; Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1421, Sec. 6, eff. Sept. 1, 1997.

Sec. 2256.011. AUTHORIZED INVESTMENTS: REPURCHASE AGREEMENTS.

- (a) A fully collateralized repurchase agreement is an authorized investment under this subchapter if the repurchase agreement:
- (1) has a defined termination date;
 - (2) is secured by obligations described by Section 2256.009(a)(1); and
 - (3) requires the securities being purchased by the entity to be pledged to the entity, held in the entity's name, and deposited at the time the investment is made with the entity or with a third party selected and approved by the entity; and
 - (4) is placed through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in this state.
- (b) In this section, "repurchase agreement" means a simultaneous agreement to buy, hold for a specified time, and sell back at a future date obligations described by Section 2256.009(a)(1), at a market value at the time the funds are disbursed of not less than the principal amount of the funds disbursed. The term includes a direct security repurchase agreement and a reverse security repurchase agreement.
- (c) Notwithstanding any other law, the term of any reverse security repurchase agreement may not exceed 90 days after the date the reverse security repurchase agreement is delivered.

- (d) Money received by an entity under the terms of a reverse security repurchase agreement shall be used to acquire additional authorized investments, but the term of the authorized investments acquired must mature not later than the expiration date stated in the reverse security repurchase agreement.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.0115. AUTHORIZED INVESTMENTS: SECURITIES LENDING PROGRAM.

- (a) A securities lending program is an authorized investment under this subchapter if it meets the conditions provided by this section.
- (b) To qualify as an authorized investment under this subchapter:
- (1) the value of securities loaned under the program must be not less than 100 percent collateralized, including accrued income;
 - (2) a loan made under the program must allow for termination at any time;
 - (3) a loan made under the program must be secured by:
 - (A) pledged securities described by Section 2256.009;
 - (B) pledged irrevocable letters of credit issued by a bank that is:
 - (i) organized and existing under the laws of the United States or any other state; and
 - (ii) continuously rated by at least one nationally recognized investment rating firm at not less than A or its equivalent; or
 - (C) cash invested in accordance with Section:
 - (i) 2256.009;
 - (ii) 2256.013;
 - (iii) 2256.014; or
 - (iv) 2256.016;
 - (4) the terms of a loan made under the program must require that the securities being held as collateral be:
 - (A) pledged to the investing entity;
 - (B) held in the investing entity's name; and
 - (C) deposited at the time the investment is made with the entity or with a third party selected by or approved by the investing entity;
 - (5) a loan made under the program must be placed through:
 - (A) a primary government securities dealer, as defined by 5 C.F.R. Section 6801.102(f), as that regulation existed on September 1, 2003; or
 - (B) a financial institution doing business in this state; and
 - (6) an agreement to lend securities that is executed under this section must have a term of one year or less.

Added by Acts 2003, 78th Leg., ch. 1227, Sec. 1, eff. Sept. 1, 2003.

Sec. 2256.012. AUTHORIZED INVESTMENTS: BANKER'S ACCEPTANCES. A bankers' acceptance is an authorized investment under this subchapter if the bankers' acceptance:

- (1) has a stated maturity of 270 days or fewer from the date of its issuance;
- (2) will be, in accordance with its terms, liquidated in full at maturity;
- (3) is eligible for collateral for borrowing from a Federal Reserve Bank; and
- (4) is accepted by a bank organized and existing under the laws of the United States or any state, if the short-term obligations of the bank, or of a bank holding company of which the bank is the largest subsidiary, are rated not less than A-1 or P-1 or an equivalent rating by at least one nationally recognized credit rating agency.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.013. AUTHORIZED INVESTMENTS: COMMERCIAL PAPER.

Commercial paper is an authorized investment under this subchapter if the commercial paper:

- (1) has a stated maturity of 270 days or fewer from the date of its issuance; and
- (2) is rated not less than A-1 or P-1 or an equivalent rating by at least:
 - (A) two nationally recognized credit rating agencies; or
 - (B) one nationally recognized credit rating agency and is fully secured by an irrevocable letter of credit issued by a bank organized and existing under the laws of the United States or any state.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.014. AUTHORIZED INVESTMENTS: MUTUAL FUNDS.

(a) A no-load money market mutual fund is an authorized investment under this subchapter if the mutual fund:

- (1) is registered with and regulated by the Securities and Exchange Commission;
- (2) provides the investing entity with a prospectus and other information required by the Securities Exchange Act of 1934 (15 U.S.C. Section 78a et seq.) or the Investment Company Act of 1940 (15 U.S.C. Section 80a-1 et seq.);
- (3) has a dollar-weighted average stated maturity of 90 days or fewer; and
- (4) includes in its investment objectives the maintenance of a stable net asset value of \$1 for each share.

(b) In addition to a no-load money market mutual fund permitted as an authorized investment in Subsection (a), a no-load mutual fund is an authorized investment under this subchapter if the mutual fund:

- (1) is registered with the Securities and Exchange Commission;
- (2) has an average weighted maturity of less than two years;
- (3) is invested exclusively in obligations approved by this subchapter;
- (4) is continuously rated as to investment quality by at least one nationally recognized investment rating firm of not less than AAA or its equivalent; and
- (5) conforms to the requirements set forth in Sections 2256.016(b) and (c) relating to the eligibility of investment pools to receive and invest funds of investing entities.

(c) An entity is not authorized by this section to:

- (1) invest in the aggregate 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 described in Subsection (b);
- (2) invest any portion of bond proceeds, reserves and funds held for debt service, in mutual funds described in Subsection (b); or
- (3) invest its funds or funds under its control, including bond proceeds and reserves and other funds held for debt service, in any one mutual fund described in Subsection (a) or (b) in an amount that exceeds 10 percent of the total assets of the mutual fund.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1421, Sec. 7, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 1454, Sec. 8, eff. Sept. 1, 1999.

Sec. 2256.015. AUTHORIZED INVESTMENTS: GUARANTEED INVESTMENT CONTRACTS.

(a) A guaranteed investment contract is an authorized investment for bond proceeds under this subchapter if the guaranteed investment contract:

- (1) has a defined termination date;
 - (2) is secured by obligations described by Section 2256.009(a)(1), excluding those obligations described by Section 2256.009(b), in an amount at least equal to the amount of bond proceeds invested under the contract; and
 - (3) is pledged to the entity and deposited with the entity or with a third party selected and approved by the entity.
- (b) Bond proceeds, other than bond proceeds representing reserves and funds maintained for debt service purposes, may not be invested under this subchapter in a guaranteed investment contract with a term of longer than five years from the date of issuance of the bonds.
- (c) To be eligible as an authorized investment:
- (1) the governing body of the entity must specifically authorize guaranteed investment contracts as an eligible investment in the order, ordinance, or resolution authorizing the issuance of bonds;
 - (2) the entity must receive bids from at least three separate providers with no material financial interest in the bonds from which proceeds were received;
 - (3) the entity must purchase the highest yielding guaranteed investment contract for which a qualifying bid is received;
 - (4) the price of the guaranteed investment contract must take into account the reasonably expected drawdown schedule for the bond proceeds to be invested; and
 - (5) the provider must certify the administrative costs reasonably expected to be paid to third parties in connection with the guaranteed investment contract.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995;
 Acts 1997, 75th Leg., ch. 1421, Sec. 8, eff. Sept. 1, 1997; Acts 1999,
 76th Leg., ch. 1454, Sec. 9, 10, eff. Sept. 1, 1999.

Sec. 2256.016. AUTHORIZED INVESTMENTS: INVESTMENT POOLS.

- (a) An entity may invest its funds and funds under its control through an eligible investment pool if the governing body of the entity by rule, order, ordinance, or resolution, as appropriate, authorizes investment in the particular pool. An investment pool shall invest the funds it receives from entities in authorized investments permitted by this subchapter.
- (b) To be eligible to receive funds from and invest funds on behalf of an entity under this chapter, an investment pool must furnish to the investment officer or other authorized representative of the entity an offering circular or other similar disclosure instrument that contains, at a minimum, the following information:
- (1) the types of investments in which money is allowed to be invested;
 - (2) the maximum average dollar-weighted maturity allowed, based on the stated maturity date, of the pool;
 - (3) the maximum stated maturity date any investment security within the portfolio has;
 - (4) the objectives of the pool;
 - (5) the size of the pool;
 - (6) the names of the members of the advisory board of the pool and the dates their terms expire;
 - (7) the custodian bank that will safekeep the pool's assets;
 - (8) whether the intent of the pool is to maintain a net asset value of one dollar and the risk of market price fluctuation;

- (9) whether the only source of payment is the assets of the pool at market value or whether there is a secondary source of payment, such as insurance or guarantees, and a description of the secondary source of payment;
 - (10) the name and address of the independent auditor of the pool;
 - (11) the requirements to be satisfied for an entity to deposit funds in and withdraw funds from the pool and any deadlines or other operating policies required for the entity to invest funds in and withdraw funds from the pool; and
 - (12) the performance history of the pool, including yield, average dollar-weighted maturities, and expense ratios.
- (c) To maintain eligibility to receive funds from and invest funds on behalf of an entity under this chapter, an investment pool must furnish to the investment officer or other authorized representative of the entity:
- (1) investment transaction confirmations; and
 - (2) a monthly report that contains, at a minimum, the following information:
 - (A) the types and percentage breakdown of securities in which the pool is invested;
 - (B) the current average dollar-weighted maturity, based on the stated maturity date, of the pool;
 - (C) the current percentage of the pool's portfolio in investments that have stated maturities of more than one year;
 - (D) the book value versus the market value of the pool's portfolio, using amortized cost valuation;
 - (E) the size of the pool;
 - (F) the number of participants in the pool;
 - (G) the custodian bank that is safekeeping the assets of the pool;
 - (H) a listing of daily transaction activity of the entity participating in the pool;
 - (I) the yield and expense ratio of the pool;
 - (J) the portfolio managers of the pool; and
 - (K) any changes or addenda to the offering circular.
- (d) An entity by contract may delegate to an investment pool the authority to hold legal title as custodian of investments purchased with its local funds.
- (e) In this section, "yield" shall be calculated in accordance with regulations governing the registration of open-end management investment companies under the Investment Company Act of 1940, as promulgated from time to time by the federal Securities and Exchange Commission.
- (f) To be eligible to receive funds from and invest funds on behalf of an entity under this chapter, a public funds investment pool created to function as a money market mutual fund must mark its portfolio to market daily, and, to the extent reasonably possible, stabilize at a \$1 net asset value. If the ratio of the market value of the portfolio divided by the book value of the portfolio is less than 0.995 or greater than 1.005, portfolio holdings shall be sold as necessary to maintain the ratio between 0.995 and 1.005.
- (g) To be eligible to receive funds from and invest funds on behalf of an entity under this chapter, a public funds investment pool must have an advisory board composed:
- (1) equally of participants in the pool and other persons who do not have a business relationship with the pool and are qualified to advise the pool, for a public funds investment pool created under Chapter 791 and managed by a state agency; or
 - (2) of participants in the pool and other persons who do not have a business relationship with the pool and are qualified to advise the pool, for other investment pools.

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

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995;
Acts 1997, 75th Leg., ch. 1421, Sec. 9, eff. Sept. 1, 1997.

Sec. 2256.017. EXISTING INVESTMENTS. An entity is not required to liquidate investments that were authorized investments at the time of purchase.

Added by Acts 1995, 74th Leg., ch. 76, Sec. 5.46(a), eff. Sept. 1, 1995;
Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995. Amended by
Acts 1997, 75th Leg., ch. 1421, Sec. 10, eff. Sept. 1, 1997.

Sec. 2256.019. RATING OF CERTAIN INVESTMENT POOLS. A public funds investment pool must be continuously rated no lower than AAA or AAA-m or at an equivalent rating by at least one nationally recognized rating service or no lower than investment grade by at least one nationally recognized rating service with a weighted average maturity no greater than 90 days.

Added by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.
Amended by Acts 1997, 75th Leg., ch. 1421, Sec. 11, eff. Sept. 1, 1997.

Sec. 2256.020. AUTHORIZED INVESTMENTS: INSTITUTIONS OF HIGHER EDUCATION. In addition to the authorized investments permitted by this subchapter, an institution of higher education may purchase, sell, and invest its funds and funds under its control in the following:

- (1) cash management and fixed income funds sponsored by organizations exempt from federal income taxation under Section 501(f), Internal Revenue Code of 1986 (26 U.S.C. Section 501(f));
- (2) negotiable certificates of deposit issued by a bank that has a certificate of deposit rating of at least 1 or the equivalent by a nationally recognized credit rating agency or that is associated with a holding company having a commercial paper rating of at least A-1, P-1, or the equivalent by a nationally recognized credit rating agency; and
- (3) corporate bonds, debentures, or similar debt obligations rated by a nationally recognized investment rating firm in one of the two highest long-term rating categories, without regard to gradations within those categories.

Added by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.0201. AUTHORIZED INVESTMENTS; MUNICIPAL UTILITY.

- (a) A municipality that owns a municipal electric utility that is engaged in the distribution and sale of electric energy or natural gas to the public may enter into a hedging contract and related security and insurance agreements in relation to fuel oil, natural gas, and electric energy to protect against loss due to price fluctuations. A hedging transaction must comply with the regulations of the Commodity Futures Trading Commission and the Securities and Exchange Commission. If there is a conflict between the municipal charter of the municipality and this chapter, this chapter prevails.
- (b) A payment by a municipally owned electric or gas utility under a hedging contract or related agreement in relation to fuel supplies or fuel reserves is a fuel expense, and the utility may credit any amounts it receives under the contract or agreement against fuel expenses.
- (c) The governing body of a municipally owned electric or gas utility or the body vested with power to manage and operate the municipally owned electric or gas utility may set policy regarding hedging transactions.

- (d) In this section, "hedging" means the buying and selling of fuel oil, natural gas, and electric energy futures or options or similar contracts on those commodity futures as a protection against loss due to price fluctuation.

Added by Acts 1999, 76th Leg., ch. 405, Sec. 48, eff. Sept. 1, 1999.

Sec. 2256.021. EFFECT OF LOSS OF REQUIRED RATING. An investment that requires a minimum rating under this subchapter does not qualify as an authorized investment during the period the investment does not have the minimum rating. An entity shall take all prudent measures that are consistent with its investment policy to liquidate an investment that does not have the minimum rating.

Added by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.022. EXPANSION OF INVESTMENT AUTHORITY. Expansion of investment authority granted by this chapter shall require a risk assessment by the state auditor or performed at the direction of the state auditor, subject to the legislative audit committee's approval of including the review in the audit plan under Section 321.013.

Added by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Amended by Acts 2003, 78th Leg., ch. 785, Sec. 42, eff. Sept. 1, 2003.

Sec. 2256.023. INTERNAL MANAGEMENT REPORTS.

- (a) Not less than quarterly, the investment officer shall prepare and submit to the governing body of the entity a written report of investment transactions for all funds covered by this chapter for the preceding reporting period.
- (b) The report must:
- (1) describe in detail the investment position of the entity on the date of the report;
 - (2) be prepared jointly by all investment officers of the entity;
 - (3) be signed by each investment officer of the entity;
 - (4) contain a summary statement, prepared in compliance with generally accepted accounting principles, of each pooled fund group that states the:
 - (A) beginning market value for the reporting period;
 - (B) additions and changes to the market value during the period;
 - (C) ending market value for the period; and
 - (D) fully accrued interest for the reporting period;
 - (5) state the book value and market value of each separately invested asset at the beginning and end of the reporting period by the type of asset and fund type invested;
 - (6) state the maturity date of each separately invested asset that has a maturity date;
 - (7) state the account or fund or pooled group fund in the state agency or local government for which each individual investment was acquired; and
 - (8) state the compliance of the investment portfolio of the state agency or local government as it relates to:
 - (A) the investment strategy expressed in the agency's or local government's investment policy; and
 - (B) relevant provisions of this chapter.
- (c) The report shall be presented not less than quarterly to the governing body and the chief executive officer of the entity within a reasonable time after the end of the period.
- (d) If an entity invests in other than money market mutual funds, investment pools or accounts offered by its depository bank in the form of certificates of deposit, or money market accounts or similar accounts, the reports prepared by the investment officers under this section shall be formally reviewed at least annually by an independent auditor, and the result of the review shall be reported to the governing body by that auditor.

Added by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.
Amended by Acts 1997, 75th Leg., ch. 1421, Sec. 12, eff. Sept. 1, 1997.

Sec. 2256.024. SUBCHAPTER CUMULATIVE.

- (a) The authority granted by this subchapter is in addition to that granted by other law. Except as provided by Subsection (b), this subchapter does not:
- (1) prohibit an investment specifically authorized by other law; or
 - (2) authorize an investment specifically prohibited by other law.
- (b) Except with respect to those investing entities described in Subsection (c), a security described in Section 2256.009(b) is not an authorized investment for a state agency, a local government, or another investing entity, notwithstanding any other provision of this chapter or other law to the contrary.
- (c) Mortgage pass-through certificates and individual mortgage loans that may constitute an investment described in Section 2256.009(b) are authorized investments with respect to the housing bond programs operated by:
- (1) the Texas Department of Housing and Community Affairs or a nonprofit corporation created to act on its behalf;
 - (2) an entity created under Chapter 392, Local Government Code; or
 - (3) an entity created under Chapter 394, Local Government Code.

Added by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.025. SELECTION OF AUTHORIZED BROKERS. The governing body of an entity subject to this subchapter or the designated investment committee of the entity shall, at least annually, review, revise, and adopt a list of qualified brokers that are authorized to engage in investment transactions with the entity.

Added by Acts 1997, 75th Leg., ch. 1421, Sec. 13, eff. Sept. 1, 1997.

Sec. 2256.026. STATUTORY COMPLIANCE. All investments made by entities must comply with this subchapter and all federal, state, and local statutes, rules, or regulations.

Added by Acts 1997, 75th Leg., ch. 1421, Sec. 13, eff. Sept. 1, 1997.

SUBCHAPTER B. MISCELLANEOUS PROVISIONS

Sec. 2256.051. ELECTRONIC FUNDS TRANSFER. Any local government may use electronic means to transfer or invest all funds collected or controlled by the local government.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.052. PRIVATE AUDITOR. Notwithstanding any other law, a state agency shall employ a private auditor if authorized by the legislative audit committee either on the committee's initiative or on request of the governing body of the agency.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.053. PAYMENT FOR SECURITIES PURCHASED BY STATE. The comptroller or the disbursing officer of an agency that has the power to invest assets directly may pay for authorized securities purchased from or through a member in good standing of the National Association of Securities Dealers or from or through a national or state bank on receiving an invoice from the seller of the securities showing that the securities have been purchased by the board or agency and that the amount to be paid for the securities is just, due, and unpaid. A purchase of securities may not be made at a price that exceeds the existing market value of the securities.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995;
Acts 1997, 75th Leg., ch. 1423, Sec. 8.67, eff. Sept. 1, 1997.

Sec. 2256.054. DELIVERY OF SECURITIES PURCHASED BY STATE. A security purchased under this chapter may be delivered to the comptroller, a bank, or the board or agency investing its funds. The delivery shall be made under normal and recognized practices in the

securities and banking industries, including the book entry procedure of the Federal Reserve Bank.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995;
Acts 1997, 75th Leg., ch. 1423, Sec. 8.68, eff. Sept. 1, 1997.

Sec. 2256.055. DEPOSIT OF SECURITIES PURCHASED BY STATE. At the direction of the comptroller or the agency, a security purchased under this chapter may be deposited in trust with a bank or federal reserve bank or branch designated by the comptroller, whether in or outside the state. The deposit shall be held in the entity's name as evidenced by a trust receipt of the bank with which the securities are deposited.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995;
Acts 1997, 75th Leg., ch. 1423, Sec. 8.69, eff. Sept. 1, 1997.

GOVERNMENT CODE
CHAPTER 2257. COLLATERAL FOR PUBLIC FUNDS
SUBCHAPTER A. GENERAL PROVISIONS

Sec. 2257.001. SHORT TITLE. This chapter may be cited as the Public Funds Collateral Act.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Sec. 2257.002. DEFINITIONS. In this chapter:

- (1) "Bank holding company" has the meaning assigned by Section 31.002(a), Finance Code.
- (2) "Control" has the meaning assigned by Section 31.002(a), Finance Code.
- (3) "Deposit of public funds" means public funds of a public entity that:
 - (A) the comptroller does not manage under Chapter 404; and
 - (B) are held as a demand or time deposit by a depository institution expressly authorized by law to accept a public entity's demand or time deposit.
- (4) "Eligible security" means:
 - (A) a surety bond;
 - (B) an investment security;
 - (C) an ownership or beneficial interest in an investment security, other than an option contract to purchase or sell an investment security;
 - (D) a fixed-rate collateralized mortgage obligation that has an expected weighted average life of 10 years or less and does not constitute a high-risk mortgage security; or
 - (E) a floating-rate collateralized mortgage obligation that does not constitute a high-risk mortgage security.
- (5) "Investment security" means:
 - (A) an obligation that in the opinion of the attorney general of the United States is a general obligation of the United States and backed by its full faith and credit;
 - (B) a general or special obligation issued by a public agency that is payable from taxes, revenues, or a combination of taxes and revenues; or
 - (C) a security in which a public entity may invest under Subchapter A, Chapter 2256.
- (6) "Permitted institution" means:
 - (A) a Federal Reserve Bank;
 - (B) a clearing corporation, as defined by Section 8.102, Business & Commerce Code;
 - (C) a bank eligible to be a custodian under Section 2257.041; or
 - (D) a state or nationally chartered bank that is controlled by a bank holding company that controls a bank eligible to be a custodian under Section 2257.041.
- (7) "Public agency" means a state or a political or governmental entity, agency, instrumentality, or subdivision of a state, including a municipality, an institution of higher education, as defined by Section 61.003, Education Code, a junior college, a district created under Article XVI, Section 59, of the Texas Constitution, and a public hospital.

- (8) "Public entity" means a public agency in this state, but does not include an institution of higher education, as defined by Section 61.003, Education Code.
 - (9) "State agency" means a public entity that:
 - (A) has authority that is not limited to a geographic portion of the state; and
 - (B) was created by the constitution or a statute.
 - (10) "Trust receipt" means evidence of receipt, identification, and recording, including:
 - (A) a physical controlled trust receipt; or
 - (B) a written or electronically transmitted advice of transaction.
- Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.
 Amended by Acts 1995, 74th Leg., ch. 76, Sec. 5.48(a), eff. Sept. 1, 1995; Acts 1995, 74th Leg., ch. 914, Sec. 5, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 254, Sec. 1, eff. Sept. 1, 1997; Acts 1997, 75th Leg., ch. 891, Sec. 3.22(4), eff. Sept. 1, 1997; Acts 1997, 75th Leg., ch. 1423, Sec. 8.70, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 62, Sec. 7.63, eff. Sept. 1, 1999.

Sec. 2257.0025. HIGH-RISK MORTGAGE SECURITY.

- (a) For purposes of this chapter, a fixed-rate collateralized mortgage obligation is a high-risk mortgage security if the security:
 - (1) has an average life sensitivity with a weighted average life that:
 - (A) extends by more than four years, assuming an immediate and sustained parallel shift in the yield curve of plus 300 basis points; or
 - (B) shortens by more than six years, assuming an immediate and sustained parallel shift in the yield curve of minus 300 basis points; and
 - (2) is price sensitive; that is, the estimated change in the price of the mortgage derivative product is more than 17 percent, because of an immediate and sustained parallel shift in the yield curve of plus or minus 300 basis points.
- (b) For purposes of this chapter, a floating-rate collateralized mortgage obligation is a high-risk mortgage security if the security:
 - (1) bears an interest rate that is equal to the contractual cap on the instrument; or
 - (2) is price sensitive; that is, the estimated change in the price of the mortgage derivative product is more than 17 percent, because of an immediate and sustained parallel shift in the yield curve of plus or minus 300 basis points.

Added by Acts 1997, 75th Leg., ch. 254, Sec. 2, eff. Sept. 1, 1997.

Sec. 2257.003. CHAPTER NOT APPLICABLE TO DEFERRED COMPENSATION PLANS. This chapter does not apply to funds that a public entity maintains or administers under a deferred compensation plan, the federal income tax treatment of which is governed by Section 401(k) or 457 of the Internal Revenue Code of 1986 (26 U.S.C. Sections 401(k) and 457).

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Sec. 2257.004. CONFLICT WITH OTHER LAW. This chapter prevails over any other law relating to security for a deposit of public funds to the extent of any conflict.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Sec. 2257.005. CONTRACT GOVERNS LEGAL ACTION. A legal action brought by or against a public entity that arises out of or in connection with the duties of a depository, custodian, or permitted institution under this chapter must be brought and maintained as provided by the contract with the public entity.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

SUBCHAPTER B. DEPOSITORY; SECURITY FOR DEPOSIT OF PUBLIC FUNDS

Sec. 2257.021. COLLATERAL REQUIRED. A deposit of public funds shall be secured by eligible security to the extent and in the manner required by this chapter.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Sec. 2257.022. AMOUNT OF COLLATERAL.

- (a) Except as provided by Subsection (b), the total value of eligible security to secure a deposit of public funds must be in an amount not less than the amount of the deposit of public funds:
 - (1) increased by the amount of any accrued interest; and
 - (2) reduced to the extent that the United States or an instrumentality of the United States insures the deposit.
- (b) The total value of eligible security described by Section 45.201(4)(D), Education Code, to secure a deposit of public funds of a school district must be in an amount not less than 110 percent of the amount of the deposit as determined under Subsection (a). The total market value of the eligible security must be reported at least once each month to the school district.
- (c) The value of a surety bond is its face value.
- (d) The value of an investment security is its market value.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Amended by Acts 2003, 78th Leg., ch. 201, Sec. 46, eff. Sept. 1, 2003.

Sec. 2257.023. COLLATERAL POLICY.

- (a) In accordance with a written policy approved by the governing body of the public entity, a public entity shall determine if an investment security is eligible to secure deposits of public funds.
- (b) The written policy may include:
 - (1) the security of the institution that obtains or holds an investment security;
 - (2) the substitution or release of an investment security; and
 - (3) the method by which an investment security used to secure a deposit of public funds is valued.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Sec. 2257.024. CONTRACT FOR SECURING DEPOSIT OF PUBLIC FUNDS.

- (a) A public entity may contract with a bank that has its main office or a branch office in this state to secure a deposit of public funds.
- (b) The contract may contain a term or condition relating to an investment security used as security for a deposit of public funds, including a term or condition relating to the:
 - (1) possession of the collateral;
 - (2) substitution or release of an investment security;
 - (3) ownership of the investment securities of the bank used to secure a deposit of public funds; and
 - (4) method by which an investment security used to secure a deposit of public funds is valued.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Amended by Acts 1999, 76th Leg., ch. 344, Sec. 5.006, eff. Sept. 1, 1999.

Sec. 2257.025. RECORDS OF DEPOSITORY.

- (a) A public entity's depository shall maintain a separate, accurate, and complete record relating to a pledged investment security, a deposit of public funds, and a transaction related to a pledged investment security.
- (b) The comptroller or the public entity may examine and verify at any reasonable time a pledged investment security or a record a depository maintains under this section.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Amended by Acts 1997, 75th Leg., ch. 891, Sec. 3.16, eff. Sept. 1, 1997.

Sec. 2257.026. CHANGE IN AMOUNT OR ACTIVITY OF DEPOSITS OF PUBLIC FUNDS. A public entity shall inform the depository for the public entity's deposit of public funds of a significant change in the amount or activity of those deposits within a reasonable time before the change occurs.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

SUBCHAPTER C. CUSTODIAN; PERMITTED INSTITUTION

Sec. 2257.041. DEPOSIT OF SECURITIES WITH CUSTODIAN.

- (a) In addition to other authority granted by law, a depository for a public entity other than a state agency may deposit with a custodian a security pledged to secure a deposit of public funds.
- (b) At the request of the public entity, a depository for a public entity other than a state agency shall deposit with a custodian a security pledged to secure a deposit of public funds.
- (c) A depository for a state agency shall deposit with a custodian a security pledged to secure a deposit of public funds. The custodian and the state agency shall agree in writing on the terms and conditions for securing a deposit of public funds.
- (d) A custodian must be approved by the public entity and be:
 - (1) a state or national bank that:
 - (A) is designated by the comptroller as a state depository;
 - (B) has its main office or a branch office in this state; and
 - (C) has a capital stock and permanent surplus of \$5 million or more;
 - (2) the Texas Treasury Safekeeping Trust Company;
 - (3) a Federal Reserve Bank or a branch of a Federal Reserve Bank; or
 - (4) a federal home loan bank.
- (e) A custodian holds in trust the securities to secure the deposit of public funds of the public entity in the depository pledging the securities.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Amended by Acts 1995, 74th Leg., ch. 1010, Sec. 1, eff. June 17, 1995;

Acts 1997, 75th Leg., ch. 891, Sec. 3.17, eff. Sept. 1, 1997; Acts 1999,

76th Leg., ch. 344, Sec. 5.007, eff. Sept. 1, 1999.

Sec. 2257.042. DEPOSIT OF SECURITIES WITH PERMITTED INSTITUTION.

- (a) A custodian may deposit with a permitted institution an investment security the custodian holds under Section 2257.041.
- (b) If a deposit is made under Subsection (a):

- (1) the permitted institution shall hold the investment security to secure funds the public entity deposits in the depository that pledges the investment security;
- (2) the trust receipt the custodian issues under Section 2257.045 shall show that the custodian has deposited the security in a permitted institution; and
- (3) the permitted institution, on receipt of the investment security, shall immediately issue to the custodian an advice of transaction or other document that is evidence that the custodian deposited the security in the permitted institution.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Sec. 2257.043. DEPOSITORY AS CUSTODIAN OR PERMITTED INSTITUTION.

- (a) A public entity other than a state agency may prohibit a depository or an entity of which the depository is a branch from being the custodian of or permitted institution for a security the depository pledges to secure a deposit of public funds.
- (b) A depository or an entity of which the depository is a branch may not be the custodian of or permitted institution for a security the depository pledges to secure a deposit of public funds by a state agency.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Sec. 2257.044. CUSTODIAN AS BAILEE.

- (a) A custodian under this chapter or a custodian of a security pledged to an institution of higher education, as defined by Section 61.003, Education Code, whether acting alone or through a permitted institution, is for all purposes the bailee or agent of the public entity or institution depositing the public funds with the depository.
- (b) To the extent of any conflict, Subsection (a) prevails over Chapter 8 or 9, Business & Commerce Code.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Sec. 2257.045. RECEIPT OF SECURITY BY CUSTODIAN. On receipt of an investment security, a custodian shall:

- (1) immediately identify on its books and records, by book entry or another method, the pledge of the security to the public entity; and
- (2) promptly issue and deliver to the appropriate public entity officer a trust receipt for the pledged security.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Sec. 2257.046. BOOKS AND RECORDS OF CUSTODIAN; INSPECTION.

- (a) A public entity's custodian shall maintain a separate, accurate, and complete record relating to each pledged investment security and each transaction relating to a pledged investment security.
- (b) The comptroller or the public entity may examine and verify at any reasonable time a pledged investment security or a record a custodian maintains under this section. The public entity or its agent may inspect at any time an investment security evidenced by a trust receipt.
- (c) The public entity's custodian shall file a collateral report with the comptroller in the manner and on the dates prescribed by the comptroller.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Amended by Acts 1997, 75th Leg., ch. 891, Sec. 3.18, eff. Sept. 1, 1997.

Sec. 2257.047. BOOKS AND RECORDS OF PERMITTED INSTITUTION.

- (a) A permitted institution may apply book entry procedures when an investment security held by a custodian is deposited under Section 2257.042.
- (b) A permitted institution's records must at all times state the name of the custodian that deposits an investment security in the permitted institution.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Sec. 2257.048. ATTACHMENT AND PERFECTION OF SECURITY INTEREST.

- (a) A security interest that arises out of a depository's pledge of a security to secure a deposit of public funds by a public entity or an institution of higher education, as defined by Section 61.003, Education Code, is created, attaches, and is perfected for all purposes under state law from the time that the custodian identifies the pledge of the security on the custodian's books and records and issues the trust receipt.
- (b) A security interest in a pledged security remains perfected in the hands of a subsequent custodian or permitted institution.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

SUBCHAPTER D. AUDITS AND EXAMINATIONS; PENALTIES

Sec. 2257.061. AUDITS AND EXAMINATIONS. As part of an audit or regulatory examination of a public entity's depository or custodian, the auditor or examiner shall:

- (1) examine and verify pledged investment securities and records maintained under Section 2257.025 or 2257.046; and
- (2) report any significant or material noncompliance with this chapter to the comptroller.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Amended by Acts 1997, 75th Leg., ch. 891, Sec. 3.19, eff. Sept. 1, 1997.

Sec. 2257.062. PENALTIES.

- (a) The comptroller may revoke a depository's designation as a state depository for one year if, after notice and a hearing, the comptroller makes a written finding that the depository, while acting as either a depository or a custodian:
 - (1) did not maintain reasonable compliance with this chapter; and
 - (2) failed to remedy a violation of this chapter within a reasonable time after receiving written notice of the violation.
- (b) The comptroller may permanently revoke a depository's designation as a state depository if the comptroller makes a written finding that the depository:
 - (1) has not maintained reasonable compliance with this chapter; and
 - (2) has acted in bad faith by not remedying a violation of this chapter.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Amended by Acts 1997, 75th Leg., ch. 891, Sec. 3.19, eff. Sept. 1, 1997.

Sec. 2257.063. MITIGATING CIRCUMSTANCES.

- (a) The comptroller shall consider the total circumstances relating to the performance of a depository or custodian when the comptroller makes a finding required by Section 2257.062, including the extent to which the noncompliance is minor, isolated, temporary, or nonrecurrent.
- (b) The comptroller may not find that a depository or custodian did not maintain reasonable compliance with this chapter if the noncompliance results from the public entity's failure to comply with Section 2257.026.
- (c) This section does not relieve a depository or custodian of the obligation to secure a deposit of public funds with eligible security in the amount and manner required by this chapter within a reasonable time after the public entity deposits the deposit of public funds with the depository.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Amended by Acts 1997, 75th Leg., ch. 891, Sec. 3.19, eff. Sept. 1, 1997.

Sec. 2257.064. REINSTATEMENT. The comptroller may reinstate a depository's designation as a state depository if:

- (1) the comptroller determines that the depository has remedied all violations of this chapter; and
- (2) the depository assures the comptroller to the comptroller's satisfaction that the depository will maintain reasonable compliance with this chapter.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Amended by Acts 1997, 75th Leg., ch. 891, Sec. 3.19, eff. Sept. 1, 1997.

SUBCHAPTER E. EXEMPT INSTITUTIONS

Sec. 2257.081. DEFINITION. In this subchapter, "exempt institution" means:

- (1) a public retirement system, as defined by Section 802.001; or
 - (2) the permanent school fund, as described by Section 43.001, Education Code.
- Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.
Amended by Acts 1997, 75th Leg., ch. 165, Sec. 6.31, eff. Sept. 1, 1997.

Sec. 2257.082. FUNDS OF EXEMPT INSTITUTION. An exempt institution is not required to have its funds fully insured or collateralized at all times if:

- (1) the funds are held by:
 - (A) a custodian of the institution's assets under a trust agreement; or
 - (B) a person in connection with a transaction related to an investment;
 and
- (2) the governing body of the institution, in exercising its fiduciary responsibility, determines that the institution is adequately protected by using a trust agreement, special deposit, surety bond, substantial deposit insurance, or other method an exempt institution commonly uses to protect itself from liability.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Sec. 2257.083. INVESTMENT; SELECTION OF DEPOSITORY. This chapter does not:

- (1) prohibit an exempt institution from prudently investing in a certificate of deposit; or
- (2) restrict the selection of a depository by the governing body of an exempt institution in accordance with its fiduciary duty.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

C. Master Repurchase Agreement

Public Securities Association
40 Broad Street , New York, NY 10004 - 2373
Telephone (212) 809 - 7000

PSA

Master Repurchase Agreement

Between:

Dated as of

and

1. Applicability

From time to time the parties hereto may enter into transactions in which one party ("Seller") agrees to transfer to the other ("Buyer") securities or financial instruments ("Securities") against the transfer of funds by Buyer, with a simultaneous agreement by Buyer to transfer to Seller such Securities at a date certain or on demand, against the transfer of funds by Seller. Each such transaction shall be referred to herein as a "Transaction" and shall be governed by this Agreement, including any supplemental terms or conditions contained in Annex I hereto, unless otherwise agreed in writing.

2. Definitions

(a) "Act of Insolvency", with respect to any party, (i) the commencement by such party as debtor of any case or proceeding under any bankruptcy, insolvency, reorganization, liquidation, dissolution or similar law, or such party seeking the appointment of a receiver, trustee, custodian or similar official for such party or any substantial part of its property, or (ii) the commencement of any such case or proceeding against such party, or another seeking such an appointment, or the filing against a party of an application for a protective decree under the provisions of the Securities Investor Protection Act of 1970, which (A) is consented to or not timely contested by such party, (B) results in the entry of an order for relief, such an appointment, the issuance of such a protective decree or the entry of an order having a similar effect, or (C) is not dismissed within 15 days, (iii) the making by a party of a general assignment for the benefit of creditors, or (iv) the admission in writing by a party of such party's inability to pay such party's debts as they become due;

(b) "Additional Purchased Securities", Securities provided by the Seller to Buyer pursuant to Paragraph 4(a) hereof;

(c) "Buyer's Margin Amount", with respect to any Transaction as of any date, the amount obtained by application of a percentage (which may be equal to the percentage that is agreed to as the Seller Margin Amount under subparagraph (q) of this Paragraph), agreed to by Buyer and Seller prior to entering into the Transaction, to the Repurchase Price for such Transaction as of such date;

(d) "Confirmation", the meaning specified in Paragraph 3(b) hereof;

(e) "Income", with respect to any Security at any time, any principal thereof then payable and all interest, dividends or other distributions thereon;

(f) "Margin Deficit", the meaning specified in Paragraph 4(a) hereof;

(g) "Margin Excess", the meaning specified in Paragraph 4(b) hereof;

(h) "Market Value", with respect to any Securities as of any date, the price for such Securities on such date obtained from a generally recognized source agreed to by the parties or the most recent closing bid quotation from such a source, plus accrued Income to the extent not included therein (other than any Income credited or transferred to, or applied to the obligations of, Seller pursuant to Paragraph 5 hereof) as of such date (unless contrary to market practice for such Securities);

(i) "Price Differential", with respect to any Transaction hereunder as of any date, the aggregate amount obtained by daily application of the Pricing Rate for such Transaction to the Purchase Price for such Transaction on a 360 day per year basis for the actual number of days during the period commencing on (and including) the Purchase Date for such Transaction and ending on (but excluding) the date of determination (reduced by any amount of such Price Differential previously paid by Seller to Buyer with respect to such Transaction);

(j) "Pricing Rate", the per annum percentage rate for determination of the Price Differential;

(k) "Prime Rate", the prime rate of U.S. money center commercial banks as published in *The Wall Street Journal*;

(l) "Purchase Date", the date on which Purchased Securities are transferred by Seller to Buyer;

(m) "Purchase Price", (i) on the Purchase Date, the price at which Purchased Securities are transferred by Seller to Buyer, and (ii) thereafter, such price increased by the amount of any cash transferred by Buyer to Seller pursuant to Paragraph 4(b) hereof and decreased by the amount of any cash transferred by Seller to Buyer pursuant to Paragraph 4(a) hereof or applied to reduce Seller's obligations under clause (ii) of Paragraph 5 hereof;

(n) "Purchased Securities", the Securities transferred by Seller to Buyer in a Transaction hereunder, and any Securities substituted therefor in accordance with Paragraph 9 hereof. The term "Purchased Securities" with respect to any Transaction at any time also shall include Additional Purchased Securities delivered pursuant to Paragraph 4(a) and shall exclude Securities returned pursuant to Paragraph 4(b);

(o) "Repurchase Date", the date on which Seller is to repurchase the Purchased Securities from Buyer, including any date determined by application of the provisions of Paragraph 3(c) or 11 hereof;

(p) "Repurchased Price", the price at which Purchased Securities are to be transferred from Buyer to Seller upon termination of a Transaction, which will be determined in each case (including Transactions terminable upon demand) as the sum of the Purchase Price and the Price Differential as of the date of such determination, increased by any amount determined by the application of the provisions of Paragraph 11 hereof;

(q) "Seller's Margin Amount", with respect to any Transaction as of any date, the amount obtained by application of a percentage (which may be equal to the percentage that is agreed to as the Buyer's Margin Amount under subparagraph (c) of this Paragraph), agreed to by Buyer and Seller prior to entering into the Transaction, to the Repurchase Price for such Transaction as of such date.

3. Initiation; Confirmation; Termination

(a) An agreement to enter into a Transaction may be made orally or in writing at the initiation of either Buyer or Seller. On the Purchase Date for the Transaction, the Purchased Securities shall be transferred to Buyer or its agent against the transfer of the Purchase Price to an account of Seller.

(b) Upon agreeing to enter into a Transaction hereunder, Buyer or Seller (or both), as shall be agreed, shall promptly deliver to the other party a written confirmation of each Transaction (a "Confirmation"). The Confirmation shall describe the Purchased Securities (including CUSIP number, if any), identify Buyer and Seller and set forth (i) the Purchase Date, (ii) the Purchase Price, (iii) the Repurchase Date, unless the Transaction is to be terminable on demand, (iv) the Pricing Rate or Repurchase Price applicable to the Transaction, and (v) any additional terms or conditions of the Transaction not inconsistent with this Agreement. The Confirmation, together with this Agreement, shall constitute conclusive evidence of the terms agreed between Buyer and Seller with respect to the Transaction to which the Confirmation relates, unless with respect to the Confirmation specific objection is made promptly after receipt thereof. In the event of any conflict between the terms of such Confirmation and this Agreement, this Agreement shall prevail.

(c) In the case of Transactions terminable upon demand, such demand shall be made by Buyer or Seller, no later than such time as is customary in accordance with market practice, by telephone or otherwise on or prior to the business day on which such termination will be effective. On the date specified in such demand, or on the date fixed for termination in the case of Transactions having a fixed term, termination of the Transaction will be effected by transfer to Seller or its agent of the Purchased Securities and any Income in respect thereof received by Buyer (and not previously credited or transferred to, or applied to the obligations of, Seller pursuant to Paragraph 5 hereof) against the transfer of the Repurchase Price to an account of Buyer.

4. Margin Maintenance

(a) If at any time the aggregate Market Value of all Purchased Securities subject to all Transactions in which a particular party hereto is acting as Buyer is less than the aggregate Buyer's Margin Amount for all such Transactions (a "Margin Deficit"), then Buyer may by notice to Seller require Seller in such Transactions, at Seller's option, to transfer to Buyer cash or additional Securities reasonably acceptable to Buyer ("Additional Purchased Securities"), so that the cash and aggregate Market Value of the Purchased Securities, including any such Additional Purchased Securities, will thereupon equal or exceed such aggregate Buyer's Margin Amount (decreased by the amount of any Margin Deficit as of such date arising from any Transactions in which such Buyer is acting as Seller).

(b) If at any time the aggregate Market Value of all Purchased Securities subject to all Transactions in which a particular party hereto is acting as Seller exceeds the aggregate Seller's Margin Amount for all such Transactions at such time (a "Margin Excess"), then Seller may by notice to Buyer require Buyer in such Transactions, at Buyer's option, to transfer cash or Purchased Securities to Seller, so that the aggregate Market Value of the Purchased Securities, after deduction of any such cash or any Purchased Securities so transferred, will thereupon not exceed such aggregate Seller's Margin Amount (increased by the amount of any Margin Excess as of such date arising from any Transactions in which such Seller is acting as Buyer).

(c) Any cash transferred pursuant to this Paragraph shall be attributed to such Transactions as shall be agreed upon by Buyer and Seller.

(d) Seller and Buyer may agree, with respect to any or all Transactions hereunder, that the respective rights of Buyer and Seller (or both) under subparagraphs (a) and (b) of this Paragraph

may be exercised only where a Margin Deficit or Margin Excess exceeds a specified dollar amount or a specified percentage of the Repurchase Prices for such Transactions (which amount or percentage shall be agreed to by Buyer and Seller prior to entering into any such Transactions).

(e) Seller and Buyer may agree, with respect to any or all Transactions hereunder, that the respective rights of Buyer and Seller under subparagraphs (a) and (b) of this Paragraph to require the elimination of a Margin Deficit or a Margin Excess, as the case may be, may be exercised whenever such a Margin Deficit or Margin Excess exists with respect to any single Transaction hereunder (calculated without regard to any other Transaction outstanding under this Agreement).

5. Income Payments

Where a particular Transaction's term extends over an Income payment date on the Securities subject to that Transaction, Buyer shall, as the parties may agree with respect to such Transaction (or, in the absence of any agreement, as Buyer shall reasonably determine in its discretion), on the date such Income is payable either (i) transfer to or credit to the account of Seller an amount equal to such Income payment or payments with respect to any Purchased Securities subject to such Transaction or (ii) apply the Income payment or payments to reduce the amount to be transferred to Buyer by Seller upon termination of the Transaction. Buyer shall not be obligated to take any action pursuant to the preceding sentence to the extent that such action would result in the creation of a Margin Deficit, unless prior thereto or simultaneously therewith Seller transfers to Buyer cash or Additional Purchased Securities sufficient to eliminate such Margin Deficit.

6. Security Interest

Although the parties intend that all Transactions hereunder be sales and purchases and not loans, in the event any such Transactions are deemed to be loans, Seller shall be deemed to have pledged to Buyer as security for the performance by Seller of its obligations under each such Transaction, and shall be deemed to have granted to Buyer a security interest in, all of the Purchased Securities with respect to all Transactions hereunder and all proceeds thereof.

7. Payment and Transfer

Unless otherwise mutually agreed, all transfers of funds hereunder shall be in immediately available funds. All Securities transferred by one party hereto to the other party (i) shall be in suitable form for transfer or shall be accompanied by duly executed instruments of transfer or assignment in blank and such other documentation as the party receiving possession may reasonably request, (ii) shall be transferred on the book-entry system of a Federal Reserve Bank, or (iii) shall be transferred by any other method mutually acceptable to Seller and Buyer. As used herein with respect to Securities, "transfer" is intended to have the same meaning as when used in Section 8-313 of the New York Uniform Commercial Code or, where applicable, in any federal regulation governing transfers of the Securities.

8. Segregation of Purchased Securities

To the extent required by applicable law, all Purchased Securities in the possession of the Seller shall be segregated from other securities in its possession and shall be identified as subject to this Agreement. Segregation may be accomplished by appropriate identification on the books and records of the holder, including a financial intermediary or a clearing corporation. Title to all Purchased Securities shall pass to Buyer and, unless otherwise agreed by Buyer and Seller, nothing in this Agreement shall preclude Buyer from engaging in repurchase transactions with the Purchased Securities or otherwise pledging or hypothecating the Purchased Securities, but no

such transaction shall relieve Buyer of its obligations to transfer Purchased Securities to Seller pursuant to Paragraphs 3, 4 or 11 hereof, or of Buyer's obligation to credit or pay Income to, or apply Income to the obligations of, Seller pursuant to Paragraph 5 hereof.

Required Disclosure for Transactions in Which the Seller Retains Custody of the Purchased Securities

Seller is not permitted to substitute other securities for those subject to this Agreement and therefore must keep Buyer's securities segregated at all times, unless in this Agreement Buyer grants Seller the right to substitute other securities. If Buyer grants the right to substitute, this means that Buyer's securities will likely be commingled with Seller's own securities during the trading day. Buyer is advised that, during any trading day that Buyer's securities are commingled with Seller's securities, they [will]* [may]** be subject to liens granted by Seller to [its clearing bank]* [third parties]** and may be used by Seller for deliveries on other securities transactions. Whenever the securities are commingled, Seller's ability to resegment substitute securities for Buyer will be subject to Seller's ability to satisfy [the clearing]* [any]** lien or to obtain substitute securities.

* Language to be used under 17 C.F.R. d 403.4(e) if Seller is a government securities broker or dealer other than a financial institution.

** Language to be used under 17 C.F.R. d 403.5 (d) if Seller is a financial institution.

9. Substitution

(a) Seller may, subject to agreement with and acceptance by Buyer, substitute other Securities for any Purchased Securities. Such substitution shall be made by transfer to Buyer of such other Securities and transfer to Seller of such Purchased Securities. After substitution, the substituted Securities shall be deemed to be Purchased Securities.

(b) In Transactions in which the Seller retains custody of Purchased Securities, the parties expressly agree that Buyer shall be deemed, for purposes of subparagraph (a) of this Paragraph, to have agreed to and accepted in this Agreement substitution by Seller of other Securities for Purchased Securities; *provided, however*, that such other Securities shall have a Market Value at least equal to the Market Value of the Purchased Securities for which they are substituted.

10. Representations

Each of Buyer and Seller represents and warrants to other that (i) it is duly authorized to execute and deliver this Agreement, to enter into the Transactions contemplated hereunder and to perform its obligations hereunder and has taken all necessary action to authorize such execution, delivery and performance, (ii) it will engage in such Transactions as principal (or, if agreed in writing in advance of any Transaction by the other party hereto, as agent for a disclosed principal), (iii) the person signing this Agreement on its behalf is duly authorized to do so on its behalf (or on behalf of any such disclosed principal), (iv) it has obtained all authorizations of any governmental body required in connection with this Agreement and the Transactions hereunder and such authorizations are in full force and effect and (v) the execution, delivery and performance of this Agreement and the Transactions hereunder will not violate any law, ordinance, charter, by-law or rule applicable to it or any agreement by which it is bound or by which any of its assets are affected. On the Purchase Date for any Transaction Buyer and Seller shall each be deemed to repeat all the foregoing representations made by it.

11. Events of Default

In the event that (i) Seller fails to repurchase or Buyer fails to transfer Purchased Securities upon the applicable Repurchase Date, (ii) Seller or Buyer fails, after one business day's notice, to comply with Paragraph 4 hereof, (iii) Buyer fails to comply with Paragraph 5 hereof, (iv) an Act of Insolvency occurs with respect to Seller or Buyer, (v) any representation made by Seller or Buyer shall have been incorrect or untrue in any material respect when made or repeated or deemed to have been made or repeated, or (vi) Seller or Buyer shall admit to the other its inability to, or its intention not to, perform any of its obligations hereunder (each an "Event of Default"):

(a) At the option of the non defaulting party, exercised by written notice to the defaulting party (which option shall be deemed to have been exercised, even if no notice is given, immediately upon the occurrence of an Act of Insolvency), the Repurchase Date for each Transaction hereunder shall be deemed immediately to occur.

(b) In all Transactions in which the defaulting party is acting as Seller, if the non defaulting party exercises or is deemed to have exercised the option referred to in subparagraph (a) of this Paragraph, (i) the defaulting party's obligations hereunder to repurchase all Purchased Securities in such Transactions shall thereupon become immediately due and payable, (ii) to the extent permitted by applicable law, the Repurchase Price with respect to each such Transaction shall be increased by the aggregate amount obtained by daily application of (x) the greater of the Pricing Rate for such Transaction or the Prime Rate to (y) the Repurchase Price for such Transaction as of the Repurchase Date as determined pursuant to subparagraph (a) of this Paragraph (decreased as of any day by (A) any amounts retained by the non defaulting party with respect to such Repurchase Price pursuant to clause (iii) of this subparagraph, (B) any proceeds from the sale of Purchased Securities pursuant to subparagraph (d) (i) of this Paragraph, and (C) any amounts credited to the account of the defaulting party pursuant to subparagraph (e) of this Paragraph) on a 360 day per year basis for the actual number of days during the period from and including the date of the Event of Default giving rise to such option to but excluding the date of payment of the Repurchase Price as so increased, (iii) all Income paid after such exercise or deemed exercise shall be retained by the non defaulting party and applied to the aggregate unpaid Repurchase Prices owed by the defaulting party, and (iv) the defaulting party shall immediately deliver to the non defaulting party any Purchased Securities subject to such Transactions then in the defaulting party's possession.

(c) In all Transactions in which the defaulting is acting as Buyer, upon tender by the non defaulting party of payment of the aggregate Repurchase Prices for all such Transactions, the defaulting party's right, title and interest in all Purchased Securities subject to such Transactions shall be deemed transferred to the non defaulting party, and the defaulting party shall deliver all such Purchased Securities to the non defaulting party.

(d) After one business day's notice to the defaulting party (which notice need not be given if an Act of Insolvency shall have occurred, and which may be the notice given under subparagraph (a) of this Paragraph or the notice referred to in clause (ii) of the first sentence of this Paragraph), the non defaulting party may :

(i) as to Transactions in which the defaulting party is acting as Seller, (A) immediately sell, in a recognized market at such price or prices as the non defaulting party may reasonably deem satisfactory, any or all Purchased Securities subject to such Transactions and apply the proceeds thereof to the aggregate unpaid Repurchase Prices and any other amounts owing by the defaulting party hereunder or (B) in its sole discretion elect, in lieu of selling all or a portion of such Purchased Securities, to give the defaulting party credit for such Purchased Securities in an amount equal to the price therefor on such date, obtained from a generally recognized source or the most recent closing bid quotation from such a source, against the aggregate unpaid Repurchase Prices and any other amounts owing by the defaulting party hereunder, and

(ii) as to Transactions in which the defaulting party is acting as Buyer, (A) purchase securities ("Replacement Securities") of the same class and amount as any Purchased Securities that are not delivered by the defaulting party to the non defaulting party as required hereunder or (B) in its sole discretion elect, in lieu of purchasing Replacement Securities, to be deemed to have purchased Replacement Securities at the price therefor on such date, obtained from a generally recognized source or the most recent closing bid quotation from such a source.

(e) As to Transactions in which the defaulting party is acting as Buyer, the defaulting party shall be liable to the non defaulting party (i) with respect to Purchased Securities (other than Additional Purchased Securities), for any excess of the price paid (or deemed paid) by the non defaulting party for Replacement Securities therefor over the Repurchase Price for such Purchased Securities and (ii) with respect to Additional Purchased Securities, for the price paid (or deemed paid) by the non defaulting party for the Replacement Securities, therefor. In addition, the defaulting party shall be liable to the non defaulting party for interest on such remaining liability with respect to each such purchase (or deemed purchase) of Replacement Securities from the date of such purchase (or deemed purchase) until paid in full by Buyer. Such interest shall be at a rate equal to the greater of the Pricing Rate for such Transaction or the Prime Rate.

(f) For purposes of this Paragraph 11, the Repurchase Price for each Transaction hereunder in respect of which the defaulting party is acting as Buyer shall not increase above the amount of such Repurchase Price for such Transaction determined as of the date of the exercise or deemed exercise by the non defaulting party of its option under subparagraph (a) of this Paragraph.

(g) The defaulting party shall be liable to the non defaulting party for the amount of all reasonable legal or other expenses incurred by the non defaulting party in connection with or as a consequence of an Event of Default, together with interest thereon at a rate equal to the greater of the Pricing Rate for the relevant Transaction or the Prime Rate.

(h) The non defaulting party shall have, in addition to its rights hereunder, any rights otherwise available to it under any other agreement or applicable law.

12. Single Agreement

Buyer and Seller acknowledge that, and have entered hereunto and will enter into each Transaction hereunder in consideration of and in reliance upon the fact that, all Transactions hereunder constitute a single business and contractual relationship and have been made in consideration of each other. Accordingly, each of Buyer and Seller agrees (i) to perform all of its obligations in respect of each Transaction hereunder, and that a default in the performance of any such obligations shall constitute a default by it in respect of all Transactions hereunder, (ii) that each of them shall be entitled to set off claims and apply property held by them in respect of any Transaction against obligations owing to them in respect of any other Transactions hereunder and (iii) that payments, deliveries and other transfers made by either of them in respect of any other Transaction shall be deemed to have been made in consideration of payments, deliveries and other transfers in respect of any other Transactions hereunder, and the obligations to make any such payments, deliveries and other transfers may be applied against each other and netted.

13. Notices and Other Communications

Unless another address is specified in writing by the respective party to whom any notice or other communication is to be given hereunder, all such notices or communications shall be in writing or confirmed in writing and delivered at the respective addresses set forth in Annex II attached hereto.

14. Entire Agreement; Severability

This Agreement shall supersede any existing agreements between the parties containing general terms and conditions for repurchase transactions. Each provision and agreement herein shall be treated as separate and independent from any other provision or agreement herein and shall be enforceable notwithstanding the unenforceability of any such other provision or agreement.

15. Non-assignability; Termination

The rights and obligations of the parties under this Agreement and under any Transaction shall not be assigned by either party without the prior written consent of the other party. Subject to the foregoing, this Agreement and any Transactions shall be binding upon and shall inure to the benefit of the parties and their respective successors and assigns. This Agreement may be canceled by either party upon giving written notice to the other, except that this Agreement shall, notwithstanding such notice, remain applicable to any Transactions then outstanding.

16. Governing Law

This Agreement shall be governed by the laws of the State of New York without giving effect to the conflict of law principles thereof.

17. No Waivers, Etc.

No express or implied waiver of any Event of Default by either party shall constitute a waiver of any other Event of Default and no exercise of any remedy hereunder by any party shall constitute a waiver of its right to exercise any other remedy hereunder. No modification or waiver of any provision of this Agreement and no consent by any party to a departure herefrom shall be effective unless and until such shall be in writing and duly executed by both of the parties hereto. Without limitation on any of the foregoing, the failure to give a notice pursuant to subparagraphs 4(a) or 4(b) hereof will not constitute a waiver of any right to do so at a later date.

18. Use of Employee Plan Assets

(a) If assets of an employee benefit plan subject to any provision of the Employee Retirement Income Security Act of 1974 ("ERISA") are intended to be used by either party hereto (the "Plan Party") in a Transaction, the Plan Party shall so notify the other party prior to the Transaction. The Plan Party shall represent in writing to the other party that the Transaction does not constitute a prohibited transaction under ERISA or is otherwise exempt therefrom, and the other party may proceed in reliance thereon but shall not be required so to proceed.

(b) Subject to the last sentence of subparagraph (a) of this Paragraph, any such Transaction shall proceed only if Seller furnishes or has furnished to Buyer its most recent available audited statement of its financial condition and its most recent subsequent unaudited statement of its financial condition.

(c) By entering into a Transaction pursuant to this Paragraph, Seller shall be deemed (i) to represent to Buyer that since the date of Seller's latest such financial statements, there has been no material adverse change in Seller's financial condition which Seller has not disclosed to Buyer, and (ii) to agree to provide Buyer with future audited and unaudited statements of its financial condition as they are issued, so long as it is a Seller in any outstanding Transaction involving a Plan Party.

19. Intent

(a) The parties recognize that each Transaction is a "repurchase agreement" as that term is defined in Section 101 of Title 11 of the United States Code, as amended (except insofar as the type of Securities subject to such Transaction or the term of such Transaction would render such definition inapplicable), and a "securities contract" as that term is defined in Section 741 of Title 11 of the United States Code, as amended.

(b) It is understood that either party's right to liquidate Securities delivered to it in connection with Transactions hereunder or to exercise any other remedies pursuant to Paragraph 11 hereof, is a contractual right to liquidate such Transaction as described in Sections 555 and 559 of Title 11 of the United States Code, as amended.

20. Disclosure Relating to Certain Federal Protections

The parties acknowledge that they have been advised that:

(a) in the case of Transactions in which one of the parties is a broker or dealer registered with the Securities and Exchange Commission ("SEC") under Section 15 of the Securities Exchange Act of 1934 ("1934 Act"), the Securities Investor Protection Corporation has taken the position that the provisions of the Securities Investor Protection Act of 1970 ("SIPA") do not protect the other party with respect to any Transaction hereunder;

(b) in the case of Transactions in which one of the parties is a government securities broker or a government securities dealer registered with the SEC under Section 15C of the 1934 Act, SIPA will not provide protection to the other party with respect to any Transaction hereunder; and

(c) in the case of Transactions in which one of the parties is a financial institution, funds held by the financial institution pursuant to a Transaction hereunder are not a deposit and therefore are not insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation or the National Credit Union Share Insurance Fund, as applicable.

[Name of Party]

[Name of Party]

By _____

By _____

Title _____

Title _____

Date _____

Date _____

D. Broker/Dealer Certification

**TEXAS PUBLIC FUNDS INVESTMENT ACT
ACKNOWLEDGMENTS**

These Acknowledgments are executed on behalf of the City of Rowlett ("Investor") and _____ ("Business Organization") pursuant to the Public Funds Investment Act, Chapter 2256, Government Code, Texas Codes Annotated (the "Act"), in connection with investment transactions conducted between the Investor and the Business Organization.

Acknowledgment by Investor

The undersigned investment officer of the Investor ("Investment Officer") hereby acknowledges, represents and agrees on behalf of the Investor that:

- (i) The Investment Officer (a) has been duly designated by official action of the governing body of the Investor to act as its Investment Officer pursuant to the Act, (b) is vested with full power and authority under the Act and other applicable law to engage in investment activities on behalf of the Investor, and (c) is duly authorized to execute this Acknowledgment on behalf of the Investor,
- (ii) Pursuant to the Act, the governing body of the Investor has duly adopted a written investment policy which complies with the Act, including an investment strategy (as the same may be amended, the "Investment Policy"), and the Investment Officer (a) has furnished a true and correct copy of the Investment Policy to the Business Organization and (b) will notify the Business Organization of any revision of, or amendment to, the Investment Policy. The Business Organization shall be entitled to rely upon the most recent version of the Investment Policy furnished by the Investment Officer until provided with an amended version;
- (iii) Attached hereto is a list of investments that are authorized pursuant to the Investment Policy and that the Investment Officer understands may be available from the Business Organization. The attached list may be amended from time to time by mutual agreement of the Investor and the Business Organization, and
- (iv) In connection with any investment transaction between the Business Organization and the Investor, the Business Organization is not responsible for assuring compliance with those aspects of the Investment Policy over which the Business Organization has no control or knowledge, such as restrictions as to diversity and average maturity, or which require an interpretation of subjective investment standards.

INVESTMENT OFFICER

Name: _____
Title: _____
Date: _____

Acknowledgment by Business Organization

In reliance upon the foregoing "Acknowledgment by Investor," the undersigned qualified representative of the Business Organization ("Qualified Representative") acknowledges, represents, and agrees on behalf of the Business Organization that:

- (I) The Qualified Representative (a) is registered under the rules of the National Association of Securities Dealers, (b) is the duly appointed and acting officer of the Business Organization, holding the office set forth underneath its name below, and (c) is duly authorized to execute this Certification on behalf of the Business Organization,
- (ii) The Qualified Representative has received and reviewed the Investment Policy furnished by the Investment Officer,
- (iii) The Business Organization will provide the Investment Officer with periodic account and other reasonably requested information that will assist the Investment Officer in carrying out his or her responsibility to make investment decisions consistent with the Investment Policy; and
- (iv) The Business Organization will not sell to the Investor investments other than those on the attached list, which may be amended from time to time by mutual agreement of the Investor and the Business Organization.

QUALIFIED REPRESENTATIVE

Name: _____
Title _____
Date: _____