# CASH MANAGEMENT/INVESTMENT POLICY

*(adopted July 2003)*

*Reviewed by the Treasurer Cyndi Livermore April 24, 2017*

## I. Scope

This policy applies to the investment of short-term operating funds under the supervision of the Treasurer. Longer-term funds, including investments of employees' investment retirement funds and proceeds from certain bond issues, as well as funds belonging to the Bedford Public Library and Trust Funds (as required by RSA 31:25) are covered by a separate investment policy.

1. **Pooling of Funds** Except for cash in certain restricted and special funds, the Town will consolidate cash balances from all funds, when it is advantageous, to maximize investment earnings. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

## II. General Objectives

The primary objectives, in priority order, of investment activities shall be safety (ie. risk rating), liquidity, and income and maturity. It is recognized that income is a product of yield to maturity, therefore; fixed income securities may be purchased either at a discount to minimize initial cash outlay and take advantage of capital appreciation, or at a premium to optimize cash flow when conditions warrant.

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

   a. **Credit Risk** The Town will minimize credit risk, the risk of loss due to the failure of the security issuer or backer, by:

   - Limiting investments to the safest types of securities
   - Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisers with which the Town will do business
   - Diversifying the investment portfolio so that potential losses on individual securities will be minimized.

**b. Interest Rate Risk** The Town will minimize the risk that the market value of securities in the portfolio will fall due to changes in general interest rates, by:

- Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity
- Investing operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools.

**2. Liquidity:** The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This will be accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands. Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets. A portion of the portfolio also may be placed in money market mutual funds or local government investment pools (NHPDIP), which offer same-day liquidity for short-term funds.

**3. Income/Yield:** The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The majority of investments are limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall not be sold prior to maturity with the following exceptions:

- A security with declining credit may be sold early to minimize loss of principal.
- A security swap would improve the quality, yield, or target duration in the portfolio.
- Liquidity needs of the portfolio require that the security be sold.

## III. Standards of Care

**1. Delegation of Authority:** Authority to manage the investment program is granted to the Treasurer (hereinafter referred to as investment officer) and derived from the following the Bedford Town Charter section 1-4-10. Responsibility for the operation of the investment program is hereby delegated to the investment officer, who shall act in accordance with established written procedures and internal controls for the operation of the investment program consistent with this investment policy. Procedures should include references to: safekeeping, delivery vs. payment, investment accounting, repurchase agreements, wire transfer agreements, and collateral/depository agreements. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the investment officer. The investment officer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials. The investment officer may delegate the daily operational responsibilities to the Finance Director.

**2. Prudence:** The standard of prudence to be used by investment officials shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and this investment 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 expectations are reported in a timely fashion and the liquidity and the sale of securities are carried out in accordance with the terms of this policy.

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.

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

## IV. Safekeeping and Custody

**1. Authorized Financial Dealers and Institutions** A list will be maintained of financial institutions authorized to provide investment services. In addition, a list also will be maintained of approved security broker/dealers selected by creditworthiness (e.g., a minimum capital requirement of $10,000,000 and at least five years of operation). These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).

All financial institutions and broker/dealers who desire to become qualified for investment transactions must supply the following as appropriate:

- Audited financial statements
- Proof of National Association of Securities Dealers (NASD) certification
- Proof of state registration
- Completed broker/dealer questionnaire
- Certification of having read and understood and agreeing to comply with the Town's investment policy.

An annual review of the financial condition and registration of qualified financial institutions and broker/dealers will be conducted by the investment officer.

From time to time, the investment officer may choose to invest in instruments offered by minority and community financial institutions. In such situations, a waiver to the criteria under Paragraph 1 may be granted. All terms and relationships will be fully disclosed prior to purchase and will be approved by the Town Manager with the consent of the Council in advance.

**2. Internal Controls:** The investment officer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the Town are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived and (2) the valuation of costs and benefits requires estimates and judgments by management.

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

- Control of collusion
- Separation of transaction authority from accounting and record-keeping
- Custodial safekeeping
- Avoidance of physical delivery securities
- Clear delegation of authority to subordinate staff members
- Written confirmation of transactions for investments and wire transfers
- Development of a wire transfer agreement with the lead bank and third-party custodian

**3. Delivery vs. Payment:** All trades where applicable will be executed by delivery vs. payment (DVP) to ensure that securities are deposited in an eligible financial institution prior to the release of funds. Securities will be held by a third-party custodian as evidenced by safekeeping receipts.

## V. Authorized Investment Instruments

**1. Investment Types:** *The following are approved investment vehicles as defined in RSA 6:8, 387:6, 387:6-a, and 387:14:*

<u>The New Hampshire Public Deposit Investment Pool (NHPDIP)</u>
United States Treasury Securities or securities with an unconditional guarantee of principal and interest by the federal government

<u>Federal Agency Securities</u>
Federal Farm Credit System, Federal Home Loan Banks, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, Student Loan Marketing Association, and Tennessee Valley Authority.

<u>Repurchase Agreements</u>
The underlying security must be U.S. government or agency securities with a market value equal to 100% of principal, and executed through any New Hampshire or Massachusetts bank that meets the following criteria:

1. The issuing (parent) bank must have assets in excess of $500 million.
2. Equity capital to asset ratio must equal or exceed 5%.
3. Non-performing assets to equity ratio may not exceed 35%.
4. The maximum maturity should not be greater than 180 days.

Repurchase Agreements may also be executed through any of the primary government security dealers as designated by the Federal Reserve.

Commercial Paper

All commercial paper must be from issuers having an A1/P1 rating or better and an AA or better long term debt rating from one or more of the primary rating agencies (Standard & Poor, Moody's and Fitch). The maximum maturity of commercial paper will be 30 days.

Money Market Funds

Shares of funds, which hold diversified portfolios and follow standard rules for such funds as issued by the Securities and Exchange Commission.

Certificates of Deposit

CDs of State or federally chartered banking institutions within a branch in New Hampshire are approved. The bank must meet the following three requirements:

1. The issuing (parent) bank must have Veribanc Inc.'s highest classification with assets in excess of $500 million.
2. Equity capital to asset ratio must equal or exceed 5%.
3. Non-performing assets to equity ratio may not exceed 35%.

Generally, the maximum maturity for a CD will be one year. However, a longer maturity term may be issued provided that there are no penalties for early withdrawal and accrued interest will be credited up to the date of withdrawal.

**2. Collateralization:** Where allowed by state law and in accordance with the GFOA Recommended Practices on the Collateralization of Public Deposits, full collateralization will be required on non-negotiable certificates of deposit.

## VI. Investment Parameters

**1. Diversification** The investments shall be diversified by:

- limiting investments to avoid overconcentration in securities from a specific issuer or business sector (excluding U.S. Treasury securities),
- limiting investment in securities that have higher credit risks,
- investing in securities with varying maturities, and
- continuously investing a portion of the portfolio in readily available funds such as local government investment pools (LGIPs), money market funds or overnight repurchase agreements to ensure that appropriate liquidity is maintained in order to meet ongoing obligations

**2. Maximum Maturities** To the extent possible, the Town shall attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the Town will not directly invest in securities maturing more than five (5) years from the date of purchase or in accordance with state and local statutes and ordinances. This paragraph shall not limit the investment officer's ability to invest in longer-term securities provided that such investment is in the best interest of the Town and provides a greater net return.

## VII. Reporting

**1. Methods:** The investment officer shall prepare an investment report at least bi-annually, including a management summary that provides an analysis of the status of the current investment portfolio and transactions made over the last quarter. This management summary will be prepared in a manner which will allow the Town to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report will be provided to the investment officer, the Town Manager and Town Council. The report will include the following:

- Listing of individual securities held at the end of the reporting period.
- Realized and unrealized gains or losses resulting from appreciation or depreciation by listing the cost and market value of securities over one-year duration that are not intended to be held until maturity (in accordance with Governmental Accounting Standards Board (GASB) requirements).
- Average weighted yield to maturity of portfolio on investments as compared to applicable benchmarks.
- Listing of investment by maturity date.
- Percentage of the total portfolio, which each type of investment represents.

**2. Performance Standards:** The investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio should obtain a market average rate of return during a market/economic environment of stable interest rates. A series of appropriate benchmarks shall be established against which portfolio performance shall be compared on a regular basis.

**3. Marking to Market:** The market value of the portfolio shall be calculated at least bi-annually and a statement of the market value of the portfolio shall be issued at least bi-annually. This will ensure that review of the investment portfolio, in terms of value and price volatility, has been performed.

## VIII. Policy Considerations

**1. Exemption** Any investment currently held that does not meet the guidelines of this policy shall be exempted from the requirements of this policy. At maturity or liquidation, such monies shall be reinvested only as provided by this policy.

**2. Amendments** This policy shall be reviewed on an annual basis. Any changes to this policy must be approved by the investment officer, Town Manager and Town Council.

## Appendix 1: Glossary of Cash Management Terms

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

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

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

**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.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Delivery Versus Payment (DVP)** - A type of securities transaction in which the purchaser pays for the securities when they are delivered either to the purchaser or his/her custodian.

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

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

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

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

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

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

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

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

**Interest Rate** - See "Coupon Rate."

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

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

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

**Investment Company Act of 1940**- Federal legislation which 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 Policy** - A concise and clear statement of the objectives and parameters formulated by an investor or investment manager for a portfolio of investment securities.

**Investment-grade Obligations** - An investment instrument suitable for purchase by institutional investors under the prudent person rule. Investment-grade is restricted to those obligations rated BBB or higher by a rating agency.
**Liquidity** - An asset that can be converted easily and quickly into cash.
**Local Government Investment Pool (LGIP)** - An investment by local governments in which their money is pooled as a method for managing local funds.
**Mark-to-market** - The process whereby the book value or collateral value of a security is adjusted to reflect its current market value.
**Market Risk** - The risk that the value of a security will rise or decline as a result of changes in market conditions.
**Market Value** - Current market price of a security.
**Maturity** - The date on which payment of a financial obligation is due. The final stated maturity is the date on which the issuer must retire a bond and pay the face value to the bondholder. See "Weighted Average Maturity."
**Money Market Mutual Fund** - Mutual funds that invest solely in money market instruments (short-term debt instruments, such as Treasury bills, commercial paper, bankers' acceptances, repos and federal funds).
**Mutual Fund** - An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments. Mutual funds are regulated by the Investment Company Act of 1940 and must abide by the following Securities and Exchange Commission (SEC) disclosure guidelines:

1. Report standardized performance calculations.
2. Disseminate timely and accurate information regarding the fund's holdings, performance, management and general investment policy.
3. Have the fund's investment policies and activities supervised by a board of trustees, which are independent of the adviser, administrator or other vendor of the fund.
4. Maintain the daily liquidity of the fund's shares.
5. Value their portfolios on a daily basis.
6. Have all individuals who sells SEC-registered products licensed with a self-regulating organization (SRO) such as the National Association of Securities Dealers (NASD).
7. Have an investment policy governed by a prospectus which is updated and filed by the SEC annually.

**Mutual Fund Statistical Services** - Companies that track and rate mutual funds, e.g., IBC/Donoghue, Lipper Analytical Services, and Morningstar.
**National Association of Securities Dealers (NASD)** - A self-regulatory organization (SRO) of brokers and dealers in the over-the-counter securities business. Its regulatory mandate includes authority over firms that distribute mutual fund shares as well as other securities.

**Net Asset Value** - The market value of one share of an investment company, such as a mutual fund. This figure is calculated by totaling a fund's assets which includes securities, cash, and any accrued earnings, subtracting this from the fund's liabilities and dividing this total by the number of shares outstanding. This is calculated once a day based on the closing price for each security in the fund's portfolio. (See below.) [(Total assets) - (Liabilities)]/(Number of shares outstanding)

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

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

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

**Par** - Face value or principal value of a bond, typically $1,000 per bond.

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

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

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

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

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

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

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

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

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

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

**Rule 2a-7 of the Investment Company Act** - Applies to all money market mutual funds and mandates such funds to maintain certain standards, including a 13- month maturity limit and a 90-day average maturity on investments, to help maintain a constant net asset value of one dollar ($1.00).

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

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

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

**Swap** - Trading one asset for another.

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

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

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

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

**Treasury Bonds** - Long-term U.S. government debt securities with maturities of ten years or longer and issued in minimum denominations of $1,000. Currently, the longest outstanding maturity for such securities is 30 years.

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

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

**"Volatility Risk" Rating** - A rating system to clearly indicate the level of volatility and other non-credit risks associated with securities and certain bond funds. The ratings for bond funds range from those that have extremely low sensitivity to changing market conditions and offer the greatest stability of the returns ("aaa" by S&P; "V-1" by Fitch) to those that are highly sensitive with currently identifiable market volatility risk ("ccc-" by S&P, "V-10" by Fitch).

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

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

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

**Yield-to-call (YTC)** - The rate of return an investor earns from a bond assuming the bond is redeemed (called) prior to its nominal maturity date. Yield Curve - A graphic representation that depicts the relationship at a given point in time between yields and maturity for bonds that are identical in every way except maturity. A normal yield curve may be alternatively referred to as a positive yield curve.

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

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

## Appendix 2: Investment Pools

### 1. Definition

In most states, there are provisions for the creation and operation of a government investment pool. The purpose of a pool is to allow political subdivisions to pool investable funds in order to achieve a potentially higher yield.

There are basically three (3) types of pools: 1) state-run pools; 2) pools that are operated by a political subdivision where allowed by law and the political subdivision is the trustee; and 3) pools that are operated for profit by third parties. Prior to any political subdivision being involved with any type of pool, a thorough investigation of the pool and its policies and procedures must be reviewed.

### 2. Pool Questionnaire

Prior to entering a pool, the following questions and issues should be considered:

**Securities:** Government pools may invest in a broader range of securities than an entity may invest in. It is important to be aware of, and comfortable with, the securities a pool buys. The following is a list of questions an investment officer may wish to ask a prospective pool:

1. Does the pool provide a written statement of investment policy and objectives?
2. Does the statement contain:

    a. a description of eligible investment instruments?
    b. the credit standards for investments?
    c. the allowable maturity range of investments?
    d. the maximum allowable dollar weighted average portfolio maturity?
    e. the limits of portfolio concentration permitted for each type of security?
    f. the policy on reverse repurchase agreements, options, short sales and futures?

3. Are changes in the policies communicated to the pool participants?
4. Does the pool contain only the types of securities that are permitted by your investment policy?

**Interest:** Interest is not reported in a standard format, so it is important to know how interest is quoted, calculated, and distributed in order to make comparisons with other investment alternatives.

## Interest Calculations

5. Does the pool disclose the following about yield calculations:

    a. the methodology used to calculate interest? (simple maturity, yield to maturity, etc.)
    b. the frequency of interest payments?
    c. how interest is paid? (credited to principal at the end of the month, each quarter; mailed?)
    d. how are gains/losses reported? factored monthly or only when realized?

## Reporting

6. Is the yield reported to participants of the pool monthly? (If not, how often?)
7. Are expenses of the pool deducted before quoting the yield?
8. Is the yield generally in line with the market yields for other investment alternatives?
9. How often does the pool report? What information does that report include? Does it include the market value of securities?

**Security:** The following questions are designed to help safeguard funds from loss of principal and loss of market value.

10. Does the pool disclose safekeeping practices?
11. Is the pool subject to audit by an independent auditor at least annually?
12. Is a copy of the audit report available to participants?
13. Who makes the portfolio decisions?
14. How does the manager monitor the credit risk of the securities in the pool?
15. Is the pool monitored by someone on the board of a separate neutral party external to the investment function to ensure compliance with written policies?
16. Does the pool have specific policies with regard to the various investment vehicles?

    a. What are the different investment alternatives?
    b. What are the policies for each type of investment?

17. Does the pool mark the portfolio to its market value?
18. Does the pool disclose the following about how portfolio securities are valued:

    a. the frequency with which the portfolio securities are valued?
    b. the method used to value the portfolio (cost, current value, or some other method)?

**Operations:** The answers to these questions will help determine whether this pool meets the entity's operational requirements:

19. Does the pool limit eligible participants?
20. What entities are permitted to invest in the pool?
21. Does the pool allow multiple accounts and sub-accounts?
22. Is there a minimum or maximum account size?
23. Does the pool limit the number of transactions each month? What is the number of transactions permitted each month?
24. Is there a limit on transaction amounts for withdrawals and deposits?

    a. What is the minimum and maximum withdrawal amount permitted?
    b. What is the minimum and maximum deposit amount permitted?

25. How much notice is required for withdrawals/deposits?
26. What is the cutoff time for deposits and withdrawals?
27. Can withdrawals be denied?
28. Are the funds 100 percent withdrawable at anytime?
29. What are the procedures for making deposits and withdrawals?

    a. What is the paperwork required, if any?
    b. What is the wiring process?

30. Can an account remain open with a zero balance?
31. Are confirmations sent following each transaction?

**Statements:** It is important for (the designated official) and the agency's trustee (when applicable), to receive statements monthly so the pool's records of activity and holdings are reconciled by (the designated official) and its trustee.

32. Are statements for each account sent to participants?

    a. What are the fees?
    b. How often are they passed?
    c. How are they paid?
    d. Are there additional fees for wiring funds? (What is the fee?)

33. Are expenses deducted before quoting the yield?

**Questions to Consider for Bond Proceeds:** It is important to know (1) whether the pool accepts bond proceeds and (2) whether the pool qualifies with the U.S. Department of the Treasury as an acceptable commingled fund for arbitrage purposes.

34. Does the pool accept bond proceeds subject to arbitrage rebate?
35. Does the pool provide accounting and investment records suitable for proceeds of bond issuance subject to arbitrage rebate?

36. Will the yield calculation reported by the pool be acceptable to the IRS or will it have to be recalculated?
37. Will the pool accept transaction instructions from a trustee?
38. Are separate accounts allowed for each bond issue so that the interest earnings of funds subject to rebate are not commingled with funds not subject to regulations?