Buncombe County
Investment Policy

SCOPE

This policy applies to all financial assets of Buncombe County except authorized petty cash accounts and trust funds administered by the Social Services Director. Proceeds of debt issuance shall be invested in accordance with the County's general investment philosophy as set forth in this policy; however, such proceeds are to be invested pursuant to the permitted investment provisions of their specific bond documents. The County pools the cash resources of its various funds into a single pool in order to maximize investment opportunities. These funds are accounted for in the County's Comprehensive Annual Financial Report. Each fund's portion of total cash and investments is summarized by fund type in the combined balance sheet as equity or deficit in pooled cash and investments. This policy applies to all transactions involving the financial assets and related activity of all the various funds accounted for in the County's Comprehensive Annual Financial Report.

OBJECTIVES

1. Safety

Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To attain this objective, the County will diversify its investments by investing funds among a variety of securities with independent returns.

2. Liquidity

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands **(static liquidity)**. Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets **(dynamic liquidity)**.

3. Return on Investments

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 least importance compared to the safety and liquidity objectives described above. The core of investments are limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed.

STANDARDS OF CARE

1. 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 judgement 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.

2. 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 any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of their entity.

3. Delegation of Authority

Authority to manage the investment program is granted to the Finance Director by North Carolina General Statute 159-30(a). Responsibility for the operation of the investment program is delegated by the Finance Director to the Investment Officer or other County employee who shall carry out established written procedures and internal controls for the operation of the investment program consistent with this investment policy. Procedures shall include references to: safekeeping, delivery v. payment, investment accounting, repurchase agreements, wire transfer agreements, collateral/depository agreements, and banking service contracts. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Finance Director. The Finance Director shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

The County may engage the support services of advisors, consultants and professionals in regard to its investment program, so long as it can be clearly demonstrated that these services produce a net financial advantage or necessary financial protection of the County's financial resources. Investment Advisors shall be registered with the Securities Exchange Commission under the Investment Advisors Act of 1940. Advisors shall be selected using the County's authorized purchasing procedures for selection of professional services. Advisors shall be subject to the provisions of this Policy, and shall not, under any circumstances, take custody of any County funds or securities.

SAFEKEEPING AND CUSTODY

1. Authorized Financial Dealer and Institution

A list will be maintained of financial institutions authorized to provide investment services. In addition, a list will also be maintained of approved security broker/dealers selected by creditworthiness (minimum capital requirement $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 Rule 15C3-1 (uniform net capital rule).

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

a. Audited financial statements;

b. Proof of Financial Industry Regulatory Authority (FINRA) certification;

c. Proof of state registration;

d. Completed broker/dealer questionnaire; and

e. Certification of having read North Carolina General Statute 159-30(c) and the entity's Investment Policy.

An annual review of the financial condition and registration of qualified bidders will be conducted by the Finance Director.

Selection of broker/dealers used by an external investment adviser retained by the County will be at the sole discretion of the adviser. Where possible, transactions with broker/dealers shall be selected on a competitive basis and their bid or offering prices shall be recorded. If there is no other readily available competitive offering, best efforts will be made to document quotations for comparable or alternative securities. When purchasing original issue instrumentality securities, no competitive offerings will be required as all dealers in the selling group offer those securities at the same original issue price.

The County may purchase commercial paper from direct issuers even though they are not on the approved broker/dealer list as long as the paper meets the criteria outlined in item 1.f. of the section titled "Suitable and Authorized Investments."

To the extent practicable, the Finance Director shall endeavor to complete investment transactions using a competitive bid process whenever possible. At least three broker/dealers shall be contacted for each transaction and their bid and offering prices shall be recorded. If the County is offered a security for which there is no other readily available competitive offering, then quotations on comparable or alternative securities will be recorded.

2. Internal Controls

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

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

a. **Control of collusion.** Collusion is a situation where two or more employees are working in conjunction to defraud their employer.

b. **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.

c. **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.

d. **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.

e. **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.

f. **Written confirmation of telephone transactions for investments and wire transfers.** Due to the potential for error and improprieties arising from telephone transactions, all telephone transactions should be supported by written communications and approved by the appropriate person. Written communications may be via fax if on letterhead and the safekeeping institution has a list of authorized signatures.

g. **Development of a wire transfer agreement with the lead bank or third party custodian.** This agreement should outline the various controls, security provisions, and delineate responsibilities of each party making and receiving wire transfers.

3. Delivery vs. Payment

All trades where applicable will be executed by Delivery vs. Payment (DVP). This ensures that securities are deposited in the eligible financial institution prior to the release of funds. Securities will be held by a third party custodian as evidenced by safekeeping receipts.

SUITABLE AND AUTHORIZED INVESTMENTS

1. Investment Types

Except as specifically defined in this Policy, all investments of the County shall be made in accordance with applicable laws contained in North Carolina General Statute 159-30(c). Any revisions or extensions of this section will be assumed to be part of this Investment Policy immediately upon the effective date thereof.

Only the following investments will be permitted by this policy:

a. Obligations of the United States or obligations fully guaranteed both as to principal and interest by the United States.

- Maturities shall not exceed five years from the date of trade settlement.
- There are no limits on the dollar amount or percentage that the County may invest in obligations fully guaranteed by the United States.

b. Obligations of the Federal Financing Bank, the Federal Farm Credit Bank, the

Bank for Cooperatives, the Federal Intermediate Credit Bank, the Federal Land Banks, the Federal Home Loan Banks, the Federal Home Loan Mortgage Corporation, Fannie Mae, the Government National Mortgage Association, the Federal Housing Administration, the Farmers Home Administration, the United States Postal Service.

- Maturities shall not exceed five years from the date of trade settlement.
- There are no limits on the dollar amount or percentage that the County may invest in the aforementioned federal agency and instrumentality securities.
- No more than 35% of the total portfolio may be invested in any single Agency/instrumentality issuer listed above.

c. Obligations of the State of North Carolina

- Maturities shall not exceed five years from the date of trade settlement.
- The securities are rated in a rating category of "A" or its equivalent or better by at least two nationally recognized statistical rating organizations ("NRSROs") at the time of purchase.
- The combined total investment in Obligations of the State of North Carolina and Obligations of any North Carolina local government or public authority may not exceed 30% of the total portfolio.
- No more than 5% of the total portfolio may be invested in the securities of any single issuer.

d. Bonds and notes of any North Carolina local government or public authority, subject to such restrictions as the Secretary of the Local Government Commission may impose.

- Maturities shall not exceed five years from the date of trade settlement.
- The securities are rated in a rating category of "A" or its equivalent or better by at least two nationally recognized statistical rating organizations ("NRSROs") at the time of purchase.
- The combined total investment in Obligations of the State of North Carolina and Obligations of any North Carolina local government or public authority may not exceed 30% of the total portfolio.
- No more than 5% of the total portfolio may be invested in the securities of any single issuer.

e. Deposits at interest or savings certificates of deposit with any bank, savings and loan association or trust company in North Carolina, provided such deposits or certificates of deposit are fully collateralized.

- Maturities shall not exceed five years from the date of trade settlement.
- No more than 30% of the total portfolio may be invested in certificates of deposit.
- No more than 10% of the total portfolio may be invested in any one issuer.

f. Prime quality commercial paper bearing the highest rating at the time of purchase of at least one nationally recognized rating service and not bearing a rating below the highest (A1, P1, F1) by any nationally recognized rating service which rates the particular obligation.

- The combined total investment in commercial paper and bankers' acceptances may not exceed twenty-five (25%) of the total portfolio.
- No more than 5% of the total portfolio may be invested in the securities of any single issuer.

g. Banker's Acceptances provided the accepting bank or its holding company is either (1) incorporated in the State of North Carolina or (2) has outstanding publicly held obligations bearing the highest rating at the time of purchase of at least one nationally recognized rating service and not bearing a rating below the highest (Aaa or AAA) by any nationally recognized rating service which rates the particular obligations.

- The combined total investment in commercial paper and bankers' acceptances may not exceed twenty-five (25%) of the total portfolio.
- No more than 5% of the total portfolio may be invested in the securities of any single issuer.

h. Participating shares in a mutual fund for local government investment (such as the N.C. Capital Management Trust) which is certified by the N.C. Local Government Commission; a commingled investment pool established and administered by the State Treasurer pursuant to G.S. 147-69.3; a commingled investment pool established by interlocal agreement by two or more units of local government pursuant to G.S. 160-A-460 through G.S. 160A-464, if the investment of the pool are limited to those qualifying for investment under G.S. 159-30(c). There are no limits on the dollar amount or percentage that the County may invest in funds or pools for local government investment as described in this section.

i. Repurchase agreements with terms pursuant to G.S. 159-30(c), collateralized with direct obligations of the United States and maintained at a level of at least 102% of the market value of the Repurchase Agreement. There are no limits on the dollar amount or percentage that the Agency may invest, provided that:

- Securities used as collateral for Repurchase Agreements will be delivered to an acceptable third party custodian.
- Repurchase Agreements are subject to a Master Repurchase Agreement between the Agency and the provider of the repurchase agreement. The Master Repurchase Agreement will be substantially in the form developed by the Securities Industry and Financial Markets Association (SIFMA).
- The maximum maturity does not exceed one (1) year.

Prohibited Investment Vehicles and Practices

State law notwithstanding, any investments not specifically authorized pursuant to this approved Investment Policy are prohibited, including but not limited to:

- Futures and options
- Investment in inverse floaters, range notes, or mortgage derived interest-only strips
- Investment in any security that could result in a zero interest accrual if held to maturity
- Trading securities for the sole purpose of speculating on the future direction of interest rates
- Purchasing or selling securities on margin
- The purchase of foreign currency denominated securities

Investment Pools

The County shall conduct a thorough investigation of any local government investment pool or fund prior to making an investment, and on a continual basis thereafter. There shall be a questionnaire developed which will answer the following general questions:

1. A description of eligible investment securities, and a written statement of investment policy and objectives.

2. A description of interest calculations and how it is distributed, and how gains and losses are treated.

3. A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced and the program audited.

4. A description of who may invest in the program, how often, what size deposit and withdrawal are allowed.

5. A schedule for receiving statements and portfolio listings.

6. Are reserves, retained earnings, etc. utilized by the pool/fund?

7. A fee schedule, and when and how is it assessed.

8. Is the pool/fund eligible for bond proceeds and/or will it accept such proceeds?

Maximum Maturities

To the extent possible, investments shall be matched with anticipated cash flow requirements and known future liabilities.

The County will not invest in securities maturing more than 5 years from the date of trade settlement, unless the Board of County Commissioners has by resolution granted authority to make such an investment.

RISK MANAGEMENT AND DIVERSIFICATION

MITIGATING CREDIT RISK IN THE PORTFOLIO

Credit risk is the risk that a security or a portfolio will lose some or all of its value due to a real or perceived change in the ability of the issuer to repay its debt. The County will mitigate credit risk by adopting the following strategies:

- The diversification requirements included in the “Suitable and Authorized Investments” section of this policy are designed to mitigate credit risk in the portfolio.

- No more than 5% of the total portfolio may be invested in securities of any single issuer of North Carolina state and municipal bonds, prime commercial paper, or bankers’ acceptances, as further described in the “Suitable and Authorized Investments” section of this policy.

- The County may elect to sell a security prior to its maturity and record a capital gain or loss in order to improve the quality, liquidity or yield of the portfolio in response to market conditions or the County's risk preferences.

- If securities owned by the County are downgraded by a nationally recognized statistical ratings organization (NRSRO) to a level below the quality required by this Investment Policy, it will be the County's policy to review the credit situation and make a determination as to whether to sell or retain such securities in the portfolio.

- If a security is downgraded, the Finance Director will use discretion in determining whether to sell or hold the security based on its current maturity, the economic outlook for the issuer, and other relevant factors.

- If a decision is made to retain a downgraded security in the portfolio, its presence in the portfolio will be monitored and reported monthly to the Board of County Commissioners.

MITIGATING MARKET RISK IN THE PORTFOLIO

Market risk is the risk that the portfolio value will fluctuate due to changes in the general level of interest rates. The County recognizes that, over time, longer-term portfolios have the potential to achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The County will mitigate market risk by providing adequate liquidity for short-term cash needs, and by making longer-term investments only with funds that are not needed for current cash flow purposes.

The County further recognizes that certain types of securities, including variable rate securities, securities with principal pay downs prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments. The County, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

- The County shall maintain at least 10% of its total portfolio in instruments maturing in 90 days or less to provide sufficient liquidity for expected disbursements.

- The maximum percent of callable securities (does not include "make whole call" securities as defined in the Glossary) in the portfolio will be 20%.

- The maximum stated final maturity of individual securities in the portfolio will be five years, except as otherwise stated in this policy.

The duration of the portfolio will at all times be approximately equal to the duration (typically, plus or minus 20%) of a Market Benchmark, an index selected by the County based on the County's investment objectives, constraints and risk tolerances.

REPORTING

1. Methods

The Investment Officer shall submit a monthly investment report to the Finance Director. The report shall include a general description of the portfolio in terms of investment securities, maturities, yields and other features. The report will show investment earnings for the month and fiscal year-to-date, including the annualized earned yield percentage for the portfolio. The report will compare actual investment earnings with budgeted earnings.

The Finance Director shall prepare an investment report at least semi- annually, including a succinct management summary that provides a clear picture of the status of the current investment portfolio and transactions made over the last six months. This management summary will be prepared in a manner which will disclose whether investment activities during the reporting period have conformed to the investment policy. The report shall be provided to the County Manager and the Board of County Commissioners. The report will include the following at a minimum:

a. An asset listing showing par value, cost and independent third-party fair market value of each security as of the date of the report, the source of the valuation, type of investment, issuer, maturity date, and interest rate.

b. Transactions for the period.

c. A description of the funds, investments and programs managed by contracted parties (i.e. local government investment pools)

d. A one-page summary report that shows:

- Average maturity of the portfolio and modified duration of the portfolio;
- Maturity distribution of the portfolio;
- Percentage of the portfolio represented by each investment category;
- Average portfolio credit quality; and,
- Time-weighted total rate of return for the portfolio for the prior one month, three months, twelve months and since inception compared to the County’s market benchmark returns for the same periods;

e. A statement of compliance with the Investment Policy, including a schedule of any transactions or holdings which do not comply with this Policy or with North Carolina General Statutes, including a justification for their presence in the portfolio and a timetable for resolution.

2. Performance Standards

The investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio shall obtain a market average rate of return throughout budgetary and economic cycles, taking into account the County's risk constraints, the cash flow characteristics of the portfolio, and state and local laws, ordinances or resolutions that restrict investments.. The Finance Director shall monitor and evaluate the portfolio's performance relative to a market benchmark, which will be included in the Finance Director's periodic reports. The Finance Director shall select an appropriate, readily available index to use as a market benchmark.

POLICY

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. Amendment

This policy shall be reviewed on an annual basis. Any changes must be approved by the County Manager and the Board of County Commissioners as well as the individual(s) charged with maintaining internal controls.

ADOPTED 05/19/2020

Buncombe County Finance Director/Chief Financial Officer

Glossary of Investment Terms

AGENCIES. Shorthand market terminology for any obligation issued by a government-sponsored entity (GSE), or a federally related institution. Most obligations of GSEs are not guaranteed by the full faith and credit of the US government.

Examples are:

FFCB. The Federal Farm Credit Bank System provides credit and liquidity in the agricultural industry. FFCB issues discount notes and bonds.

FHLB. The Federal Home Loan Bank provides credit and liquidity in the housing market. FHLB issues discount notes and bonds.

FHLMC. Like FHLB, the Federal Home Loan Mortgage Corporation provides credit and liquidity in the housing market. FHLMC, also called "FreddieMac" issues discount notes, bonds and mortgage pass-through securities.

FNMA. Like FHLB and FreddieMac, the Federal National Mortgage Association was established to provide credit and liquidity in the housing market. FNMA, also known as "FannieMae," issues discount notes, bonds and mortgage pass-through securities.

GNMA. The Government National Mortgage Association, known as "GinnieMae," issues mortgage pass-through securities, which are guaranteed by the full faith and credit of the US Government.

ASKED. The price at which a seller offers to sell a security.

BANKER'S ACCEPTANCE. A money market instrument created to facilitate international trade transactions. It is highly liquid and safe because the risk of the trade transaction is transferred to the bank which "accepts" the obligation to pay the investor.

BENCHMARK. A comparison security or portfolio. A performance benchmark is a partial market index, which reflects the mix of securities allowed under a specific investment policy.

BID. The price at which a buyer offers to buy a security.

BROKER. A broker brings buyers and sellers together for a transaction for which the broker receives a commission. A broker does not sell securities from his own position.

CALLABLE. A callable security gives the issuer the option to call it from the investor prior to its maturity. The main cause of a call is a decline in interest rates. If interest rates decline since securities are issued, the issuer will likely call its current securities and reissue them at a lower rate of interest. Callable securities have reinvestment risk as the investor may receive its principal back when interest rates are lower than when the investment was initially made.

CERTIFICATE OF DEPOSIT (CD). A time deposit with a specific maturity evidenced by a certificate. Large denomination CDs may be marketable.

CERTIFICATE OF DEPOSIT ACCOUNT REGISTRY SYSTEM (CDARS). A private placement service that allows local agencies to purchase more than $250,000 in CDs from a single financial institution (must be a participating institution of CDARS) while still maintaining FDIC insurance coverage. CDARS is currently the only entity providing this service. CDARS facilitates the trading of deposits between the institution and other participating institutions in amounts that are less than $250,000 each, so that FDIC coverage is maintained.

COLLATERAL. Securities or cash pledged by a borrower to secure repayment of a loan or repurchase agreement. Also, securities pledged by a financial institution to secure deposits of public monies.

COMMERCIAL PAPER. The short-term unsecured debt of corporations.

COST YIELD. The annual income from an investment divided by the purchase cost. Because it does not give effect to premiums and discounts which may have been included in the purchase cost, it is an incomplete measure of return.

COUPON. The rate of return at which interest is paid on a bond.

CREDIT RISK. The risk that principal and/or interest on an investment will not be paid in a timely manner due to changes in the condition of the issuer.

CURRENT YIELD. The annual income from an investment divided by the current market value. Since the mathematical calculation relies on the current market value rather than the investor’s cost, current yield is unrelated to the actual return the investor will earn if the security is held to maturity.

DEALER. A dealer acts as a principal in security transactions, selling securities from and buying securities for his own position.

DEBENTURE. A bond secured only by the general credit of the issuer.

DELIVERY VS. PAYMENT (DVP). A securities industry procedure whereby payment for a security must be made at the time the security is delivered to the purchaser’s agent.

DERIVATIVE. Any security that has principal and/or interest payments which are subject to uncertainty (but not for reasons of default or credit risk) as to timing and/or amount, or any security which represents a component of another security which has been separated from other components (“Stripped” coupons and principal). A derivative is also defined as a financial instrument the value of which is totally or partially derived from the value of another instrument, interest rate, or index.

DISCOUNT. The difference between the par value of a bond and the cost of the bond, when the cost is below par. Some short-term securities, such as T-bills and banker's acceptances, are known as discount securities. They sell at a discount from par, and return the par value to the investor at maturity without additional interest. Other securities, which have fixed coupons, trade at a discount when the coupon rate is lower than the current market rate for securities of that maturity and/or quality.

DIVERSIFICATION. Dividing investment funds among a variety of investments to avoid excessive exposure to any one source of risk.

DURATION. The weighted average time to maturity of a bond where the weights are the present values of the future cash flows. Duration measures the price sensitivity of a bond to changes in interest rates. (See modified duration).

FEDERAL FUNDS RATE. The rate of interest charged by banks for short-term loans to other banks. The Federal Reserve Bank through open-market operations establishes it.

FEDERAL OPEN MARKET COMMITTEE. A committee of the Federal Reserve Board that establishes monetary policy and executes it through temporary and permanent changes to the supply of bank reserves.

LEVERAGE. Borrowing funds in order to invest in securities that have the potential to pay earnings at a rate higher than the cost of borrowing.

LIQUIDITY. The speed and ease with which an asset can be converted to cash.

LOCAL GOVERNMENT INVESTMENT POOL. Investment pools such N.C. Capital Management Trust certified by the NC Local Government Commission, a commingled investment pool established and administered by the State Treasurer pursuant to G.S. 147-69.3; a commingled investment pool established by interlocal agreement by two or more units of local government. These funds are not subject to the same SEC rules applicable to money market mutual funds.

MAKE WHOLE CALL. A type of call provision on a bond that allows the issuer to pay off the remaining debt early. Unlike a call option, with a make whole call provision, the issuer makes a lump sum payment that equals the net present value (NPV) of future coupon payments that will not be paid because of the call. With this type of call, an investor is compensated, or "made whole."

MARGIN. The difference between the market value of a security and the loan a broker makes using that security as collateral.

MARKET RISK. The risk that the value of securities will fluctuate with changes in overall market conditions or interest rates.

MARKET VALUE. The price at which a security can be traded.

MARKING TO MARKET. The process of posting current market values for securities in a portfolio.

MATURITY. The final date upon which the principal of a security becomes due and payable.

MEDIUM TERM NOTES. Unsecured, investment-grade senior debt securities of major corporations which are sold in relatively small amounts on either a continuous or an intermittent basis. MTNs are highly flexible debt instruments that can be structured to respond to market opportunities or to investor preferences.

MODIFIED DURATION. The percent change in price for a 100 basis point change in yields. Modified duration is the best single measure of a portfolio's or security's exposure to market risk.

MONEY MARKET. The market in which short-term debt instruments (T-bills, discount notes, commercial paper, and banker's acceptances) are issued and traded.

MUNICIPAL SECURITIES. Securities issued by state and local agencies to finance capital and operating expenses.

MUTUAL FUND. An entity which pools the funds of investors and invests those funds in a set of securities which is specifically defined in the fund's prospectus. Mutual funds can be invested in various types of domestic and/or international stocks, bonds, and money market instruments, as set forth in the individual fund's prospectus. For most large, institutional investors, the costs associated with investing in mutual funds are higher than the investor can obtain through an individually managed portfolio.

NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO). A credit rating agency that the Securities and Exchange Commission in the United States uses for regulatory purposes. Credit rating agencies provide assessments of an investment's risk. The issuers of investments, especially debt securities, pay credit rating agencies to provide them with ratings. The three most prominent NRSROs are Fitch, S&P, and Moody's.

NEGOTIABLE CD. A short-term debt instrument that pays interest and is issued by a bank, savings or federal association, state or federal credit union, or state-licensed branch of a foreign bank. Negotiable CDs are traded in a secondary market and are payable upon order to the bearer or initial depositor (investor).

PREMIUM. The difference between the par value of a bond and the cost of the bond, when the cost is above par.

PRIMARY DEALER. A financial institution (1) that is a trading counterparty with the Federal Reserve in its execution of market operations to carry out U.S. monetary policy, and (2) that participates for statistical reporting purposes in compiling data on activity in the U.S. Government securities market.

PRUDENT PERSON (PRUDENT INVESTOR) RULE. A standard of responsibility which applies to fiduciaries.

REALIZED YIELD. The change in value of the portfolio due to interest received and interest earned and realized gains and losses. It does not give effect to changes in market value on securities, which have not been sold from the portfolio.

REGIONAL DEALER. A financial intermediary that buys and sells securities for the benefit of its customers without maintaining substantial inventories of securities and that is not a primary dealer.

REPURCHASE AGREEMENT. Short-term purchases of securities with a simultaneous agreement to sell the securities back at a higher price. From the seller's point of view, the same transaction is a reverse repurchase agreement.

SAFEKEEPING. A service to bank customers whereby securities are held by the bank in the customer's name.

STRUCTURED NOTE. A complex, fixed income instrument, which pays interest, based on a formula tied to other interest rates, commodities or indices. Examples include inverse floating rate notes which have coupons that increase when other interest rates are falling, and which fall when other interest rates are rising, and "dual index floaters," which pay interest based on the relationship between two other interest rates - for example, the yield on the ten-year Treasury note minus the Libor rate. Issuers of such notes lock in a reduced cost of borrowing by purchasing interest rate swap agreements.

TOTAL RATE OF RETURN. A measure of a portfolio's performance over time. It is the internal rate of return, which equates the beginning value of the portfolio with the ending value; it includes interest earnings, realized and unrealized gains, and losses in the portfolio.

U.S. TREASURY OBLIGATIONS. Securities issued by the U.S. Treasury and backed by the full faith and credit of the United States. Treasuries are considered to have no credit risk, and are the benchmark for interest rates on all other securities in the US and overseas. The Treasury issues both discounted securities and fixed coupon notes and bonds.

TREASURY BILLS. All securities issued with initial maturities of one year or less are issued as discounted instruments, and are called Treasury bills. The Treasury currently issues three- and six-month T-bills at regular weekly auctions. It also issues "cash management" bills as needed to smooth out cash flows.

TREASURY NOTES. All securities issued with initial maturities of two to ten years are called Treasury notes, and pay interest semi-annually.

TREASURY BONDS. All securities issued with initial maturities greater than ten years are called Treasury bonds. Like Treasury notes, they pay interest semi-annually.

VOLATILITY. The rate at which security prices change with changes in general economic conditions or the general level of interest rates.

YIELD TO MATURITY. The annualized internal rate of return on an investment which equates the expected cash flows from the investment to its cost.