



Investment Policy

FINANCE COMMITTEE PRESENTATION

11/14/2016

We have leveraged the prior investment policy with some minor changes



- ▶ **Current policy gives explicit authority to Treasury manager is conduct investment operations; this is problematic**
 - Provides certain level of independence
 - DWSD treasury operations are not versed in investment and investment risk management strategies

- ▶ **Accordingly, we have replaced responsibility for investment strategy with the CFO**
 - CFO designated as Treasurer as well; this is common in all industries
 - Current CFO is Commodity Trading Advisor (NFA Series 3) with significant experience in asset investment and risk management

- ▶ **Remainder of policy is fairly straightforward and comprehensive**
 - The short is that DWSD is allowed to invest in limited risk securities
 - Eliminates ability by policy to speculate (prudent investor standard)

- ▶ **The policy does not address the use of derivative financial instruments to manage asset risks – this will be dealt with in a subsequent policy recommendation**

**DETROIT WATER AND SEWERAGE DEPARTMENT
BOARD OF WATER COMMISSIONERS
INVESTMENT POLICY**

November 16, 2016-102

SECTION 1 – PURPOSE

The purpose of this Investment Policy Statement is to establish a clear understanding of the philosophy and the investment objectives for Financial Assets (the Assets) (defined under section, “Scope”) of the Detroit Water & Sewerage Department (DWSD). This document will further describe the standards that will be utilized by the DWSD’s Board of Water Commissioners in monitoring investment performance of the Assets, as well as, serve as a guideline for DWSD’s Finance Officers, any investment manager retained by the DWSD, or financial institution(s) utilized by the DWSD in its routine financial activities.

DWSD endeavors to accumulate sufficient assets to build capital for future use with the corresponding obligations to support near-term and long- term needs of the DWSD and offset the interest accumulated while capital funds are waiting to be expended. The Assets are to be invested consistent with the policies of the DWSD’s Board of Water Commissioners and this policy document, as amended from time to time.

This policy is not intended to cover derivative financial instruments or allowable asset risk management strategies which will be covered under separate policies.

SECTION 2 – DWSD CHIEF FINANCIAL OFFICER

The Board of Water Commissioners hereby delegates to the Chief Financial Officer (the CFO) and / or Treasurer, and such delegates as the CFO/Treasurer may designate from time-to-time, primary responsibility for recommending investment policies and strategies, trustees, investment managers and/or advisors, and other fiduciaries, and monitoring the performance of the Finance Division’s Managers, including but not limited to the Treasury Manager and Finance Manager, advisors and other fiduciaries of the DWSD. This delegation is not intended to conflict with the Board of Water Commissioners ultimate authority and responsibility for the financial assets of the DWSD. The Board of Water Commissioners may at its discretion set policy and practices for periodic reporting of the results of investment performance, review of market conditions and other such information as it may require.

This Investment Policy Statement and the policies and guidance herein are not intended to substitute or conflict with routine finance or treasury reporting duties and practices of the Finance Department and the Chief Financial Officer as managed for the Board of Water Commissioners.

SECTION 3 – DELEGATION OF AUTHORITY

The Chief Financial Officer / Treasurer may delegate management responsibility for the day to day or routine activities of the investment program with the Treasury Manager, under the

supervision of the Chief Financial Officer / Treasurer. The Chief Financial Officer / Treasurer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials, and their procedures in the absence of the Chief Financial Officer.

The Chief Financial Officer / Treasurer shall establish written investment policy procedures for the operation of the investment program consistent with this Investment Policy Statement. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Chief Financial Officer.

SECTION 4 – SCOPE

This Investment Policy Statement applies to the Financial Assets, all transactions and investment decisions and practices for which the Chief Financial Officer / Treasurer has authority and oversight. Such assets shall include investments classified in the audited financial statements of DWSD as Current Assets and Long Term Assets with the exception of pension fund assets or deferred compensation.

SECTION 5 – THE PRUDENT INVESTOR STANDARD

The Assets are to be invested and managed 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.

The standard of prudence to be used by the DWSD's CFO / Treasurer or his / her delegate will be the "prudent person" and / or "prudent investor" standard and shall be applied in the context of managing the overall portfolio of assets. The CFO / Treasurer or his / her delegate 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 appropriate action is taken to control adverse developments.

SECTION 6 – ETHICS

Officers and employees involved in the investment process shall refrain from personal business activity that would conflict with the proper execution and management of the investment program, or that 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 which business is conducted on behalf of DWSD.

SECTION 7 – INVESTMENT OBJECTIVES

The investment policies of the DWSD will be carried out by means of investment strategies that reflect continuous evaluation of changing investment environments, judgment regarding the allocation of the DWSD's assets among different kinds of investment opportunities, identification

of appropriate investment vehicles, and the making of specific investment decisions.

The objective of the investments will be to provide for the DWSD's continued operations on a reasonably consistent basis and to achieve income and growth of principal in line with current market rates without undue exposure to risk. Therefore, the primary focus will be preservation of principal, income generation and capital appreciation a secondary consideration together with the current spending requirements and short and intermediate term capital requirements of DWSD. The Assets of DWSD will be managed in accordance with the following objectives, in priority order:

- A. Safety – Safety of principal is the foremost objective of the DWSD'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 risk.
 - 1. Credit Risk – The DWSD will minimize credit risk, the risk of loss due to the failure of the security issuer or backer, by:
 - i. Limiting investments to the safest types of securities
 - ii. Pre-qualifying the financial institutions, broker/dealers, and intermediaries with which the DWSD will do business
 - iii. Diversifying the portfolio so that the potential losses on individual securities will be minimized
 - 2. Interest Rate Risk - The DWSD will minimize the risk that market value of the securities in the portfolio will fall due to changes in the general interest rates, by:
 - i. Structuring maturities of the portfolio to meet cash requirements of ongoing operations, thereby minimizing the need to liquidate securities prior to maturity
 - ii. Investing operating funds primarily in short-term securities or investment pools
 - iii. Purchasing securities with the intent to hold until maturity and matched to mature with consideration for capital improvement plans
 - 3. Custodial credit risk – The DWSD will minimize custodial risk by:
 - i. Using only financial institutions and brokers meeting pre-established criteria.
 - ii. Holding all securities in the name of Detroit Water & Sewerage Department.
- B. Liquidity – The investment portfolio of the DWSD will remain sufficiently liquid to enable the DWSD to meet all operating requirements that may be reasonably anticipated. Investment maturities for operating funds shall be scheduled to coincide with projected cash flow needs, taking into account large routine expenditures (such as payroll and debt service), as well as considering sizable blocks of anticipated revenue (water and sewerage fee collections).
 - 1. Time horizon for operating cash investments average life shall not exceed 270-days.
 - 2. Time horizon for long-term capital investments average life shall not exceed 36-months
 - 3. Time horizon for long-term debt service reserves average life shall not exceed 60-

months

- C. Return on Investments – The investment portfolio of the DWSD shall be designed and managed with the objective of attaining a benchmark rate of return throughout the budgetary and economic cycles, commensurate with DWSD’s investment risk constraints, operating cash flow and long-term capital needs. The predominant investment strategy of the DWSD is passive. Performance standards for:
1. Short-term assets: yields of the portfolio will be the average of U.S. Treasury Bills most closely commensurate with the average life of the portfolio.
 2. Long-term assets: yields of the portfolio will be the average of U.S. Treasury Bills and Notes most closely commensurate with the average life of the portfolio.
- D. Diversification - It is the policy of the DWSD to maintain a diversified investment portfolio. Assets held in a common fund or concentration account and other investment funds will be diversified to reduce the risk of loss resulting from over concentration of assets in a specific maturity, individual financial institution(s) or a specific class of securities. Diversification strategies will be determined and revised by the CFO / Treasurer or his / her delegate, from time to time to meet diversification objectives while seeking to attain market rates of return or the benchmark index standards, set out herein.

It is also understood that temporary deviations from this objective may be necessary from time to time in order to accommodate certain financial goals and obligations.

The following instruments and maximum percentages are:

<u>Securities / Instrument</u>	<u>Maximum % of all Accounts / Funds</u>
United States Treasury Obligations	100%
United States Government Agency Securities & Instruments	100%
United States Government Short term or intermediate term mutual funds	100%
Obligations of the State of Michigan or any Michigan political subdivision	50%
Certificates of Deposits	100%
Certificates of Deposit Account Registry Service	100%
Money market funds	100%
Mutual funds	100%
Commercial paper	50%
Banker’s Acceptance	50%

SECTION 8 – AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS

The Chief Financial Officer / Treasurer or his / her delegate shall maintain a listing of financial institutions and broker/dealers authorized to provide investment services. The Chief Financial Officer / Treasurer or his / her delegate will actively monitor and will conduct an annual evaluation of each financial institution and broker/dealer for credit worthiness to determine whether it should be on the “Qualified Institutions” listing. The authorized listing of institutions, approved depositories, and / or broker/dealers shall be approved periodically by the Board of Water Commissioners Finance Committee or as may be amended.

SECTION 9 – AUTHORIZED INVESTMENTS

In accordance with Michigan Public Act 20 of 1943 as amended from time to time and consistent with DWSD's bond indentures, State authorizing bond statutes and ordinances, the surplus funds of DWSD will be invested as follows:

- A. Bonds, securities, and other obligations of the United States or an agency or instrumentality of the United States.
- B. Certificates of deposit, savings accounts, deposit accounts, or depository receipts of a bank or a savings and loan association which is a member of the Federal Deposit Insurance Corporation or a credit union which is insured by the National Credit Union Administration. The bank, savings and loan association or credit union must be eligible to be a depository of surplus funds belonging to the State.
- C. Commercial paper rated at the time of purchase within the highest classifications established by not less than two standard rating services and which matures not more than 270 days after the date of purchase.
- D. United States government or federal agency obligation repurchase agreements. Repurchase agreements shall be negotiated only with dealers or financial institutions with which DWSD has negotiated a Master Repurchase Agreement. Repurchase Agreements must be signed with the bank or dealer and must contain provisions similar to those outlined in the Public Security Association's (or successor Association) model Master Repurchase Agreement.
- E. Bankers' acceptances of United States banks.
- F. Obligations of the state of Michigan or any of its political subdivisions that at the time of purchase are rated no lower than a single-A rating category and by not less than one (1) rating agency, see Addendum A.
- G. Mutual funds registered under the investment company act of 1940, title I of Michigan chapter 686, 54 Stat. 789, 15 U.S.C. 80a-1 to 80a-3 and 80a-4 to 80a-64, with authority to purchase only investment vehicles that are legal for direct investment by a public corporation. Included in this authorization are mutual funds that have net asset values (NAV) that fluctuate or can fluctuate on a periodic basis. A mutual fund is not disqualified as a permissible investment solely by reason of either of the following:
 - 1. The purchase of securities on a when-issued or delayed delivery basis;
 - 2. The ability to lend portfolio securities as long as the mutual fund receives collateral at all times equal to at least 100% of the value of the securities loaned;
 - 3. The limited ability to borrow and pledge a like portion of the portfolio's assets for temporary or emergency purposes; and,
 - 4. Investment pools organized under the surplus funds investment pool act, 1982 PA 367, 129.111 to 129.118.
- H. Obligations described in (A) through (G) if purchased through an inter-local agreement under the urban cooperation act of 1967, 1967(Ex Sess) P.A. 7, MCL 124.501 to 124.512. For purposes of this section, the objectives listed in Section 7 shall be altered in that the return on investment shall be of primary concern, followed by safety of capital and liquidity.

Although permitted under state law, collateralization will not be required on all investments with the exception of repurchase or reverse repurchase agreements. Repurchase and reverse repurchase agreements must be collateralized at not less than 102% of the market value of principal and accrued interest. All other investments will be looked at on a case-by-case basis taking into account liquidity, safety and yield.

- I. Investment Pools -Any investment into a pooled type account can only be made after the Chief Financial Officer / Treasurer or his / her delegate has completed a thorough investigation. After the initial investment has been approved, the CFO / Treasurer or his / her delegate must continue to monitor the account, reviewing the account's suitability as an investment vehicle. When reviewing the pooled account, the CFO / Treasurer or his / her delegate shall take into account the following:
 1. Detailed description of eligible investments made by the pool or fund;
 2. A written statement of the investment policy and the pool or fund objectives;
 3. A description of interest calculations and how interest is distributed;
 4. An explanation on how the fund will handle gains and losses within the fund;
 5. A description on how the funds will be safeguarded, and how often the underlying securities will be marked-to-market;
 6. Who will audit the fund or pool and how often;
 7. An explanation of who will be able to invest in the fund, how often investments can be made, and what size limitations, if any, will be in effect for the fund;
 8. A schedule for receiving statements and portfolio listings;
 9. A fee schedule, explaining how and when the fees will be assessed;
 10. Whether the fund will be able to receive bond proceeds, and whether they will accept bond proceeds; and,
 11. Does the pool or fund utilize any type of reserves or a retained earnings account? If so, how does this affect the interest earnings of the participants?

SECTION 10 – MUTUAL / COLLECTIVE INVESTMENT FUNDS

The Chief Financial Officer / Treasurer or his / her is authorized to invest in mutual / collective investment funds (for purposes of investing in bonds, money market instruments, and other securities) after investigation of the prospectus and the following:

- A. The investment policy and objectives of the fund
- B. A description of Authorized Investment securities
- C. A description of interest calculation and distribution of income or dividends
- D. A description of how funds are safeguarded and securities priced
- E. How often the fund is audited and by who
- F. A description of any limitations on the size and frequency of deposits or withdrawals
- G. A fee schedule, break points, including assessments of such
- H. Frequency and delivery of statements and portfolio of securities in the fund

SECTION 11 – SAFE KEEPING AND CUSTODY

Adopted January 21, 2014
Amended June 25, 2014 - Section 7D

All securities purchased by the DWSD under this section will be properly designated as an asset of the DWSD and shall be conducted on a delivery versus payment (DVP) basis. Certificates of deposit purchased from financial institutions or brokers shall be held in a safe keeping account and evidenced by safe keeping receipt. Securities purchased from broker – dealers will be held by a third party custodian in a safe keeping account designated by the DWSD Chief Financial Officer / Treasurer or his / her delegate and evidenced by safekeeping receipts.

For purposes of this Policy, third party custodians shall be defined as a separate financial institution or a separate and distinct division or department of the same institution whose function is safe keeping and / or trust services. No withdrawal of such securities, in whole or in part, shall be made from safe keeping except by the DWSD Finance Officers as authorized herein, or by its designee.

The DWSD will execute third party custodial agreement(s) with its bank(s) and depository institution(s). Such agreements will include letters of authority from the DWSD, details as to responsibilities of each party, notification of securities purchases, sales, delivery, repurchase agreements, wire transfers, safe keeping and transaction costs, procedures in case of wire failure or other unforeseen mishaps including the liability of each party.

SECTION 12 – INTERNAL CONTROLS & PRACTICES

The CFO / Treasurer and / or his / her delegate shall maintain a system of internal controls and practices which shall be designed, in addition to conforming to generally accepted accounting principles, to minimize losses of funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of DWSD.

SECTION 13 – REPORTING

The CFO / Treasurer and / or his / her delegate shall generate a quarterly investment report that provides a clear picture of the status of the current investment portfolio. Each quarterly report will indicate any areas of policy concern and suggested or planned revisions of investment strategies. The report shall include:

- A. A summary of investments by type
- B. A summary of available funds and percentage invested
- C. A summary of interest income and average invested balances by financial asset classifications
- D. An analysis of investments by maturity dates
- E. A detailed report of all investments by type including fund, investment amount, rate, purchase date and maturity date and market price

SECTION 14 -INVESTMENT POLICY ADOPTION

The DWSD's Investment Policy shall be adopted by resolution of the Board of Water Commissioners. The Policy shall be reviewed periodically by the Board of Water Commissioners' Finance Committee. Any modifications made to the Investment Policy must be approved by the Board of Water Commissioners.

Addendum A - Investment Grade Classifications

Long-Term Ratings

	Standard & Poor's	Moody's Investors Service	Fitch Investors Service	Capacity to repay debt
	AAA	Aaa	AAA	Extremely strong capacity
	AA+	Aa1	AA+	Very strong capacity
	AA	Aa2	AA	
	AA-	Aa3	AA-	
Investment Grade Debt	A+	A1	A+	Strong capacity; some susceptibility to adverse economic circumstances or effects
	A	A2	A	
	A-	A3	A-	
	BBB+	Baa1	BBB+	Adequate capacity; however <i>more likely</i> to be weakened due to adverse economic circumstances or effects
	BBB	Baa2	BBB	
	BBB-	Baa3	BBB-	
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Non-Investment Grade or Speculative	BB+	Ba1	BB+	Vulnerable to default; faces <i>major</i> ongoing uncertainties or exposure
	BB	Ba2	BB	
	BB-	Ba3	BB-	

Short Term Note Ratings

<u>S & P</u>	<u>Moody's</u> (Moody's investment grade)
SP-1+	MIG-1
SP-1	-
SP-2	MIG-2
SP-3	MIG-3

Commercial Paper Ratings

An Issuer's ability to honor its' short term obligations

<u>S&P</u>	<u>Moody's</u> (Prime)
A1	P1
A2	P2
A3	P3

Addendum B

Glossary of Terms

Average Life

An estimate of the number of terms to maturity, taking the possibility of early payments into account. Average life is calculated using the weighted average time to the receipt of all future cash flows.

Agency Bond

A bond issued by a government sponsored enterprise (GSE) or agency. These bonds are not fully guaranteed in the same way as U.S. Treasury and municipal bonds. Examples include Fannie Mae, (FNMA) Federal National Mortgage Association; Freddie Mac (FHLMC) Federal Home Loan Mortgage Corporation, Sallie Mae Student Loan Marketing Association; Ginnie Mae (GNMA) Government National Mortgage Association.

Asked

The price at which securities are offered.

Banker's Acceptance (BA)

A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer. Acceptances are traded at a discount from face value on the secondary market. Banker's acceptances are very similar to T-bills and are often used in money market funds.

Benchmark

A comparative base for measuring the performance of risk tolerance of the investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio's investments.

Bid

The price offered by a buyer of securities. (When you are selling securities, you ask for a bid.)

Bond

A debt investment in which an investor loans money to an entity (corporate or governmental) that borrows the funds for a defined period of time at a fixed interest rate. Bonds are used by companies, municipalities, states and U.S. and foreign governments to finance a variety of projects and activities.

Broker

A Broker brings buyers and sellers together for a commission.

Certificate of Deposit

A time deposit with a specific maturity evidenced by a Certificate. Large denomination CDs are typically negotiable.

Collateral

Securities, evidence of deposit or other property, which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits.

Collective Investment Fund

A fund that is operated by a trust company or a bank and handles a pooled group of trust accounts. Collective investment funds combine the assets of various individuals and organizations to create a larger, well-diversified portfolio.

Commercial Paper

An unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts receivable, inventories and meeting short-term liabilities. Maturities on commercial paper rarely range any longer than 270 days. The debt is usually issued at a discount, reflecting prevailing market interest rates.

Commercial paper is not usually backed by any form of collateral, so only firms with high-quality debt ratings will easily find buyers without having to offer a substantial discount (higher cost) for the debt issue.

A major benefit of commercial paper is that it does not need to be registered with the Securities and Exchange Commission (SEC) as long as it matures before nine months (270 days), making it a very cost-effective means of financing. The proceeds from this type of financing can only be used on current assets (inventories) and are not allowed to be used on fixed assets, such as a new plant, without SEC involvement.

Coupon

The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. Also a certificate attached to a bond evidencing interest due on a payment.

Dealer

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

Discount

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

Discount securities

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

Diversification

Dividing investment funds among a variety of securities offering independent returns.

Delivery versus Payment – DVP

A securities industry procedure in which the buyer's payment for securities is due at the time of delivery. Security delivery and payment are simultaneous. Also known as delivery against payment, delivery against cash, or from the sell side.

Federal Deposit Insurance Corporation (FDIC)

A federal agency that insure bank deposits, currently up to \$250,000 per deposit account. (If a depositor wants an FDIC insured account, the desired bank must be a participant in the FDIC program. Banks that

are participants of the FDIC are required to display an official sign at each teller window or station where deposits are regularly received. The maximum dollar amount that is insured in a qualified account is \$250,000 per bank. In other words, it is possible for a depositor to deposit \$1 million in four different banks and each account will be fully insured.) (The different accounts that can be FDIC insured are NOW, checking, savings, Certificate of Deposits (CD) and money market deposit accounts.)

Federal Funds Rate

The rate of interest at which Fed Funds are traded. The Federal Reserve through open-market operations currently pegs this rate.

Federal Open Market Committee

The branch of the Federal Reserve Board that determines the direction of monetary policy. The FOMC is composed of the board of governors, which has seven members, and five reserve bank presidents. The president of the Federal Reserve Bank of New York serves continuously, while the presidents of the other reserve banks rotate their service of one-year terms.

Federal Reserve System

The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C., twelve regional banks in major cities around the country.

Government-Sponsored Enterprise - GSE

Privately held corporations with public purposes created by the U.S. Congress to reduce the cost of capital for certain borrowing sectors of the economy. Members of these sectors include 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 Treasuries. Examples of GSEs include: Federal Home Loan Bank, Federal Home Loan Mortgage Corporation (Freddie Mac), Federal Farm Credit Bank and the Resolution Funding Corporation.

Investment Grade

A rating that indicates that a municipal or corporate bond has a relatively low risk of default. Bond rating firms, such as Moody's, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality, and are commonly referred to as "junk bonds".

Liquidity

1. The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid assets. 2.) The ability to convert an asset to cash quickly, also known as, "marketability".

Market Value

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

Master Trust

A collection of funds from individual investors that are pooled together in order to obtain wholesale prices and rates unavailable for regular investors.

Adopted January 21, 2014

Amended June 25, 2014 - Section 7D

Master Repurchase Agreement

A written contract covering all future transactions between the parties to a repurchase – reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

Maturity

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

Money Market

A segment of the financial market in which financial instruments with high liquidity and very short maturities are traded. The money market is used by participants as a means for borrowing and lending in the short term, from several days to just under a year. Money market securities consist of negotiable certificates of deposit (CDs), bankers acceptances, U.S. Treasury bills, commercial paper, municipal notes, federal funds and repurchase agreements (repos).

Municipal Bond

A debt security issued by a state, municipality or county to finance its capital expenditures. Municipal bonds are exempt from federal taxes and from most state and local taxes, especially if you live in the state in which the bond is issued. At times taxable municipal bonds are issued to finance a project or activity that does not provide a major benefit to the public. In such cases, the federal government will not permit the tax-exemption that is a prominent feature of most municipal bonds.

Mutual Fund

An investment vehicle that is made up of a pool of funds collected from many investors for the purpose of investing in securities such as, bonds, money market instruments and similar assets. Mutual funds are operated by money managers, who invest the fund's capital and attempt to produce capital gains and income for the fund's investors. A mutual fund's portfolio is structured and maintained to match the investment objectives stated in its prospectus.

Each shareholder participates proportionally in the gain or loss of the fund. Mutual fund units, or shares, are issued and can typically be purchased or redeemed as needed at the fund's current net asset value (NAV) per share.

Offer

The price asked by a seller of securities. (When you are buying securities, you ask for an offer.)

Open Market Operations

Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank, as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

Portfolio

Collection of securities held by an investor.

Rate of return

The gain or loss on an investment over a specified period, expressed as a percentage increase over the initial investment cost. Gains on investments are considered to be any income received from the security plus realized capital gains.

Repurchase Agreement - Repo

A form of short-term borrowing for dealers in government securities. The dealer sells the government securities to investors, usually on an overnight basis, and buys them back the following day.

For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction, (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement.

Securities & Exchange Commission (SEC)

An agency created by Congress to protect investors in securities transactions by administering securities legislation.

SEC Rule 15C3-1

Requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called the net capital ratio.

Structured Notes

Notes issued by Government Sponsored Enterprises (FHLB, FNMA, SLMA, etc.) and corporations, which have imbedded options (e.g. call features, step-up coupons, floating rate coupons, derivative-based returns) into their debt structure.

Total Return

When measuring performance, the actual rate of return of an investment or a pool of investments over a given evaluation period. Total return includes interest, capital gains, dividends and distributions realized over a given period of time.

Total return accounts for two categories of return: income and capital appreciation. Income includes interest paid by fixed-income investments, distributions or dividends. Capital appreciation represents the change in the market price of an asset.

Treasury Bills

A non-interest bearing deposit security issued by the U.S. Treasury to finance national debt. Most bills are issued to mature in three months, six months or one-year.

Treasury Bonds

Long-term coupon bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having final maturities of more than ten years.

Treasury Notes

Medium-term coupon bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from two to ten years.

Yield

The rate of annual income return on an investment, expressed as a percentage. 1.) Income yield is obtained by dividing the current dollar income by the current market price for the security. 2.) Net yield or Yield to Maturity is the current income yield minus any premium above par plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.