



# TexPool Prime Investment Policy

Texas Local Government  
Investment Pool

Revised August 2016

## **I. PURPOSE AND OBJECTIVES STATEMENT**

### **A. TEXPOOL PRIME**

The Interlocal Cooperation Act, chapter 791 of the Texas Government Code, and the Public Funds Investment Act, chapter 2256 of the Texas Government Code (the “Act”), provide for the creation of public funds investment pools through which political subdivisions and other entities may invest public funds.

TexPool Prime will use amortized cost to value portfolio assets and follow the criteria established by Governmental Accounting Standards Board (“GASB”) Statement No. 79 for use of amortized cost. This Investment Policy shall be interpreted and applied in a manner consistent with GASB guidance on external investment pools that use amortized cost to value all portfolio assets.

Pursuant to subchapter G of chapter 404, the Comptroller of Public Accounts (the “Comptroller”) administers the Texas Local Government Investment Pools (the “TexPool Prime Portfolios”) as public funds investment pools through the Texas Treasury Safekeeping Trust Company (the “Trust Company”). The Trust Company is a special-purpose trust company authorized to receive, transfer, and disburse money and securities as provided by statute or belonging to the state, agencies, and local political subdivisions and other organizations created on behalf of the state or agency or political subdivision of the state. The Comptroller is the sole officer, director, and shareholder of the Trust Company.

The Comptroller and the Trust Company have contracted with an administrator and investment manager (“Investment Manager”) for the TexPool Portfolios. The TexPool Portfolios comprise two investment alternatives: TexPool and TexPool Prime. This Investment Policy relates only to TexPool Prime. TexPool Prime invests in U.S. Treasury and government agency securities, repurchase agreements, certain mutual funds, commercial paper, and certificates of deposit.

In accordance with the Act, the Comptroller has appointed the TexPool Prime Investment Advisory Board (the “Board”) to advise with respect to TexPool Prime. The Board is composed equally of participants in the TexPool Prime Portfolios and other persons who do not have a business relationship with the TexPool Prime Portfolios and are qualified to advise the TexPool Portfolios.

### **B. PURPOSE**

The purpose of TexPool Prime is to offer a safe, efficient, and liquid investment alternative to local governments in the State of Texas. The expectation is that local governments will benefit from the receipt of higher investment returns as a result of economies of scale and the investment expertise and management oversight of the Comptroller and the Trust Company. Investments are made in accordance with this investment policy (the “TexPool Prime Investment Policy”) established by the Trust Company and approved by the Comptroller. The TexPool Prime Investment Policy’s investment parameters are more conservative than those contained in the Act. The TexPool Prime Investment Policy is reviewed annually and revised as necessary.

## C. OBJECTIVES

As required by the Act, the investment objectives of TexPool Prime in order of priority are: •

- preservation and safety of principal;
- liquidity; and
- yield

TexPool Prime’s additional objective is to maintain a stable \$1.00 price per unit. In accordance with the Act, TexPool Prime securities are marked to market daily, and if the ratio of the market value of the portfolio divided by the book value of the portfolio is less than 0.995 or greater than 1.005, TexPool Prime will take any appropriate action necessary to maintain the ratio between 0.995 and 1.005. However, the \$1.00 price is not guaranteed or insured by the State of Texas.

## D. STANDARD OF CARE

As also required by the Act, TexPool Prime investments are made subject to the “prudent person” standard of care. Accordingly, the Investment Manager must make investment decisions:

*“with [the] judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person’s own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived.”*

## E. STRATEGIES

### 1. Portfolio Composition

The TexPool Prime portfolio is designed and managed to ensure that it maintains its AAAM rating (or the equivalent) by a nationally recognized statistical rating organization (“NRSRO”).

The following guidelines shall be followed by the Investment Manager to maintain the portfolio maturity consistent with a stable net asset value per share:

- 1) The maximum remaining maturity of any security or other investment acquired for the portfolio shall be 397 calendar days or less.
- 2) The portfolio should maintain a weighted average maturity of 60 days or less.
- 3) The portfolio should maintain a weighted average life of 120 days or less.

Maturity limits are applied as defined in GASB 79.

A cure period of not more than 10 business days shall be permitted in the event that the weighted average maturity of the portfolio exceeds these limits, consistent with NRSRO guidelines.

### 2. Risk Management

Principal is protected and market and credit risks minimized by investing in a diversified pool of assets of high credit quality. Actual risks are minimized by adequate collateralization and use of **2**

delivery versus payment procedures.

The following procedure shall be followed by the Investment Manager to monitor investment rating changes:

- 1) Perform ongoing monitoring of the credit risks of all securities.
- 2) Create and update, as necessary, an approved list of issuers and securities.

- 3) Maintain the approved list in the Investment Manager’s trading and compliance system and utilize the system to monitor the credit risk on a pre-trade compliance basis.
- 4) Note any changes in the rating of a security and determine whether such change is in compliance with the Act.
- 5) If an investment is downgraded such that it is not in compliance with the Act, liquidate the security as required by the Act.

### **3. Liquidity**

Cash needs and cash expectations take priority in the design and structure of TexPool Prime. Income and expenditure history are developed and continuously updated to determine the liquidity needs of TexPool Prime. Reports of anticipated cash flow needs are used to develop the maturity structure of the portfolio to provide liquidity to all participants. To meet the anticipated liquidity needs, TexPool Prime is invested to ensure sufficient distribution of investments in liquid, short-term instruments. The maturities of the investments are distributed such that there is a continuing stream of securities maturing at frequent intervals.

### **4. Returns**

After consideration of safety and liquidity, TexPool Prime assets are invested with the goal of achieving a competitive rate of return that meets or exceeds the yield on money market mutual funds with similar investment authority. TexPool Prime is structured to benefit from anticipated market conditions and to achieve a reasonable return.

## **F. DISTRIBUTION OF GAINS AND LOSSES**

All gains and losses from the sale of securities are distributed among TexPool Prime participants and will be amortized over the remaining term to maturity of the liquidated securities.

## **II. AUTHORIZED INVESTMENTS**

The Act governs the investment of TexPool Prime. The Act sets out a number of authorized investments. TexPool Prime funds may be invested only in the following authorized investments:

### **A. GOVERNMENT SECURITIES (section 2256.009(a)(1) of the Act)**

#### **1. Statutory Requirements**

Obligations of the United States, its agencies, or instrumentalities **EXCLUDING** the following:

- a. Obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal;
- b. Obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest;
- c. Collateralized mortgage obligations that have a stated final maturity date of greater than 10 years; and

- d. Collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

## 2. Policy Guidelines

**Portfolio Composition:** Up to 100% of TexPool Prime assets may be invested in government obligations of the United States, its agencies, or instrumentalities. However, no more than 60% of the portfolio may be invested in variable rate notes.

**Maturity Limits:** The maximum final stated maturity of a security may not exceed 397 days, other than for floating or variable rate government obligations of the United States, its agencies, or instrumentalities. The final stated maturity of securities that are not obligations of the United States, its agencies or instrumentalities, is the earlier of the contractual final maturity date or the next date on which full repayment of principal can be obtained through exercise of a demand feature.

## B. REPURCHASE AGREEMENTS (section 2256.011 of the Act)

### 1. Statutory Requirements

Fully collateralized repurchase agreements or reverse repurchase agreements (i) with defined termination dates, (ii) secured by obligations of the United States, its agencies, or its instrumentalities, including certain mortgage-backed securities, (iii) that require purchased securities to be pledged to the investing entity, in the entity's name, and deposited at the time of investment with the investing entity or a third party, and (iv) that are placed through primary government securities dealers, as defined by the Federal Reserve, or a financial institution doing business in the State of Texas.

The term of a reverse repurchase agreement may not exceed 90 days after the date of delivery. Money received under a reverse repurchase agreement may be used to acquire additional authorized investments provided such investments mature not later than the expiration date stated in the reverse repurchase agreement.

### 2. Policy Guidelines

**Portfolio Composition:**

**Direct Repurchase Agreements:** Up to 100% of TexPool Prime assets may be invested in repurchase agreements.

**Term Repurchase Agreements:** A term repurchase agreement refers to any repurchase agreement with more than 7 calendar days remaining to maturity or more than 7 calendar days to the next put option that allows TexPool Prime to liquidate the position at par (principal plus accrued interest.)

**Maturity Limits:** The maximum final maturity on repurchase agreements may not exceed 365 days. . For purposes of calculating the weighted average maturity of the portfolio, the maturity date of a term repurchase agreement will be equal to the put option notice period.

**Margin Requirement:** Collateral must be equal to at least 102% of the total market value of the repurchase agreement, including accrued interest.

**b. Reverse Repurchase**

**Agreements** *Portfolio Composition:*

TexPool Prime may enter into reverse repurchase agreements for up to one third (1/3) of the value of TexPool Prime assets.

**c. Repurchase Agreements and Reverse Repurchase Agreements**

***Documentation:*** All repurchase transactions are governed by a Bond Market Association (BMA) or Securities Industry and Financial Markets Association (SIFMA) approved Master Repurchase Agreement and Master Reverse Repurchase Agreement.

***Custody:*** If collateral is to be held by a third party, the third party must have been previously approved by the Trust Company or the Investment Manager.

**C. MONEY MARKET MUTUAL FUNDS (section 2256.014 of the Act)**

**1. Statutory Requirements**

No-load money market mutual fund that (i) is registered with and regulated by the Securities and Exchange Commission, (ii) provides a prospectus and other information required by the Securities Exchange Act of 1934 or the Investment Company Act of 1940 and (iii) is a permissible investment. TexPool Prime may not acquire shares of a money market mutual fund that represent more than 10% of the outstanding shares of that fund at the time of purchase.

**2. Policy Guidelines**

***Portfolio Composition:*** TexPool Prime assets may be invested in approved money market mutual funds. The Investment Manager may utilize affiliated money market funds for this purpose provided the Investment Manager waives its management fee equal to the relevant affiliated fund’s net management fee, and provides an annual accounting of such waivers to the Trust Company.

***Concentration Limits:*** No more than 15% of the TexPool Prime assets may be invested in money market mutual funds that do not seek to maintain a stable net asset value per share.

***Rating:*** The money market mutual fund must be rated AAA or its equivalent by at least one NRSRO.

**D. SECURITIES LENDING (section 2256.0115 of the Act)**

**1. Statutory Requirements**

TexPool Prime may engage in a securities lending program that complies with the following:

- a. the value of the securities loaned, including accrued interest, must be fully collateralized by:
  - (i) government securities,
  - (ii) irrevocable letters of credit issued by a bank organized under U.S. or state law and continuously rated at least A or its equivalent by at least one NRSRO, or
  - (iii) cash invested in government securities, commercial paper, mutual funds, or investment pools authorized by the Act;
- b. the loan must be terminable at any time;

- c. the loan terms must require that the collateral be pledged to the investing entity, held in its name, and deposited with the investing entity or a third party selected and approved by the investing entity;
- d. the loan must be placed through primary dealers or financial institutions doing business in the state; and
- e. the loan agreement must have a term of one year or less.

## **2. Policy Guidelines**

Cash received under securities lending agreements must be used to acquire obligations authorized under this investment policy, provided that the average life of the obligations cannot exceed the average life of the securities lending agreements.

## **E. CERTIFICATES OF DEPOSIT (section 2256.010 of the Act)**

### **1. Statutory Requirements**

Certificates of deposit issued by a state or national bank, savings bank, or a state or federal credit union that has its main office or a branch office in Texas that are (a) guaranteed or insured by the FDIC or the National Credit Union Share Insurance Fund; (b) secured by obligations of the United States, its agencies, or its instrumentalities, including certain mortgage-backed securities that have a market value at least equal to the principal amount of the certificates; or (c) secured in the manner and amount provided by other law for deposits of the investing entity.

### **2. Policy Guidelines**

Up to 75% of TexPool Prime assets may be invested in certificates of deposit.

## **F. COMMERCIAL PAPER (section 2256.013 of the Act)**

### **1. Statutory Requirements**

Commercial paper (a) with a stated maturity of 270 days or fewer from the date of issuance; and (b) that is rated at least A-1 or P-1 or an equivalent rating by at least two NRSROs or one NRSRO and fully secured by an irrevocable letter of credit by a national or state bank.

### **2. Policy Guidelines**

**Portfolio Composition:** Up to 75% of TexPool Prime assets may be invested in commercial paper. However, no more than 25% of TexPool Prime assets may be invested in a single industry or business sector, provided that this limitation does not apply to securities issued or guaranteed by companies in the financial services industry.

**Concentration Limits:** No more than 5% of TexPool Prime assets may be invested in a single corporate entity. A 10 business day cure period shall be permitted in the event that the portfolio exceeds this limit, consistent with NRSRO guidelines.

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### III. PROHIBITED INVESTMENTS

#### A. STATUTORY

As required by section 2256.009 of the Act, TexPool Prime cannot invest in the following:

1. Obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal;
2. Obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest;
3. Collateralized mortgage obligations that have a stated final maturity date of greater than 10 years; and
4. Collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

#### B. POLICY

##### 1. Derivatives

TexPool Prime will not invest in “derivatives.” For the purposes of this Investment Policy, “derivatives” means instruments with embedded features that alter their characteristics or income stream or allow holders to hedge or speculate on a market or spreads between markets that are external to the issuer, or are not directly correlated on a one-to-one basis to the associated index or market. Derivatives include, but are not limited to, the following:

- a. Arrangements in which an investor has swapped the natural cash flows or some portion of the natural cash flows of an instrument for a different set of cash flows. (*i.e.*, interest rate swaps).
- b. Over-the-counter/exchange traded options or futures (*i.e.*, option contracts, futures contracts).
- c. Collateralized mortgage obligations, inverse floating rate notes, range index notes, non-money market index based notes, dual index notes, index amortizing notes, inverse multi-index bonds, stepped inverse index bonds, inverse index bonds.

Securities that are **not** considered derivatives and that are authorized investments for TexPool Prime include the following:

Treasury Bills, Treasury Notes, Treasury Bonds, Treasury Strips, repurchase agreements, reverse repurchase agreements, U.S. agency notes with a defined maturity and fixed coupon rate, U.S. agency discount notes, money market index Treasury and agency variable rate notes (*i.e.*, floating rate notes tied to money market indices such as three and six month Treasury Bills; one, three, and six month London Interbank Offering Rate [LIBOR]; Fed Funds; one

year Constant Maturity Treasury; prime rate; and commercial paper composite); U.S. agency step-up notes and any authorized investment that is callable prior to its final maturity.

## **IV. ADMINISTRATIVE GUIDELINES**

### **A. COMPETITIVE BIDDING**

TexPool Prime trades, purchases, and sales are done on a best execution basis through a documented competitive bidding process. The broker/dealers used for TexPool Prime are those approved by the Comptroller and the Trust Company and in compliance with the Comptroller rules.

### **B. SAFEKEEPING**

All eligible book-entry securities whether purchased outright or under repurchase agreements, are held in a separate custodial account at the Federal Reserve Bank in the name of the TexPool Portfolios or in an independent third party institution designated by Federated on behalf of the TexPool Portfolios. All securities not held in book entry form are held at an independent third-party institution designated by Federated on behalf of the TexPool Portfolios. Third party institutions must issue original safekeeping receipts to the Investment Manager.

### **C. AUTHORIZED PERSONNEL**

The Investment Manager personnel authorized to buy and sell investment instruments, send and receive securities, and make fund transfers and other types of related investment transactions are directly supervised by senior investment management personnel in the Investment Manager's Investment Management Group.

### **D. DOCUMENTATION**

Complete documentation and audit trails are maintained for all investment transactions.

### **E. MONITORING MARKET PRICE**

State Street Bank and Trust, the custodian designated by the Investment Manager (the "Custodian") provides fund accounting services for TexPool Prime and is responsible for marking-to-market the portfolio holdings of TexPool Prime on a daily basis. The Custodian receives electronic transmissions from various pricing vendors in order to determine the individual market price of each security held in TexPool Prime. These electronic transmissions are checked daily for current data and validity of information. The Custodian also performs a reasonability test to determine whether the prices received are within a set tolerance range. In the event that any of the prices fall outside of the range, then these prices are investigated against secondary pricing sources. As a further check, the Investment Manager also monitors the prices of securities held in TexPool Prime, in order to independently determine reasonableness and validity.

The shadow price is the net asset value per share of TexPool Prime, calculated using total investments measured at fair value at the calculation date. The Investment Manager calculates TexPool Prime's shadow price at a minimum on a monthly basis. The monthly calculation of the

shadow price should occur no earlier than five business days prior to and no later than the end of the month.

#### **F. PARTICIPATION AGREEMENTS**

Each participant must have a fully executed participation agreement on file with the Trust Company before participating in TexPool Prime.

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## **G. DEPOSIT AND WITHDRAWAL DEADLINES**

See separate TexPool Prime Operating Procedures for detailed deposit and withdrawal deadlines.

## **H. REPORTING AND DISCLOSURE**

The Act requires that public fund investment pools provide basic information regarding the pool's investments and operations. The pool is to provide the investment officer, or other authorized representative of a participating entity, disclosure information in an Information Statement. The required disclosure items are listed in the Act. This information is provided to all participants. Further, to maintain eligibility to receive funds from and invest funds on behalf of the pool's participants, TexPool Prime must furnish investment confirmations and a monthly report disclosing certain information. Finally, the Comptroller requires that TexPool Prime be audited annually by an independent auditor.

## **I. AUTHORIZED DEALERS**

The Comptroller maintains a list of approved dealers and brokers (collectively, "dealers") authorized to provide investment services. All dealers who desire to become qualified bidders for investment transactions for TexPool Prime must be on the approved list. The Comptroller annually reviews the financial condition and registration of the qualified dealers and revises the approved list as needed.

## **J. ETHICS AND CONFLICT OF INTEREST**

The Comptroller requires the Investment Manager and its staff that are involved with making investment decisions for or executing trades on behalf of TexPool Prime to disclose any personal or business relationship with a broker/dealer seeking to sell investments to TexPool Prime. These employees are also required to 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. The Investment Manager's Compliance Officer is required to file a quarterly statement with the Trust Company evidencing compliance with foregoing matters by the Investment Manager and its employees.

Moreover, agents, advisors, and contractors providing services in connection with the custody, management, and investment of public funds under a contract with the Comptroller are required to at all times avoid any actual or apparent conflict of interest with respect to the custody, management, and investment of public funds. For purposes of this investment policy, a conflict of interest refers to any circumstances in which an agent, advisor, or contractor who, in the context of duties under its contract with the Comptroller, has interests that are or may become inconsistent with the interests of the agent, advisor, or contractor with respect to other duties, contractual or otherwise.