Texas State University System  
Operating Funds Investment Policy

I. DEFINITIONS

Texas State University System ("TSUS") refers to System Administration, Lamar University, Sam Houston State University, Sul Ross State University, Texas State University-San Marcos, Lamar Institute of Technology, Lamar State College-Orange, Lamar State College-Port Arthur, and Sul Ross State University Rio Grande College.

II. POLICY AND OBJECTIVES

It is the policy of TSUS to invest public funds in a manner which complies with the Public Funds Investment Act (Texas Government Code Chapter 2256, the "Act"), and the Public Funds Collateral Act (Texas Government Code 2257). The Operating Funds Investment Policy ("Policy") of TSUS is designed to fulfill the following objectives:

- provide maximum safety of invested principal;
- ensure liquidity for all operating requirements which may be reasonably anticipated;
- manage interest-rate risk;
- maximize overall return within the established risk constraints; and
- provide for diversification of investment assets.

To meet these objectives, TSUS will base investment decisions on long-term, intermediate-term, and short-term needs based on cash flow analyses of present and anticipated financial requirements. The rate of return will be secondary to the overall safety of the funds and general economic conditions.

This Policy applies to all operating funds held by TSUS. These funds are defined as Current Funds (Unrestricted and Restricted), Loan Funds, Bond Funds, Plant Funds, Board Designated Reserves held as Quasi-Endowment Funds (the principal of these funds may be utilized at the discretion of the governing board), and Agency Funds which apply to the ongoing operations of TSUS. The funds may be held in investments authorized by this Policy, based on liquidity needs or bond covenants, or in authorized depositories which would be needed for day-to-day operations within any fund group. Funds held in banking institutions are also covered by the TSUS Depository Funds Policy. This Policy is not applicable to Endowment Funds or Foundation Funds.

This Policy and the amended Public Funds Investment Act do not apply to investments donated to TSUS for a particular purpose or donated according to terms specified by a donor if those donated investments are outside the authorized investments.

Funds covered under this Policy are classified as:

**Short Term Funds**: Funds needed to meet daily or short term operating requirements, usually held in an approved local government investment pool. These are funds meant to be used within the year and are typically invested in:

- Investments with maturities of less than 180 days or
- Investments with maturities of up to twelve (12) months.
**Long Term Funds**: Operating funds that have not been needed in the past, and are not anticipated to be needed for a minimum of 12 months or more. They are typically invested in investments with maturities of more than twelve (12) months.

**Bond Proceed Funds** – Bond proceeds and reserves may be invested in a manner consistent with the requirements and restrictions stated in the applicable Bond Covenants, but typically not longer than three years.

### III. DELEGATION OF AUTHORITY AND RESPONSIBILITY Board of Regents

The TSUS Board of Regents (the “Board”) retains ultimate responsibility for investments as fiduciaries of TSUS assets regardless of who is investing those assets. The Board is statutorily required to:

- designate Investment Officers, at least annually, review and adopt this Policy, at least annually, review and adopt a list of qualified broker/dealers authorized to engage in investment transactions with TSUS,
- at least quarterly, receive and review investment reports prepared in accordance with this Policy, and
- attend at least one training session as regards to Board responsibilities under the Act within six (6) months of assuming office as provided by the Higher Education Coordinating Board.

**Investment Officers**

The Chief Financial Officer (CFO) for System Administration and the CFO for each component are designated as Investment Officers for their respective entities by the Board. Additional Investment Officers may be designated by the Chancellor or President of the component.

Investment Officers are responsible for investment management decisions and activities and all transactions undertaken.

The Investment Officers of the components shall establish and maintain (a) written administrative procedures and guidelines in support of this Policy for their respective component, (b) distribution formulae/procedures for the funds, and (c) internal controls in support of this Policy.

Each Investment Officer must attend five hours of investment training within six months of assuming the position and not less than once each state fiscal biennium. The Board acknowledges investment act training alternatives as designated by the Texas Higher Education Coordinating Board or the Texas Society of Certified Public Accountants (Texas CPA investment training continuing education units) as acceptable sources of complying with Section 2256.007(d) of the Public Funds Investment Act. The CFO for System Administration shall prepare a report to the Board of any changes made to the Act impacting TSUS not later than the 180th day after the last day of each regular session of the Texas Legislature [2256.007(d)].
The following reporting requirements apply:

1. An Investment Officer related within the second degree by affinity or consanguinity to an individual seeking to sell an investment to TSUS shall file a statement disclosing that relationship;
2. An Investment Officer having a business relationship of any nature with an individual seeking to sell an investment to TSUS shall file a statement disclosing that relationship;
3. The disclosure shall be filed with the Board and the component President or with the Chancellor if the applicable Investment Officer is the CFO for System Administration.

No officer or designee may engage in an investment transaction except as provided under terms of this Policy. No Investment Officer or employee of TSUS may accept anything of value from counter-parties or others in connection with investment transactions.

**Investment Consultant**

System Administration and the components may contract with an investment management firm registered under the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-1 et seq.) to provide for management of the operating funds. The initial contract may not be for a term exceeding two years and renewals or extensions of the contract must be made by order or resolution of the Board.

The Consultant must certify to the receipt and review of this Policy and that it will act in accordance with the Policy; and it will provide the most recent copy of its ADV and ADV brochure to the CFO for System Administration and the CFO(s) for the component(s) that it advises.

The Investment Consultant’s responsibilities are to the System Administration and the components it advises. Additionally, the Consultant will:

- Assist in the development and implementation of investment policies, objectives, and guidelines to submit to the Board for approval each November.
- Review Investment Managers, including search, selection, and recommendation to the Investment Officer.
- Prepare and present performance evaluation reports in accordance to established investment standards.
- Review contracts and fees for both current and proposed Investment Managers.
- Communicate investment policies and objectives to managers, monitor those strategies, and notify the Investment Officers of any significant changes in portfolio managers, litigation, or violation of securities regulations.

**Investment Manager(s)**

System Administration and the components may contract with an investment management firm registered under the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-1 et seq.) or with the State Securities Board to provide for the investment and management of its public funds or other funds under its control. A contract made under authority of this subsection may not be for a term longer than two years. A renewal or extension of the contract must be made by the governing body of the investing entity by order or resolution.

The investment management firm must certify to the receipt and review of this Policy; it will
act in accordance with the Policy; and it will provide a copy of its most current ADV and ADV brochure to the CFO for System Administration and the CFO(s) for the component(s) that it advises.

All investment managers have a fiduciary responsibility to make a good faith determination that commissions paid to a broker are reasonable and competitive. All investment managers shall treat the accounts they manage as discretionary accounts and have authority to act for Investment Officers. The managers have the authority to make investment decisions for the purpose of placing orders to effect any purchase, sale, exchange, liquidation or other investment of the assets in the accounts, within their asset class, and according to this Policy, without obtaining prior approval.

TSUS requests that all orders for transactions of account assets be placed in such markets and through such brokers as shall offer the most favorable price, execution and commission cost of each order (best execution).

TSUS acknowledges that investment managers may from time to time and in accordance with applicable law pay commissions to brokers that are higher than those that might be obtainable elsewhere in order to obtain research and other services provided by such brokers in the expectation to enhance the long-term value of the account. The Investment Officers shall try to negotiate the contract without the use of these soft dollar arrangements. In the event that the soft dollar arrangements remain as part of the contract, the Investment Advisor shall review, at least annually, the investment managers’ soft dollar practices and any soft dollar purchases. The soft dollar purchases shall be aggregated and a report provided to the Investment Officers on an annual basis.

**Investment Custodians**

The Investment Custodians are responsible for the safekeeping of the Operating Fund’s assets. Their responsibilities are to:

- Provide timely and accurate reports detailing investment holdings, including:
  - statement of all securities and other assets held,
  - statement of all receipts, sales, redemptions, and principal payments,
  - statement of all distributions, expenses paid, purchases, and
  - statement of all income, and
  - establishing and maintaining separate accounts for each Investment Manager.

- Provide all normal custodian functions, including but not limited to:
  - security safekeeping,
  - collection of income,
  - settlement of trades,
  - collection of proceeds of maturing securities, and
  - daily investment of available cash.

**IV. STANDARD OF CARE**

The “prudent person standard” shall be the standard used in all investment functions and shall be applied in the context of individual transactions as well as management of the overall portfolio. Accordingly, all investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence
exercise in the management of their own affairs, not for speculation, but for investment, emphasizing the probable safety of their capital as well as the expected income to be derived.

All investments shall be consistent with this Policy. The Investment Officer shall not be held personally liable for a specific security's credit risk or market value change as long as actions were in accordance with this Policy; unexpected deviations were reported to the component President and the CFO for System Administration in a timely manner; and all appropriate actions were taken to control adverse developments.

V. INTERNAL CONTROLS

The Investment Officer(s) of each component shall establish written procedures supporting this Policy and promoting internal control. The procedures shall be directed towards preventing loss of funds due to fraud, employee error, misrepresentation, or imprudent actions. These procedures shall be reviewed annually and a copy of the procedures sent to the CFO for System Administration no later than November 1 of each year.

All components shall incorporate the following specific controls, as further defined by this Policy, into their operating procedures.

- All securities will be settled delivery versus payment (DVP) into the component’s depository or custodian bank,
- No securities will be safe-kept with a broker/dealer,
- Operating funds cash flow will be reviewed at a high level at least annually to determine investment strategy impact and projections,
- Every transaction will be documented for accounting information, and security description,
- All transaction documentation will be completed within five business days of receipt,
- An investment ledger will be maintained for reconciliation with the general ledger, bank reports, and trade confirmations on a monthly basis, at a minimum,
- A monthly reconciliation of transactions and income will be made,
- A review of the portfolio will be made by all Investment Officers at least quarterly,
- Designated levels of signatory approval will be set
- Investment reporting will be completed monthly, and
- All transactions will have dual control and/or oversight and separation of responsibilities.

VI. INVESTMENT STRATEGIES AND OBJECTIVES

Component operating funds may be commingled for investment purposes but will address the unique characteristics and needs of each fund group and classification of funds represented in the portfolio. Operating funds are constrained by expenditure plans and can serve a fiscal year or multiple year purposes.

The investment strategy for current operating, loan, plant, and agency funds has as its primary objective assurance that anticipated liabilities are matched and adequate investment liquidity provided. The secondary objective is to create a portfolio structure which will experience minimal volatility.
Funds are normally invested as follows:

**Operating Funds**
Funds needed to meet daily or short term operating requirements, usually held in an approved local government investment pool. These are funds meant to be used within the year and are typically invested in investments with maturities of less than 180 days; or investments with maturities of up to twelve (12) months.

**Non-Operating Funds**
Funds that have not been needed in the past, and are not anticipated to be needed for a minimum of 12 months or more. They are typically invested in investments with maturities of more than twelve (12) months.

A. The investment strategy for debt service funds shall have as its primary objective the assurance of available funds adequate to fund the debt service obligations on a timely basis. Two consecutive principal and interest payments must be held liquid at all times. The investment strategy for reserve funds shall have as its primary objective the ability to generate a revenue stream from high quality securities with a low degree of volatility. The potential for loss shall be further controlled through the purchase of securities within the specified maturity range dependent on use. Bond proceeds and reserves may be invested in a manner consistent with the requirements and restrictions stated in the applicable Bond Covenants.

B. The investment strategy for capital projects or capital project funds will have as its primary objective assurance that anticipated cash flows are matched and provide adequate investment liquidity. At least 10% total liquidity is planned to provide flexibility and for unanticipated project outlays. The stated final maturity dates of securities held shall be based on the project completion date, but typically may not exceed three years.

The intention is to match investments with projected cash flow and liquidity needs. TSUS may pursue an active versus a passive portfolio management strategy. That is, securities may be sold before they mature if market conditions present an opportunity for a net positive horizon fiscal benefit from the trade, or to manage a market downturn.

The Investment Officer and/or Investment Consultant will continuously monitor the contents of the portfolio, the available markets, and the relative value of all authorized, competing instruments to adjust the portfolio in response to market conditions.

VII. AUTHORIZED INVESTMENTS

Investments made by TSUS are restricted to the list reflected in this section. No change modifying or expanding this list will be authorized until the Policy is reviewed and adopted by formal action of the Board. All investments must comply with all applicable federal and state statutes, rules, regulations or policies. Investment of bond proceeds must be in accordance with the bond covenants.

Policy rating and diversification requirements must be met at time of purchase. Investments that were authorized at the time of acquisition but that are not currently authorized, including those no longer meeting the minimum rating requirements by at least one rating agency, are not required to be immediately liquidated. However, evaluation of the situation
and prudent measures will be taken, consistent with this Policy, to manage or sell these investments.

A. OPERATING CASH FUNDS LESS THAN $100 MILLION:

1. Obligations of the US Government, or its agencies and instrumentalities, direct obligations of this state or its agencies and instrumentalities, collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or an instrumentality of the United States, other obligations the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, this state or the United States or their respective agencies and instrumentalities, including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation or by the explicit full faith and credit of the United States; obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality or nationally recognized investment rating firm not less than A or its equivalent, and bonds issued, assumed, or guaranteed by the State of Israel. This includes collateralized mortgage obligations and excludes letters of credit with a maximum stated final maturity of five (5) years. Collateralized mortgage obligations may have a stated final maturity of ten years but an expected life of no more than five (5) years. The aggregate investment in all types of mortgage-backed securities shall not exceed 25% of the total portfolio.

2. Certificates of deposit issued by a state or national bank, a savings bank, or a state or federal credit union domiciled in this state, and guaranteed or insured by the FDIC or its successor or the National Credit Union Share Insurance Fund or its successor. The Certificate of Deposit must be secured by obligations that are consistent with section VI (a), including mortgage backed securities directly issued by a federal agency or instruments that have a market value of not less than the principal amount of the certificates, but excluding the mortgage backed securities listed in section VIII (f), or secured in any other manner and amount provided by law for deposits of the investing entity. Maximum allowable stated maturity for certificates of deposit is three (3) years. Investments in Federally insured or collateralized certificates of deposit through Texas banks or through Texas broker-dealers shown in Section XII.B of this Policy, provided that they are acquired, under the terms of an executed collateral agreement in accordance with FIRREA, collateralized in compliance with this Policy, to include the CDARS program, and not to exceed three (3) years to stated maturity.

3. Commercial paper with a stated final maturity not to exceed 270 days from the date of issuance rated A-1 or P-1 or equivalent by at least two nationally recognized rating agencies, or; Rated not less than A-1 or P-1 or an equivalent by one nationally recognized rating agency plus fully secured by an irrevocable letter of credit issued by a domestic bank.

4. Prime bankers acceptances must have a stated maturity of 270 days or fewer from the date of issuance, will be liquidated in full at maturity, and is eligible as collateral from a Federal Reserve Bank. Bank or bank holding company short-term obligations must be rated not less than A-1 or P-1 or an equivalent rating by at
least one nationally recognized credit rating agency.

5. Taxable or non-taxable governmental and municipal securities rated not less than A or equivalent by two nationally recognized rating organizations with a stated final maturity not to exceed five (5) years.

6. Corporate bonds, debentures, or similar debt obligations rated by a nationally recognized investment rating firm in one of the two highest long-term rating categories, without regard to gradations within those debt categories, with a maximum stated final maturity of five (5) years.

7. Constant dollar, Texas local government investment pools continuously rated AAA by at least one nationally recognized rating service and approved by resolution of the Board.

8. SEC-registered, money market mutual funds which have as an investment objective the maintenance of a stable net asset value (NAV) of $1 for each share, and have a dollar-weighted average stated maturity of 90 days or fewer. The investing entity must be provided a prospectus and other documentation as required by the SEC. In the event of SEC rules changes impacting the NAV of $1 the NAV of $1 requirement for money market mutual funds is waived.

9. No load mutual funds which are registered with and regulated by the SEC, and have a dollar-weighted average stated maturity of less than two years, and must conform to the requirements of this Policy. Maximum aggregate position size of these mutual funds is 15% of the Average Monthly Fund Balance excluding the dollar amounts of funds held for bond proceeds, reserves, and debt service. Investment in the fund can not constitute 10 % or more of the fund’s total assets under management.

10. Fully collateralized repurchase agreements with a defined termination date, secured by a combination of cash and obligations of the United States or its agencies and instrumentalities in accordance with this Policy, with securities purchased by or cash held by System Administration or the component, as applicable, to be pledged to System Administration or the component, as applicable, held in the name of System Administration or the component, as applicable, and deposited at the time the investment is made with System Administration or the component, as applicable, or with a third party selected and approved by the CFO for System Administration under the terms of a SIFMA Bond Market Master Repurchase Agreement, and placed through a primary government securities dealer, or a financial institution doing business in the state. A flex repurchase agreement may be used for bond funds with a stated maturity not to exceed the anticipated expenditure plan of the funds.

11. Interest bearing accounts in banks doing business in Texas held for investment purposes only.

12. Cash management and fixed income funds sponsored by organizations exempt from federal income taxation under section 501(f), Internal Revenue Code of 1986 (26 U.S. C. Section 501(f)).
13. Eligible investment pools. Must be continuously rated no lower than AAA or AAA- or at an equivalent rating by at least one nationally recognized rating service. Eligibility is based upon full compliance with provisions of section 2256.016 of the Public Funds Investment Act, including specific approval by the Board. An investment pool authorized by the Board must invest the funds it receives from TSUS as permitted by this Policy. An investment pool may invest its funds in money market mutual funds to the extent permitted by and consistent with the Public Funds Investment Act and objectives adopted by the investment pool. The weighted average maturity of the portfolio is limited to 60 days calculated using the reset date for variable rate notes ("VRNs") and 90 days or fewer using the final maturity date for VRNs, with the maximum maturity for any individual security in the portfolio not exceeding 397 days for fixed rate securities and 24 months for VRNs.

14. An entity is not required to liquidate investments that were authorized investments at time of purchase but have subsequently had a reduction of rating below the minimum. In cases where liquidation is desired, the CFO (or designee) for System Administration will monitor rating changes in investments acquired with public funds and will work with component CFOs (or designee) to develop prudent measures consistent with this Policy to liquidate an investment that does not meet the minimum rating requirements.

B. OPERATING CASH FUNDS GREATER THAN OR EQUAL TO $100 MILLION:

1. Obligations of the US Government, or its agencies and instrumentalities, direct obligations of this state or its agencies and instrumentalities, collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or an instrumentality of the United States, other obligations the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, this state or the United States or their respective agencies and instrumentalities, including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation or by the explicit full faith and credit of the United States; obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality or nationally recognized investment rating firm not less than A or its equivalent, and bonds issued, assumed, or guaranteed by the State of Israel. Collateralized Mortgage Obligations may have a stated final maturity date of no more than ten years.

2. Certificates of deposit issued by a state or national bank, a savings bank, or a state or federal credit union domiciled in this state, and guaranteed or insured by the FDIC or its successor or the National Credit Union Share Insurance Fund or its successor. The Certificate of Deposit must be secured by obligations that are consistent with section VI (a), including mortgage backed securities directly issued by a federal agency or instruments that have a market value of not less than the principal amount of the certificates, but excluding the mortgage backed securities listed in section VIII (f), or secured in any other manner and amount provided by law for deposits of the investing entity.

Investments in Federally insured or collateralized certificates of deposit through Texas banks or through Texas broker-dealers shown in Section XII. B of this Policy, provided that they are acquired, under the terms of an executed collateral
agreement in accordance with FIRREA, collateralized in compliance with this Policy, to include the CDARS program.

Negotiable Certificates of Deposit issued by a bank that has a certificate of deposit rating of at least 1 or the equivalent by a nationally recognized credit agency or that is associated with a holding company having a commercial paper rating of at least A1 or P1 or the equivalent by a nationally recognized credit rating agency.

3. Commercial paper with a stated final maturity not to exceed 270 days from the date of issuance rated A-1 or P-1 or equivalent by at least two nationally recognized rating agencies, or; Rated not less than A-1 or P-1 or an equivalent by one nationally recognized rating agency plus fully secured by an irrevocable letter of credit issued by a domestic bank.

4. Prime bankers acceptances must have a stated maturity of 270 days or fewer from the date of issuance, will be liquidated in full at maturity, and is eligible as collateral from a Federal Reserve Bank. Bank or bank holding company short-term obligations must be rated not less than A-1 or P-1 or an equivalent rating by at least one nationally recognized credit rating agency.

5. Taxable or non-taxable governmental and municipal securities rated not less than A or equivalent by at least one nationally recognized rating organizations.

6. Corporate bonds, debentures, or similar debt obligations rated by a nationally recognized investment rating firm in one of the two highest long-term rating categories, without regard to gradations within those categories.

7. Constant dollar, Texas local government investment pools continuously rated AAA by at least one nationally recognized rating service and approved by resolution of the Board.

8. SEC-registered, money market mutual funds which have as an investment objective the maintenance of a stable net asset value (NAV) of $1 for each share, and have a dollar-weighted average stated maturity of 90 days or fewer. The investing entity must be provided a prospectus and other documentation as required by the SEC. In the event of SEC rules changes impacting the NAV of $1 the NAV of $1 requirement for money market mutual funds is waived.

9. No load mutual funds which are registered with and regulated by the SEC, and have a dollar-weighted average stated maturity of less than two years, and must conform to the requirements of this Policy. Maximum aggregate position size of these mutual funds is 15% of the Average Monthly Fund Balance excluding the dollar amounts of funds held for bond proceeds, reserves, and debt service. Investment in the fund can not constitute 10 % or more of the fund’s total assets under management.

10. Fully collateralized repurchase agreements with a defined termination date, secured by a combination of cash and obligations of the United States or its agencies and instrumentalities in accordance with this Policy, with securities purchased by or cash held by System Administration or the component, as applicable, to be pledged to
1. System Administration or the component, as applicable, held in the name of System Administration or the component, as applicable, and deposited at the time the investment is made with System Administration or the component, as applicable, or with a third party selected and approved by the CFO of System Administration, under the terms of a SIFMA Bond Market Master Repurchase Agreement, and placed through a primary government securities dealer, or a financial institution doing business in the state.

The term of any reverse security repurchase agreement may not exceed 90 days after the date the reverse security repurchase agreement is delivered. Money received through a reverse security repurchase agreement shall be used to acquire additional authorized investments, but the term of the authorized investments acquired must mature not later than the expiration date stated in the reverse security repurchase agreement.

A flex repurchase agreement may be used for bond funds with a stated maturity not to exceed the anticipated expenditure plan of the funds.

11. Interest bearing accounts in banks doing business in Texas held for investment purposes only.

12. Cash management and fixed income funds sponsored by organizations exempt from federal income taxation under section 501(f), Internal Revenue Code of 1986 (26 U.S. C. Section 501(f)).

13. Eligible investment pools. Must be continuously rated no lower than AAA or AAA- or at an equivalent rating by at least one nationally recognized rating service. Eligibility is based upon full compliance with provisions of section 2256.016 of the Public Funds Investment Act, including specific approval by the Board. An investment pool authorized by the Board must invest the funds it receives from TSUS as permitted by this Policy. An investment pool may invest its funds in money market mutual funds to the extent permitted by and consistent with the Public Funds Investment Act and objectives adopted by the investment pool. The weighted average maturity of the portfolio is limited to 60 days calculated using the reset date for variable rate notes (“VRNs”) and 90 days or fewer using the final maturity date for VRNs, with the maximum maturity for any individual security in the portfolio not exceeding 397 days for fixed rate securities and 24 months for VRNs.

14. An entity is not required to liquidate investments that were authorized investments at time of purchase but have subsequently had a reduction of rating below the minimum. In cases where liquidation is desired, the CFO (or designee) for System Administration will monitor rating changes in investments acquired with public funds and will work with component CFOs (or designee) to develop prudent measures consistent with this Policy to liquidate an investment that does not meet the minimum rating requirements.

**Securities Lending**

A fully collateralized securities lending program may be utilized to fully maximize the value of assets held. A contract to lend securities under this option must have a term of
one year or less and is restricted to primary dealers or banks doing business in Texas. Collateral margins are 102%, including accrued income, and ownership clearly established under the loan. A loan made under the program must allow for termination at any time, and secured by pledged irrevocable letters of credit issued by a bank that is organized and existing under the laws of the United States or other state, and is continuously rated by at least one nationally recognized investment rating firm at not less than A or its equivalent. The securities being held as collateral must be pledged to the investing entity, held in the investing entity’s name, and deposited at the time the investment is made with the entity or with a third party selected by or approved by TSUS. Contracts must be competitively bid and analyzed and the program established by written agreement. The entire portfolio may be lent under the program.

VIII. DIVERSIFICATION

Investment Officers shall diversify the portfolio(s) by maturity and market sector to minimize market risks and align with the liquidity needs of their institution.

Annually, all Investment Officers shall review the projected cash flow to determine the short, intermediate, and long term cash needs of the institution. Investment Officers are required to review current levels and projections on a rolling quarterly basis and submit these to the component’s President each fiscal year end. The CFO shall consider extension risk when diversifying the portfolio.

TSUS recognizes that investment risks can result from issuer defaults, market price changes, or various technical complications leading to temporary illiquidity. Risk is controlled through portfolio diversification. The maximum limits for diversification of the total portfolio will be:

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<th>Operating Funds</th>
<th>&lt;$100 M</th>
<th>&gt;= $100 M</th>
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<td>Max. % of Portfolio</td>
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IX. PROHIBITED INVESTMENTS AND ACTIVITIES

The following are unauthorized transactions and securities for TSUS. Any change in this list shall require amendment of this Policy and adoption by the Board.

A. TSUS may not purchase or sell financial futures, options, interest rate swaps, or forward rate agreements.

B. TSUS may not engage in adjusted trading or short sales.

C. TSUS may not purchase residual interests in CMOs/REMICs, mortgages serving rights, commercial mortgage backed securities, or small business related securities (excluding Small Business Administration debentures). Specific securities that may not be purchased are:

1. inverse CMO floaters
2. principal only CMOs
3. interest only CMOs

D. TSUS may not purchase 144-A or other private placement securities not registered with the SEC.

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

X. SAFEKEEPING

All securities, including collateral bought under a repurchase agreement, but excluding investment pool funds, certificates of deposit, and mutual funds, shall be settled on a delivery versus payment (DVP) basis. All securities shall be held by System Administration’s or the component’s depository bank, as applicable, or an independent third party custodian approved by the State of Texas. All securities will be held in the name of System Administration or the component, as applicable. No broker/dealer shall be used for safekeeping purposes.

The third party custodian of TSUS-owned assets shall be required to issue an original safekeeping trust statement to the System Administration or the component, as applicable, on a timely basis describing the specific instrument, coupon, maturity, par, CUSIP, and other pertinent information. The safekeeping receipt shall clearly identify ownership by System Administration or the component, as applicable.

XI. COLLATERALIZATION

All time and demand deposits in financial institutions shall be fully collateralized on
balances in excess of federal insurance in accordance with the TSUS Depository Funds Policy. Depository agreements shall be executed in accordance with the Financial Institutions Resource, Recovery and Enforcement Act (FIRREA) which requires a written agreement and a resolution from the Bank Board or Bank Loan Committee.

In order to anticipate market price changes and provide additional security for all funds, the collateralization level will be maintained and monitored, at a minimum, at 102% of the value of principal and accrued interest. The pledging institution shall be contractually liable for monitoring and maintaining this margin daily.

Collateral pledged to secure deposits shall be held in the name of System Administration or the component, as applicable, by an independent financial institution outside the holding company of the depository in accordance with a safekeeping agreement signed by authorized representatives of System Administration or the component, as applicable, the depository, and the custodian. A collateral safekeeping trust statement must be issued to the component no less than monthly. All collateral shall be subject to inspection and audit by TSUS or its independent auditors.

**Authorized Collateral**

The following securities are the only authorized collateral for time and demand deposits:

A. FDIC insurance coverage.

B. Obligations of the United States, its agencies or instrumentalities, or other evidence of indebtedness of the United States guaranteed as to principal and interest, including MBS which pass the bank (volatility) test and are eligible as collateral with the Federal Reserve.

C. Obligations, the principal and interest on which, are guaranteed or insured by the State of Texas or Texas political subdivisions having been rated no less than “A” or its equivalent) by two nationally recognized rating agencies.

D. Obligations of any state or of a county, city or other political subdivision of a state having been rated no less than “A” (or its equivalent) by at least one nationally recognized rating agency.

In accordance with the Depository Funds Policy, if a depository offers 'pooled collateral' as a collateral alternative, the Investment Officer shall evaluate the risk and cost of the program and provide that information to the CFO for System Administration for possible approval by the Board.

**XII. AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS**

A. If a business organization (including investment pools and investment management firms under contract) is not utilized, then the transaction requires competitive bidding by at least three broker/dealers.

B. An "Authorized Broker/Dealer List" of financial institutions and broker/dealers authorized to do business with TSUS shall be compiled and maintained by the CFO
for System Administration. All Investment Officers who invest directly will utilize the authorized list. The CFO for System Administration will provide an official list to component Investment Officers.

C. Authorized broker/dealers will be required to conform with compliance requirements and procedures established by the CFO for System Administration to include the following:

- brokers/dealers must complete a questionnaire supplying basic firm and broker contact and delivery information,
- brokers/dealers may be affiliated with a Texas bank, designated by the New York Federal Reserve Bank as "primary dealers" or qualify as regional dealers under the Securities and Exchange Commission's "Uniform Net Capital Rule",
- brokers/dealers must be FINRA (Financial Institutions Regulatory Authority),
- brokers/dealers must be registered with the Texas Securities Commission, and;
- brokers/dealers must provide the written certification detailed below.

D. Certification: A written copy of this Policy shall be presented to any firm or person seeking to engage in an Operating investment transaction with TSUS. This includes business organizations, brokers/dealers, and banks.

Nothing in this section relieves the investing entity of the responsibility for monitoring the investments made by the investing entity to determine that they are in compliance with this Policy.

E. The Qualified Representative of the business organization or the broker offering to engage in an investment transaction shall certify in writing substantially to the effect that the registered principal or broker has:

1. received and reviewed this Policy and
2. acknowledged that the business organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between TSUS and the organization that are not authorized by this Policy except to the extent that this authorization is dependent on an analysis of the makeup of the entire portfolio or requires an interpretation of subjective portfolio standards.

Investment Officers may not acquire or otherwise obtain any investment from a person, bank or firm that has not delivered to the CFO for System Administration this certification as confirmed by the CFO for System Administration.

F. Banks providing certificates of deposit or demand deposits shall provide to the CFO for System Administration their most recent audited annual financial statements as soon as legally available.

Financial institutions providing safekeeping services for the collateral (for repurchase agreements) or securities of the TSUS shall provide financial statements annually and information on the institution shall be maintained by the CFO for System Administration.
XIII. INVESTMENT REPORTING AND MONITORING

A. Investment Officers shall cause to be prepared and review a written report of investment transactions for all funds covered under the Public Funds Investment Act not less than quarterly. The report is to be submitted to the CFO for System Administration or designee and any respective component President by the end of the next month following the end of each quarter.

This report will be consolidated into a system-wide summary report to be submitted to the Board through the Finance and Audit Committee in the format prescribed by the Act and Committee, the General Appropriations Act and requirements promulgated by other oversight agencies.

The reports must:

1. describe in detail the investment position of the component on the date of the report;
2. be prepared jointly by all investment officer(s) of the component;
3. be signed by each investment officer(s) of the component;
4. contain a summary statement of each pooled fund group that states the:
   (a) beginning market value (defined as trade date with accruals) for the reporting period;
   (b) ending market value (defined as trade date with accruals) for the period; and
   (c) fully accrued interest for the reporting period;
5. state the book value and market value of each separately invested asset at the end of the reporting period categorized by the type of asset and fund type invested;
6. state the maturity date of each separately invested asset that has a maturity date (liquid positions will carry next day end dates);
7. state the account, fund or portfolio for which the investment was acquired; and
8. state the compliance of the investment portfolio of the component as it relates to:
   (a) the investment strategy expressed in this Policy; and
   (b) relevant provisions of the Act.
9. state the performance investment return in comparison to the established benchmarks as established by this Policy. Investment returns are to be calculated net of fees, using the performance reporting methodology found in the Global Investment Performance Standards Handbook published under the guidance of the CFA Institute
   http://www.cfainstitute.org/ethics/codes/gipsstandards/Pages/index.aspx

The Global Investment Performance Standards (GIPS Standards) is a set of standardized, industry-wide ethical principles that provides guidance on how to calculate and report investment results.

Market prices are to be obtained from an independent, published source such as the Wall Street Journal, a custodian bank, and/or through a contractual arrangement with a pricing service. MBS prices are not to be obtained from broker/dealers having sold TSUS the MBS.
XIV. BENCHMARKS

Benchmarks designed to measure performance and risk on the portfolios are established by Policy based on the objectives and limits of cash flow and spending.

The benchmarks used for reporting purposes will be the 182 day T-Bill rate for Operating Funds, and the Merrill Lynch 1-3 year Treasury for Non-Operating Funds, or other such recognized indices which are most appropriate for the portfolio.

XV. AUDITS

A. TSUS shall have a compliance audit of management controls on investments and adherence to the Public Funds Investment Act and this Policy at least once every two years. The audit shall be performed by the Office of Audits & Analysis or by a private auditor and the results of the audit shall be reported to the Board and the State Auditor not later than January 1 of each even-numbered year.

B. If a component invests in other than money market mutual funds, investment pools or accounts offered by its depository bank in the form of certificates of deposit or money market accounts, the reports prepared by the investment(s) officers shall be reviewed at least annually by an independent auditor, and the results reported to the Board.

XVI. INVESTMENT POLICY ADOPTION AND CERTIFICATION

This Policy shall be reviewed and adopted annually by the Board. The Policy adopted by the Board shall record any changes made to either the investment policy or investment strategies.