

RESOLUTION NO. 2010-21

A RESOLUTION OF THE MAYOR AND COUNCIL OF THE TOWN OF FOUNTAIN HILLS, ARIZONA, ADOPTING THE AMENDED AND RESTATED TOWN OF FOUNTAIN HILLS INVESTMENT/CASH MANAGEMENT POLICY.

WHEREAS, the Mayor and Council of the Town of Fountain Hills (the “Town Council”) approved Resolution No. 2003-09 on March 20, 2003, adopting the Town of Fountain Hills Investment/Cash Management Policy (the “Investment Policy”) to establish the framework for the Town’s investment activities; and

WHEREAS, the Mayor and Council of the Town of Fountain Hills desire to amend and restate the Investment Policy to incorporate additional investment options.

NOW, THEREFORE, BE IT RESOLVED BY THE MAYOR AND COUNCIL OF THE TOWN OF FOUNTAIN HILLS as follows:

SECTION 1. The recitals above are hereby incorporated as if fully set forth herein.

SECTION 2. The Town of Fountain Hills Investment/Cash Management Policy, Amended and Restated December 2, 2010, is hereby adopted in the form attached hereto as Exhibit A and incorporated herein by reference.

SECTION 3. The Mayor, the Town Manager, the Town Clerk and the Town Attorney are hereby authorized and directed to take all steps and to execute all documents necessary to carry out the purpose and intent of this Resolution.

PASSED AND ADOPTED by the Mayor and Council of the Town of Fountain Hills, December 2, 2010.

FOR THE TOWN OF FOUNTAIN HILLS:

ATTESTED TO:

Jay T. Schlum, Mayor

Bevelyn J. Bender, Town Clerk

REVIEWED BY:

APPROVED AS TO FORM:

Richard L. Davis, Town Manager

Andrew J. McGuire, Town Attorney

EXHIBIT A
TO
RESOLUTION NO. 2010-21

[Town of Fountain Hills Investment/Cash Management Policy
Amended and Restated December 2, 2010]

See following pages.

**TOWN OF FOUNTAIN HILLS
INVESTMENT/CASH MANAGEMENT POLICY
AMENDED AND RESTATED
DECEMBER 2, 2010**

TOWN OF FOUNTAIN HILLS

INVESTMENT/CASH MANAGEMENT POLICY

1.0 **Policy:**

It is the investment policy of the Town of Fountain Hills that idle public funds will be invested in a manner which maintains the safety of principal, maintains liquidity to meet cash flow needs, provides competitive investment returns and conforming to all state and local statutes governing the investment of public funds. The purpose of these investment guidelines is to formalize the framework for the Town's daily investment activities to include scope, prudence, objectives, authority, eligible investments, collateralization and diversification.

The Town, pursuant to A.R.S. § 35-323, has determined that a portion of the assets of the Town fund balance are reserved and may be invested in long term (more than 30 days) government securities; the allocation of funds in long term securities shall be capped at 60% of the total reserved balance of all funds including the Rainy Day Fund.

2.0 **Scope:**

This investment policy shall be administered in a manner that follows A.R.S. Title 35, Chapter 2, Article 2.1 and other investment guidelines mandated by statute and is limited in its application to funds that are not immediately needed and are available for investment, including any and/or all districts, component units, etc. (hereinafter referred to as "the Town"). These funds are accounted for in the Town of Fountain Hills **Annual Financial Report** and may include:

2.1 **Funds:**

- 2.1.1 General Fund
- 2.1.2 Special Revenue Funds
- 2.1.3 Excise Tax Funds
- 2.1.4 Capital Project Funds
- 2.1.5 Debt Service Funds
- 2.1.6 Municipal Property Funds
- 2.1.7 Internal Service Funds
- 2.1.8 Any new fund/component unit created unless specifically exempted.

Except for cash in certain restricted, special funds and indentured funds, the Town will consolidate cash balances from all funds to maximize investment earnings. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

3.0 **Prudence:**

Investments shall be made with judgment and care--under circumstances then prevailing--which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

3.1 The standard of prudence to be used by any firm or individual given responsibility as investment official shall be the "**prudent person**" standard and shall be applied in the context of a professional investment official managing an overall portfolio or account in a manner that aims to accomplish the objectives set forth in these policies. Investment officers acting in accordance with the Town's written procedures and the 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.

4.0 **Objective:**

The primary objectives, in priority order, of the Town of Fountain Hills investment activities shall be:

4.1 **Safety:** Safety of principal is the foremost objective of the investment program. Investments of The Town shall be undertaken in a manner that seeks to ensure the preservation of principal in the overall portfolio. To attain this objective, **diversification** is required in order that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio. The objective will be to prudently mitigate credit risk and interest rate risk.

4.2 **Liquidity:** The Town of Fountain Hills investment portfolio will remain sufficiently liquid to enable the Town of Fountain Hills to meet all operating requirements which might be reasonably anticipated. Liquidity will be achieved by matching investment maturities with forecasted cash flow funding requirements, by investing in securities with active secondary markets and by diversification of maturities and call dates. Furthermore, since all possible cash demands cannot be anticipated, a portion of the portfolio may also be placed in savings accounts, Certificates of Deposit or local government investment pools which offer same day liquidity for short term funds.

4.3 **Return on Investments:** The Town of Fountain Hills investment portfolio shall be designed with the objective of regularly exceeding the average rate of return on three month U.S. Treasury Bills and commensurate with the Town of Fountain Hills investment risk constraints and the cash flow characteristics of the portfolio. Return shall be subordinated to safety and liquidity. The core of investments is limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall not be sold prior to maturity with the following exceptions:

- A security with declining credit may be sold early to minimize loss of principal.
- A security swap would improve the quality, yield or target duration in the portfolio.
- Liquidity needs of the portfolio require that the security be sold.
- If market conditions present an opportunity for the Town to benefit from the sale.

Risk of Loss: All participants in the investment process will seek to act responsibly and prudently as custodians of the public trust. Investment officials will avoid any transactions that they reasonably believe might impair public confidence in the Town's ability to govern effectively. The governing body recognizes that in a diversified portfolio, occasional measured losses due to market volatility are inevitable, and must be considered within the context of the overall portfolio's investment return, provided that adequate diversification has been implemented.

5.0 **Investment Strategy:**

The Town of Fountain Hills intends to pursue a passive portfolio management philosophy; passive management means that the financial markets will be monitored by investment officials and investments will be purchased and sold based on the Town's parameters for safety and liquidity and based on market conditions. All marketable securities purchased by the Town shall have active secondary markets, unless a specific cash outflow is being matched with an investment that will be held to maturity to meet that obligation. Securities may be purchased as a new issue or in the secondary markets. Securities may be sold as provided in Section 4.3. Securities may be purchased with the intent from the beginning, to sell them prior to maturity or with the expectation that the security would likely be called prior to maturity under the analyzed market scenario. The portfolio will be structured to benefit from anticipated market conditions and to achieve a reasonable return. Relative value between asset groups shall be analyzed and pursued as part of the investment program within the restrictions set forth by this policy. Diversification by market sector and security types, as well as maturity will be used to protect the Town from credit and market risk in order to meet liquidity requirements. Market and credit risk shall be minimized by diversification and are defined below:

Credit Risk: The Town will seek to mitigate credit risk, which is defined as the risk of loss due to failure of the security issuer or backer. Mitigating credit risk is to be accomplished by:

- Limiting investments in the portfolio to the asset classes designated as acceptable in A.R.S. §35-323 provided, however, any investments described in Paragraph 8 or 9 of such statute section shall require written consent from the Finance Director. When possible, analysis of the credit worthiness of all individual debt issuers held in the portfolio should be conducted on an annual basis in an effort to guard against investing in weak or deteriorating credit situations.
- Pre-qualifying the financial institutions, broker/dealers, and investment advisers with which the Town will do business in accordance with Section 7.

Interest Rate Risk: The Town will seek to mitigate interest rate risk, which is defined as the risk that the market value of securities held in the portfolio will decline due to increases in market interest rates subsequent to their purchase. This mitigation will be accomplished by:

- Structuring the investment portfolio so that securities mature concurrent with the anticipated cash requirements for ongoing operations, thereby avoiding, as much as possible, the need to sell securities into an adverse market environment prior to maturity
- Investing funds primarily in shorter-term securities or similar investment pools and limiting the average maturity of the portfolio in accordance with the needs of the Town
- With respect to any firm or individual given responsibility for investments utilizing external research and advice regarding the current interest rate outlook and global economic condition to optimize portfolio duration strategy.

6.0 **Responsibility and Control:**

6.1 **Delegation of Authority:** Authority to manage the Town of Fountain Hills investment program is derived from the ARS §35-323 through 328. Management responsibility for the investment program is hereby delegated to the Town of Fountain Hills Finance Director, or

designee, who shall establish written procedures for the operation of the investment program consistent with this investment policy. Procedures should include reference to: *safekeeping, PSA repurchase agreements, wire transfer agreements, banking service contracts and collateral/depository agreements*. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Finance Director.

No person shall engage in an investment transaction except as provided under the terms of this policy, the procedures established by the Finance Director, or designee, and verbal or written authorization by the Finance Director to withdraw, transfer, deposit and invest the Town's funds.

The Finance Director shall be responsible for all transactions undertaken, and shall establish a system of controls to regulate the activities of subordinate investment officials. The Finance Director has the authority to manage internally or to delegate the management of the investment program to an investment adviser. If authority to manage all or a part of the investment program of the Town is delegated to an investment adviser, the Finance Director is responsible for:

- Periodic investment portfolio reporting
- Evaluating the performance of the externally managed portfolio
- Monitoring investment adviser's compliance with the investment policy
- Conveying the investment needs of the Town to the investment adviser
- Developing investment strategy with the investment adviser

6.2 Ethics and Conflicts of Interest: All persons involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the Town Manager any material financial interests in financial institutions that conduct business within this jurisdiction, and they shall further disclose any material personal financial/investment positions that could be related to the performance of the Town of Fountain Hills, particularly with regard to the time of purchases and sales. This policy expressly incorporates the provision of Title 38, Chapter 3, Article 8, Arizona Revised Statutes.

6.3 Disclosure: Investment officials and employees shall disclose to the Town Manager any material financial interest in financial institutions that conduct business with the Town of Fountain Hills. Investment officials and employees shall further disclose any material personal investment positions that could be related to the performance of the Town's investment portfolio. Investment officials and employees shall subordinate their personal investment transaction to those of this jurisdiction, particularly with regard to the timing of purchases and sales. An investment official who is related within the second degree by affinity or consanguinity to individuals seeking to sell an investment to the Town shall file a statement disclosing that relationship.

6.4 Investment Training: Investment officials shall have a finance, accounting or related degree and knowledge of treasury functions and the State of Arizona laws governing public money management and investments. Investment training must take place not less than once in a two year period, and receive no less than ten hours of instruction relating to investment responsibilities from an independent source such as Government Finance Officers Association, Municipal Treasurers Association, American Institute of Certified Public Accountings, Arizona Finance Officers Association, Arizona Society of Public Accounting or other professional

organizations. The Finance Director and all investment officials of the Town shall attend at least one training session relating to their cash management and investment responsibilities within 12 months after assuming these duties for the Town. Training must include education in investment controls, security risks, strategy risks, market risks, and compliance with state investment statutes.

7.0 **Authorized Financial Dealers and Institutions:**

The Finance Director will maintain a list of qualified persons or firms authorized to provide investment services that have been publicly procured. In addition, a list will also be maintained of approved security **broker/dealers** selected by credit worthiness who are authorized to provide investment services in the State of Arizona. The Town shall qualify persons or firms by applying generally accepted industry standards (i.e. capital requirements, asset quality, earnings, liquidity, management and local community development) using available public agency and private rating services as appropriate. Investment transactions shall only be conducted with financial institutions that are licensed as may be required by law to do business in Arizona. Primary government securities dealers, or broker-dealers engaged in the business of selling government securities shall be registered in compliance with section 15 or 15C of the Securities Exchange Act of 1934 and registered pursuant to A.R.S. §44-3101, as amended. It shall be the responsibility of the financial institutions and broker/dealers who desire to become qualified bidders for investment transactions to provide the following:

- a) audited financial statements within six months of the close of the fiscal year,
- b) proof of National Association of Security Dealers certification, trading resolution,
- c) proof of Arizona registration,
- d) certification of having read the Town of Fountain Hills investment policy and depository contracts.

An eligible listing of broker/dealers shall be established for the purchase and sale of investment securities; a new list of approved broker/dealers will be established as needed and at least every five years. An annual review of the financial condition and registrations of qualified companies will be conducted by the Town Manager.

7.1 **Selection of Depository, Financial Institutions and Broker/Dealers:**

Depositories shall be selected through the Town's procurement process, which shall include a formal request for proposal (RFP) issued at least every five years, with a typical contract being for two (2) years with an option to extend the contract for three (3) additional one (1) year terms. In selecting depositories, the credit worthiness of institutions shall be considered, and the Finance Director shall conduct a comprehensive review of the prospective depositories' credit characteristics and financial history. No public deposit shall be made except in an eligible public depository as established by state depository laws. The depository bank bid will not include bids for investment rates on certificates of deposit.

Certificate of deposit rates will be evaluated competitively between qualified financial institutions in accordance with the manner in which all other types of investment assets are purchased. Investment officials for the Town may accept bids for certificates of deposit and for all marketable securities either orally, in writing, electronically, or in any combination of these methods. The investment official will strive to receive two to three price quotes on marketable securities being sold, but may allow one broker/dealer to sell at a predetermined price under certain market conditions. Investments purchased shall be shopped competitively between approved financial institution and broker/dealers.

7.2 **Insurability:** Banks, financial institutions, individuals and firms seeking to establish eligibility for the Town's certificates of deposit purchase program, shall submit financial statements, evidence of federal insurance and other information as required by the investment officials of the Town of Fountain Hills.

8.0 **Portfolio and Investment Asset Parameters:**

8.1 **Pricing:** Market price for investments acquired for the Town's investment portfolio shall be priced using independent pricing sources and market value monitor at least annually.

8.2 **Eligible Investments:** In addition to investments authorized by State law, the following forms of investment are specified as eligible investments; all investments will carry a minimum A (Investment Grade) or better rating of Moody's Investors Service or a A (Investment Grade) or better rating of Standard and Poor's Rating Service or their successors. All investments not listed will be considered prohibited investment purchases.

- a) Insured or if in excess of insurance, collateralized, certificates of deposit, savings accounts, deposit accounts or money market deposits issued by a national bank or savings and loan domiciled in the State of Arizona, in amounts that are continuously and fully insured by the Federal Deposit Insurance Corporation ("FDIC"), including the Bank Insurance Fund and the Savings Association Insurance Fund, collateralized at no less than 102 percent.
- b) State of Arizona Local Government Investment Pool – GOV.
- c) U.S. government obligations, senior debt of U.S. government agencies, and U.S. government instrumentality obligations, which have a liquid market with a readily determinable market value.
- d) Direct obligations of this state or its agencies.
- e) Other obligations, the principal and interest of which are unconditionally guaranteed or insured by the State of Arizona, the United States or its instrumentalities.
- f) Money market funds investing exclusively in obligations authorized by the preceding paragraphs, (a) through (e) of this section of the policy.
- g) Certificates of deposit in one or more federally insured banks or savings and loan associations pursuant to the provisions of Arizona Revised Statutes §35-323.01.

8.3 **Prohibited Investments:** In addition to the limitations on investment types according to Arizona statutes, Town funds will not be invested in:

- a) reverse repurchase agreement
- b) callable agencies
- c) derivative type investments such as collateralized mortgage obligations, strips, floaters, etc.
- d) futures, contractual swaps, options
- e) inverse floaters
- f) interest only securities
- g) forward contracts
- h) interest bearing securities that have a possibility of not accruing current income
- i) closed end management type companies

- j) securities whose yield/market value is based on currency, commodity or non-interest indices
- k) bearer-form securities

Certain types of such investments may qualify under state statute but are not deemed appropriate for use by the Town of Fountain Hills.

9.0 **Collateralization:**

Collateralization will be required on all types of investments: including certificates of deposit, money market or savings accounts, securities, etc. In order to anticipate market changes and provide a level of security for all funds, the collateralization level will be (102%) of market value of principal and accrued interest. Acceptable collateral of surplus cash in demand deposit accounts and certificates of deposit are:

- direct obligations of the United States Government, its agencies or instrumentalities to the payment of which the full faith and credit of the Government of the United States is pledged, or obligations to the payment of which the full faith and credit of this state is pledged.

The Federal Deposit Insurance Corporation (FDIC) protects deposits. The Town will seek to collateralize certificates of deposit or any other time deposits less the amount insured by the FDIC. Collateral will always be held by an independent third party with whom the Town of Fountain Hills has a current custodial agreement. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to the Town of Fountain Hills and retained.

The Town of Fountain Hills shall accept only the following insurance and securities as collateral for cash deposits, certificates of deposit, and repurchase agreements:

- a) FDIC insurance coverage
- b) Obligations of the United States of America, its agencies and instrumentalities, including agency and instrumentality issued mortgage backed collateral if directly guaranteed by the U.S of America.
- c) Other obligations , the principal of and interest on which are unconditionally guaranteed or insured by the State of Arizona, the United States of America or its agencies and instrumentalities.
- d) Obligations of states, agencies thereof, counties, cities, and other political subdivisions of any state having been rated as to investment quality by a nationally recognized investment rating firm and having received a rating of no less than A or its equivalent.

10.0 **Safekeeping and Custody:**

All security transactions including collateral for repurchase agreements, entered into by the Town of Fountain Hills or it's agents/trustees shall be conducted on a **delivery-versus-payment (DVP)** basis. That is, funds shall not be wired or paid until verification has been made that the safekeeping bank received the correct security. The safekeeping, or custody, bank is responsible for matching instructions from the Town's investment officials on an investment settlement, with what is wired from the broker/dealer, prior to releasing the Town's designated funds for a given purchase. The security shall be held in the name of the town, or held on behalf of the Town, in a bank nominee

name. A third party custodian designated by the Finance Director and evidenced by safekeeping receipts will hold securities. The safekeeping bank's records shall assure the notation of the Town's ownership of, or explicit claim on, the securities. The original copy of all safekeeping receipts shall be delivered to the Town. Securities shall be held by a custodian designated by the Town Manager and evidenced by safekeeping receipts.

11.0 **Diversification:**

The Town of Fountain Hills will diversify its investments by security type and institution. With the exception of U.S. Treasury securities and authorized pools, no more than 25% of the Town of Fountain Hills' total investment portfolio will be invested in a single security type or with a single financial institution. Investments will be diversified by:

- Limiting investments to avoid over-concentration in securities from a specific issuer or business sector;
- Limiting investments in securities with higher credit risks;
- Investing in securities with varying maturities; and
- Continuously investing a portion of the portfolio in readily available funds such as the Local Government Investment Pool or money market funds to ensure that appropriate liquidity is maintained to meet ongoing obligations.

12.0 **Maximum Maturities:**

12.1 **Maximum maturities:** To the extent possible, the Town or its agents/trustees will attempt to match its investments with anticipated operating cash flow requirements. Unless matched to a specific cash requirement, the Town shall not directly invest in securities maturing more than two (2) years from the date of purchase. Reserve or other funds with longer-term investment horizons may be invested in securities **not??** exceeding five years, if the maturities of such investments are made to coincide as nearly as practicable with the expected use of funds. The Town shall adopt weighted average maturity limitations consistent with the investment objectives.

12.2 **Maximum Dollar-Weighted Average Maturity:** Under most market conditions, the composite portfolio will be managed to achieve a two year dollar-weighted average maturity. However, under certain market conditions, investment officials may need to shorten or lengthen the average life or duration of the portfolio to protect the Town. The maximum dollar weighted average maturity based on the stated final maturity, authorized by this investment policy for the composite portfolio of the town shall be four years.

12.3 **Pricing:** Market price for investments acquired for the Town's investment portfolio shall be priced using independent pricing sources and market value monitored at least annually.

13.0 **Internal Control:**

The Town Manager shall establish an annual process of independent review as part of the external audit. This review will provide internal control by assuring compliance with policies and

procedures. The investment officer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the Town are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met.

14.0 **Reporting:**

The Town Manager or designee is charged with the responsibility of including a report on investment activity and returns in the Town of Fountain Hills Comprehensive Annual Financial Report. The report shall summarize investment transactions that occurred during the reporting period, and shall discuss the current portfolio in terms of *performance, market sector breakdown, number of trades, interest earnings, and other features.*

15.0 **General Obligation Bond Fund Proceeds**

General obligation bond fund proceeds shall be invested pursuant to applicable laws, relevant bond indenture requirements and relevant tenets of this policy. Proceeds from tax-exempt general obligation bonds shall be invested, recorded and reported in the manner set forth by the U.S. Treasury and Internal Revenue Service to preserve the tax-exempt status of the bonds. The Finance Department will maintain systems to ensure that these requirements are met. Funds set aside to defease Town debt in conjunction with an advance refunding agreement, will be invested in accordance with State statutes and appropriate bond documents and as the trustee bank holding such funds deems necessary.

16.0 **Investment Policy Adoption:**

The Town of Fountain Hills investment policy shall be adopted by resolution of the Town of Fountain Hills legislative authority. The policy shall be reviewed at least once every five years by the Town Manager and any modifications made thereto must be approved by the Town Council.

17. **Certification**

A copy of this policy will be provided upon request to the senior management of any financial institution who is approved to transact business with the Town in order that it is apprised of the policies of the Town. The certification must be signed and executed by a senior member of the financial institution before any business is conducted.

GLOSSARY

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

ASKED: The price at which securities are offered.

BANKERS' 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.

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

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

BROKER: A broker brings buyers and sellers together for commission.

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination CD's 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 of public monies.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report for the Town of Fountain Hills. It includes five combined statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

COUPON: (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. (b) A certificate attached to a bond evidencing interest due on a payment date.

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

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

DELIVERY VERSUS PAYMENT: There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

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 a discount and redeemed at maturity for full face value, e.g. U.S. Treasury Bills.

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

FEDERAL CREDIT AGENCIES: Agencies of the Federal Government set up to supply credit to various classes of institutions and individuals, e.g., S&L's small business firms, students, farmers, farm cooperatives, and exporters.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits, currently up to \$250,000 per deposit.

FEDERAL FUNDS RATE: The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

FEDERAL HOME LOAN BANKS (FHLB): The institutions that regulate and lend to savings and loan associations. The Federal Home loan Banks play a role analogous to that played by the Federal Reserve Banks vis-a-vis member commercial banks.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA): FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans, in addition to fixed-rate mortgages.

FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

FEDERAL OPEN MARKET COMMITTEE (FOMC): Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

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., 12 regional banks and about 5,700 commercial banks that are members of the system.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA OR GINNIE MAE): Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. Security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA or FMHM mortgages. The term "passthroughs" is often used to describe Ginnie Maes.

INTERNAL CONTROLS: An internal control structure designed to ensure that the assets of the entity are protected from loss, theft, or misuse. The internal control structure is designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that 1) the cost of a control should not exceed the benefits likely to be derived and 2) the valuation of costs and benefits requires estimates and judgments by management. Internal controls should address the following points:

1. Control of collusion – Collusion is a situation where two or more employees are working in conjunction to defraud their employer.
2. Separation of transaction authority from accounting and record keeping – by separating the person who authorizes or performs the transaction from the people who record or otherwise account for the transaction, a separation of duties is achieved.
3. Custodial safekeeping – Securities purchased from any bank or dealer including appropriate collateral (as defined by state law) shall be placed with an independent third party of custodial safekeeping.
4. Avoidance of physical delivery securities –

Book-entry securities are much easier to transfer and account for since actual delivery of a document never takes place. Delivered securities must be properly safeguarded against loss or destruction. The potential for fraud and loss increases with physically delivered securities.

5. Clear delegation of authority to subordinate staff members – subordinate staff members must have a clear understanding of their authority and responsibilities to avoid improper actions. Clear delegation of authority also preserves the internal control structure that is contingent on the various staff positions and their respective responsibilities.
6. Written confirmation of transactions for investments and wire transfers – due to the potential for error and improprieties arising from telephone and electronic transactions, all transactions should be supported by written communications and approved by the appropriate person. Written communications may be via fax if on letterhead and if the safekeeping institution has a list of authorized signatures.
7. Development of a wire transfer agreement with the lead bank and third-party custodian – the designated official should ensure that an agreement will be entered into and will address the following points: controls, security provisions, and responsibilities of each party making and receiving wire transfers.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

LOCAL GOVERNMENT INVESTMENT POOL (LGIP): The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment.

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

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to 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: The market in which short-term

debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

NATIONAL ASSOCIATION OF SECURITIES DEALERS (NASD): A self-regulatory organization (SRO) of brokers and dealers in the over-the-counter securities business. Its regulatory mandate includes authority over firms that distribute mutual fund shares as well as other securities.

OFFER: The price asked by a seller of securities. (When you are buying securities, you ask for an offer.) See Asked and Bid.

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.

PRIMARY DEALER: A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC)-registered securities broker-dealer, banks, and a few unregulated firms.

PRUDENT PERSON RULE: An investment standard. In some states the law requires that a fiduciary, such as a trustee, may invest money only in a list of securities selected by the custody state--the so-called legal list. In other states the trustee may invest in a security if it is one which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

QUALIFIED PUBLIC DEPOSITORIES: A financial institution which does not claim exemption from the payment of any sales or compensation use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability and which has been approved by the Public Deposit Protection Commission to hold public deposits.

RAINY DAY FUND: Designed to set revenue aside during times of above-trend economic growth and to utilize this revenue during times of below-trend growth. Can be used to balance the budget which is the intended purpose.

RATE OF RETURN: The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond the current income return.

REPURCHASE AGREEMENT (RP OR REPO): A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money, that is, increasing bank reserves.

SAFEKEEPING: A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

SECONDARY MARKET: A market made for the purchase and sale of outstanding issues following the initial distribution.

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

TREASURY NOTES: Intermediate U.S. government debt securities with maturities of one to 10 years and issued in denominations ranging from \$1,000 to \$1 million or more.

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

YIELD: The current rate of return on an investment security generally expressed as a percentage of the security's current price.

LONG FORM

SECURITY AGREEMENT

This SECURITY AGREEMENT, dated _____, is between **[name of bank]** (the “*Bank*”), a **[bank and trust company, national banking association, state banking corporation, savings bank or savings and loan association]** having an address at _____, and **[public depositor]**, having an address at _____ (the “*Public Depositor*”).

WITNESSETH:

WHEREAS, the Bank is an eligible public depository as defined in **[state statute]**, (the “*Act*”); and

WHEREAS, Public Depositor from time to time makes deposits, as said term is defined in the Act, in the Bank (its “*Public Deposits*”), which Public Deposits shall from time to time aggregate in excess of One Hundred Thousand Dollars (\$250,000); and

WHEREAS, the Public Depositor desires to have its Public Deposits secured by collateral; and

WHEREAS, the Bank has agreed to secure the Public Depositor’s Public Deposits by granting to the Public Depositor a security interest in certain collateral (“*Eligible Collateral*”) owned by the Bank, as permitted by 12 U.S.C. § 90;

NOW THEREFORE, in consideration of the Public Depositor depositing its Public Deposits as herein described, and for other good and valuable consideration, hereby acknowledged as received, it is hereby agreed between the Public Depositor and the Bank as follows:

1. In order to secure the Public Depositor’s Public Deposits the Bank hereby pledges, assigns, transfers and grants to the Public Depositor a perfected first priority security interest in (a) such amounts of the Eligible Collateral to meet the collateral ratios and other requirements described in this Agreement, and (b) the Custody Account (as defined in Section 9 below) and any and all investment property and security entitlements from time to time held in, by, or for the benefit of the Custody Account (including without limitation the Eligible Collateral) and all proceeds thereof (collectively, the “*Collateral*”). If at any time the ratio of the market value of the Eligible Collateral to the Public Depositor’s Public Deposits, plus accrued interest, is less than required by this Agreement, the Bank shall immediately, within no more than 24 hours, make such additions to the Eligible Collateral in such

amounts such that the ratio of the market value of the Eligible Collateral to the Public Depositor's Public Deposits, plus accrued interest, shall be at least equal to that required by this Agreement. Such additions to the Eligible Collateral shall constitute an assignment, transfer, pledge, and grant to the Public Depositor of a security interest in such additional Eligible Collateral pursuant to this Agreement and the Act.

2. The security interest granted herein (as described in Section 1 above) shall secure not only such Public Deposits and accrued interest of the Public Depositor as are held by the Bank at the time of this Agreement, but also any and all subsequent Public Deposits made by the Public Depositor in the Bank regardless of the accounts in which such funds may be held or identified by the Bank.
3. The pledge of Collateral by the Bank shall be in addition to, and shall in no way eliminate or diminish, any insurance coverage to which the Public Depositor may be entitled under the rules and regulations of the Federal Deposit Insurance Corporation (FDIC) or any private insurance carried by the Bank for the purpose of protecting the claims and rights of its depositors.
4. The Public Depositor is under no obligation to maintain its deposits with the Bank and may withdraw them at any time without notice. It is agreed that when the Bank shall have paid out and accounted for all or any portion of the Public Depositor's Public Deposits, any Collateral pledged under this Agreement to secure such paid out Public Deposits shall be released from the security interest created hereunder.
5. The Bank hereby represents that (i) it is a **[state banking corporation]** duly organized and validly existing under the laws of the State of Arizona (ii) it is a qualified public depository as defined by the Act; (iii) it has, or will have as of the time of delivery of any securities as Collateral under this Agreement, the right, power and authority to grant a security interest therein with priority over any other rights or interests therein; (iv) the execution and delivery of this Agreement and the pledge of securities as Collateral hereunder have been approved by resolution of the Bank's Board of Directors at its meeting of **[date]**, and the approval of the Board of Directors is reflected in the minutes of that meeting, copies of which resolution and relevant portion of the minutes of said meeting are attached hereto as Exhibit A and made a part hereof; (v) the execution and delivery of this Agreement and the pledge of securities as Collateral hereunder will not violate or be in conflict with the Articles of Incorporation or By-laws of the Bank, any agreement or instrument to which the Bank may be a party, any rule, regulation or order of any banking regulator applicable to the Bank, or any internal policy of the Bank adopted by its Board of Directors; and (vi) this Agreement shall be continuously maintained, from the time of its execution, as an official record of the Bank.
6. The Bank warrants that it is the true and legal owner of all Collateral pledged under this Agreement, that the Collateral is free and clear of all liens and claims, that no other person or entity has any right, title or interest therein, and that the Collateral

has not been pledged or assigned for any other purpose. Should an adverse claim be placed on any pledged Collateral, the Bank shall immediately substitute unencumbered Collateral of equivalent value that is free and clear of all adverse claims.

7. At any time that the Bank is not in default under this Agreement, the Bank may substitute Eligible Collateral, *provided* that (a) the total market value of Eligible Collateral held in the Custody Account shall meet the requirements of this Agreement, and (b) the Public Depositor shall have approved such actual substitution or substitution process and all documentation relating to such substitution before it becomes effective.
8. Any additional pledge of Collateral hereunder, substitution of Collateral, or release of Collateral shall be approved by an officer of the Bank duly authorized by resolution of the Board of Directors to approve such additional pledges, substitutions, or releases of Collateral under this Agreement.
9. The Bank agrees to place the Collateral with a Federal Reserve Bank, a trust department of a commercial bank, or with a trust company (the "*Custodian*") to hold in a custody account (the "*Custody Account*") for the benefit of the Public Depositor. Any such commercial bank or trust company shall be a securities intermediary that in the ordinary course of its business regularly maintains securities accounts for its customers. The Bank shall execute a custodial trust agreement with the Custodian ("*Custodial Trust Agreement*") for the custody of the Eligible Collateral consistent with the terms of this Agreement. The Custodial Trust Agreement shall contain the Custodian's agreement to hold all Collateral in the Custody Account for the benefit of the Public Depositor and subject to the Public Depositor's direction and control and to comply with entitlement orders originated by the Public Depositor without the Bank's further consent. The executed Custodial Trust Agreement is attached hereto as Exhibit B. The execution by the Bank of the Custodial Trust Agreement shall in no way relieve it of any of its duties or obligations hereunder.
10. Upon the initial transfer of Eligible Collateral under this Agreement and monthly thereafter, the Bank shall cause the Custodian to report to the Public Depositor specifying the type and market value of Eligible Collateral being held in the Custody Account for the benefit of the Public Depositor.
11. The Bank shall pledge and transfer to the Custody Account Eligible Collateral having a total market value of at least the total value of the Public Deposits, including accrued interest, of the Public Depositor, less amounts covered by insurance of the FDIC.
12. Eligible Collateral shall include only the following securities and shall have a minimum market value as expressed in the following collateral ratios:

FORM OF ELIGIBLE COLLATERAL PLEDGE	COLLATERAL RATIO* (MARKET VALUE DIVIDED BY DEPOSIT PLUS ACCRUED INTEREST)
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- A. United States treasury Bills, notes and bonds
 - i. Maturing in less than one year 102%
 - ii. Maturing in one to five years 105%
 - iii. Maturing in more than five years 110%
- B. Actively traded United States government agency securities
 - i. Maturing in less than one year 103%
 - ii. Maturing in one to five years 107%
 - iii. Maturing in more than five years 115%
- C. United States government agency variable rate securities
- D. **[State]** general obligation bonds
 - i. Maturing in less than one year 102%
 - ii. Maturing in one to five years 107%
 - iii. Maturing in more than five years 110%

- 13. The Bank shall recalculate the market value of individual securities comprising Eligible Collateral at least monthly.
- 14. The Bank has heretofore or will immediately hereafter deliver to the Custodian for immediate deposit into the Custody Account Eligible Collateral of sufficient value to meet the terms of this Agreement. Said Eligible Collateral, or substitute collateral, as herein provided for, shall be retained by the Custodian in the Custody Account so long as the Bank holds deposits of the Public Depositor.

* The collateral ratios set forth below are merely suggested ratios and may be modified by the Public Depositor to reflect applicable statutory requirements and their investment policies.

15. In the event the Bank shall (a) fail to pay the Public Depositor any funds which the Public Depositor has on deposit, (b) fail to pay and satisfy when due any check, draft, or voucher lawfully drawn against any deposit of the Public Depositor, (c) fail or suspend active operations, (d) become insolvent, or (e) fail to maintain adequate Collateral as required by this Agreement, the Bank shall be in default, the Public Depositor's deposits in such Bank shall become due and payable immediately, the Public Depositor shall have the right to unilaterally direct the Custodian to liquidate the Collateral held in the Custody Account and pay the proceeds thereof to the Public Depositor and to exercise any and all other security entitlements with respect to the Custody Account and the other Collateral, to withdraw the Collateral, or any part thereof, from the Custody Account and deliver such Collateral to the Public Depositor or to transfer the Collateral or any part thereof into the name of the Public Depositor or into the name of the Public Depositor's nominee, and ownership of the Collateral shall transfer to the Public Depositor. The Bank authorizes the release, withdrawal and delivery of the Collateral to the Public Depositor upon default by the Bank, and authorizes the Custodian to rely without verification on the written statement of the Public Depositor as to the existence of a default and to comply with entitlement orders originated by the Public Depositor without further consent of that Bank.
16. In the event of default as described in Section 15, the Public Depositor shall also have the right to sell Collateral at any public or private sale at its option without advertising such sale, upon not less than three (3) days' notice to the Bank and the Custodian. In the event of such sale, the Public Depositor, after deducting all legal expenses and other costs, including reasonable attorney's fees, from the proceeds of such sale, shall apply the remainder on any one or more of the liabilities of the Bank to the Public Depositor, including accrued interest, and shall return the surplus, if any, to the Bank, or its receiver or conservator.
17. During the term of this Agreement, the Public Depositor will, through appropriate action of its governing board, designate the officer, or officers, who singly or jointly will be authorized to represent and act on behalf of the Public Depositor in any and all matters arising under this Agreement.
18. All parties to this Agreement agree to execute any additional documents that may be reasonably required to effectuate the terms, conditions and intent of this Agreement.
19. All of the terms and provisions of this Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns.
20. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original and all of which taken together shall constitute one and the same instrument.
21. This Agreement shall be governed by and construed in accordance with the laws of [state] and the laws of the United States, and it supersedes any and all prior

agreements, arrangements or understandings with respect to the subject matter hereof. In the event that any conflict of law issue(s) should arise in the interpretation of this Agreement, the parties agree that when Arizona law is not preempted by laws of the United States, Arizona law shall govern.

22. No provision of this Agreement may be waived except by a writing signed by the party to be bound thereby and any waiver of any nature shall not be construed to act as a waiver of subsequent acts.
23. In the event that any provision or clause of this Agreement conflicts with applicable law, such conflict shall not affect other provisions of this Security Agreement, which shall be given effect without the conflicting provision. To this end the provisions of this Agreement are declared to be severable.
24. Unless applicable law requires a different method, any notice that must be given under this Agreement shall be given in writing and sent by certified mail, return receipt requested or third party overnight priority mail carrier to the address set forth herein or such other place as may be designated by written notice in the same manner from one party to the other.

[public depository bank]

By:

Its:

Date: _____

SHORT FORM

SECURITY AGREEMENT

This **SECURITY AGREEMENT**, dated _____, is between [**name of bank**] (the “*Bank*”), a [**bank and trust company, national banking association, state banking corporation, savings bank or savings and loan association**] having an address at _____, and [**public depositor**], having an address at _____, (the “*Public Depositor*”).

WITNESSETH:

WHEREAS, the Bank is a qualified public depository as defined in [**state statute**] (the “*Act*”); and

WHEREAS, Public Depositor from time to time makes deposits, as said term is defined in the Act, in the Bank (its “*Public Deposits*”), which Public Deposits shall from time to time aggregate in excess of One Hundred Thousand Dollars (\$250,000); and

WHEREAS, the Public Depositor desires to have its Public Deposits secured by collateral in the amounts required by the Act; and

WHEREAS, the Bank has agreed to secure the Public Depositor’s Public Deposits by granting to the Public Depositor a security interest in certain collateral (“*Eligible Collateral*”) owned by the Bank, which collateral meets the requirements described in the Act, as permitted by 12 U.S.C. § 90 and the Act;

NOW THEREFORE, in consideration of the Public Depositor depositing its Public Deposits as herein described, and for other good and valuable consideration, hereby acknowledged as received, it is hereby agreed between the Public Depositor and the Bank as follows:

1. Pursuant to the Act and in order to secure the Public Depositor’s Public Deposits the Bank hereby pledges, assigns, transfers and grants to the Public Depositor a perfected first priority security interest in (a) such amounts of the Eligible Collateral to meet the collateral ratios and other requirements described in the Act, and (b) the Custody Account (as defined in Section 9 below) and any and all investment property and security entitlements from time to time held in, by, or for the benefit of the Custody Account (including without limitation the Eligible Collateral) and all proceeds thereof (collectively, the “*Collateral*”). If at any time the ratio of the market value of the Eligible Collateral to the Public Depositor’s Public Deposits, plus accrued interest, is less than required by the Act, the Bank shall immediately, within no more than 24 hours, make such additions to the Eligible Collateral in such amounts such that the ratio of the market value of the Eligible Collateral to the Public Depositor’s Public Deposits, plus

accrued interest, shall be at least equal to that required by the Act. Such additions to the Eligible Collateral shall constitute an assignment, transfer, pledge, and grant to the Public Depositor of a security interest in such additional Eligible Collateral pursuant to this Agreement and the Act.

2. The security interest granted herein (as described in Section 1 above) shall secure not only such Public Deposits and accrued interest of the Public Depositor as are held by the Bank at the time of this Agreement, but also any and all subsequent Public Deposits made by the Public Depositor in the Bank regardless of the accounts in which such funds may be held or identified by the Bank.

3. The pledge of Collateral by the Bank shall be in addition to, and shall in no way eliminate or diminish, any insurance coverage to which the Public Depositor may be entitled under the rules and regulations of the Federal Deposit Insurance Corporation or any private insurance carried by the Bank for the purpose of protecting the claims and rights of its depositors.

4. The Public Depositor is under no obligation to maintain its deposits with the Bank and may withdraw them at any time without notice. It is agreed that when the Bank shall have paid out and accounted for all or any portion of the Public Depositor's Public Deposits, any Collateral pledged under this Agreement to secure such paid out Public Deposits shall be released from the security interest created hereunder.

5. The Bank hereby represents that (i) it is a **[state banking corporation]** duly organized and validly existing under the laws of **[state]**; (ii) it is a qualified public depository as defined by the Act; (iii) it has, or will have as of the time of delivery of any securities as Collateral under this Agreement, the right, power and authority to grant a security interest therein with priority over any other rights or interests therein; (iv) the execution and delivery of this Agreement and the pledge of securities as Collateral hereunder have been approved by resolution of the Bank's Board of Directors at its meeting of **[date]**, and the approval of the Board of Directors is reflected in the minutes of that meeting, copies of which resolution and relevant portion of the minutes of said meeting are attached hereto as Exhibit A and made a part hereof; (v) the execution and delivery of this Agreement and the pledge of securities as Collateral hereunder will not violate or be in conflict with the Articles of Incorporation or By-laws of the Bank, any agreement or instrument to which the Bank may be a party, any rule, regulation or order of any banking regulator applicable to the Bank, or any internal policy of the Bank adopted by its Board of Directors; and (vi) this Agreement shall be continuously maintained, from the time of its execution, as an official record of the Bank.

6. The Bank warrants that it is the true and legal owner of all Collateral pledged under this Agreement, that the Collateral is free and clear of all liens and claims, that no other person or entity has any right, title or interest therein, and that the Collateral has not been pledged or assigned for any other purpose. Should an adverse claim be placed on any pledged Collateral, the Bank shall immediately substitute unencumbered Collateral of equivalent value that is free and clear of all adverse claims.

7. At any time that the Bank is not in default under this Agreement, the Bank may substitute Eligible Collateral, provided that (a) the total market value of Eligible Collateral held in the Custody Account shall meet the requirements of the Act and this Agreement, and (b) the Public Depositor shall have approved such actual substitution or substitution process and all documentation relating to such substitution before it becomes effective.

8. Any additional pledge of Collateral hereunder, substitution of Collateral, or release of Collateral shall be approved by an officer of the Bank duly authorized by resolution of the Board of Directors to approve such additional pledges, substitutions, or releases of Collateral under this Agreement.

9. The Bank agrees to place the Collateral with a Federal Reserve Bank, a trust department of a commercial bank, or a trust company (the "*Custodian*"), to hold in a custody account (the "*Custody Account*") for the benefit of the Public Depositor, as required by the Act. Any such commercial bank or trust company shall be a securities intermediary that in the ordinary course of its business regularly maintains securities accounts for its customers. The Bank shall execute a custodial trust agreement with the Custodian ("*Custodial Trust Agreement*") for the custody of the Eligible Collateral consistent with the terms of this Agreement. The Custodial Trust Agreement shall contain the Custodian's agreement to hold all Collateral in the Custody Account for the benefit of the Public Depositor and subject to the Public Depositor's direction and control and to comply with entitlement orders originated by the Public Depositor without the Bank's further consent. The executed Custodial Trust Agreement is attached hereto as Exhibit B. The execution by the Bank of the Custodial Trust Agreement shall in no way relieve it of any of its duties or obligations hereunder or under the Act.

10. Upon the initial transfer of Eligible Collateral under this Agreement and monthly thereafter, the Bank shall cause the Custodian to report to the Public Depositor specifying the type and market value of Eligible Collateral being held in the Custody Account for the benefit of the Public Depositor.

11. The Bank has heretofore or will immediately hereafter deliver to the Custodian for immediate deposit in the Custody Account Eligible Collateral of sufficient value to meet the terms of this Agreement. Said Eligible Collateral or substitute collateral, as herein provided for, shall be retained by the Custodian in the Custody Account so long as the Bank holds deposits of the Public Depositor.

12. In the event the Bank shall (a) fail to pay the Public Depositor any funds which the Public Depositor has on deposit, (b) fail to pay and satisfy when due, any check, draft, or voucher lawfully drawn against any deposit of the Public Depositor, (c) fail or suspend active operations, (d) become insolvent, or (e) fail to maintain adequate Collateral as required by this Agreement, the Bank shall be in default, the Public Depositor's deposits in such Bank shall become due and payable immediately, the Public Depositor shall have the right to unilaterally direct the Custodian to liquidate the Collateral held in the Custody Account and pay the proceeds thereof to the Public

Depositor and to exercise any and all other security entitlements with respect to the Custody Account and the other Collateral, to withdraw the Collateral, or any part thereof, from the Custody Account and deliver such Collateral to the Public Depositor, or to transfer the Collateral or any part thereof into the name of the Public Depositor or into the name of the Public Depositor's nominee, and ownership of the Collateral shall transfer to the Public Depositor. The Bank authorizes the release, withdrawal and delivery of the Collateral to the Public Depositor upon default by the Bank, and authorizes the Custodian to rely without verification on the written statement of the Public Depositor as to the existence of a default and to comply with entitlement orders originated by the Public Depositor without further consent of the Bank.

13. In the event of default as described in Section 12, the Public Depositor shall also have the right to sell Collateral at any public or private sale at its option without advertising such sale, upon not less than three (3) days notice to the Bank and the Custodian. In the event of such sale, the Public Depositor, after deducting all legal expenses and other costs, including reasonable attorney's fees, from the proceeds of such sale, shall apply the remainder on any one or more of the liabilities of the Bank to the Public Depositor, including accrued interest, and shall return the surplus, if any, to the Bank, or its receiver or conservator.

14. During the term of this Agreement, the Public Depositor will, through appropriate action of its governing board, designate the officer, or officers, who singly or jointly will be authorized to represent and act on behalf of the Public Depositor in any and all matters arising under this Agreement.

15. All parties to this Agreement agree to execute any additional documents that may be reasonably required to effectuate the terms, conditions and intent of this Agreement.

16. All of the terms and provisions of this Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns.

17. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original and all of which taken together shall constitute one and the same instrument.

18. This Agreement shall be governed by and construed in accordance with the laws of **[state]**, and the laws of the United States, and it supersedes any and all prior agreements, arrangements or understandings with respect to the subject matter hereof. In the event that any conflict of law issue(s) should arise in the interpretation of this Agreement, the parties agree that when **[state]** law is not preempted by laws of the United States, **[state]** law shall govern.

19. No provision of this Agreement may be waived except by a writing signed by the party to be bound thereby and any waiver of any nature shall not be construed to act as a waiver of subsequent acts.

20. In the event that any provision or clause of this Agreement conflicts with applicable law, such conflict shall not affect other provisions of this Security Agreement, which shall be given effect without the conflicting provision. To this end the provisions of this Agreement are declared to be severable.

21. Unless applicable law requires a different method, any notice that must be given under this Agreement shall be given in writing and sent by certified mail, return receipt requested or third party overnight priority mail carrier to the address set forth herein or such other place as may be designated by written notice in the same manner from one party to the other.

[public depository bank]

By:

Its:

Date: _____

[public depositor]

By:

Its:

Date: _____

[public depositor]

By:

Its:

Dat

e: _____