

## ATTACHMENT 1

### INVESTMENT POLICY FOR THE CITY OF SANTA MONICA

#### 1. POLICY

It is the policy of the City of Santa Monica (City) to invest public funds in a manner which will safely preserve portfolio principal, provide adequate liquidity to meet the City's cash flow needs, and optimize returns while conforming to all federal, state, and local statutes governing the investment of public funds.

#### 2. SCOPE

This investment policy applies to all cash and financial investments of the various funds of the City of Santa Monica as identified in the City's Comprehensive Annual Financial Report, with the exception of those financial assets explicitly excluded from coverage by the Investment Policy for legal or operational reasons. Cemetery and Mausoleum Perpetual Care Funds are private funds held in trust and managed by the City. These funds do not fall under the guidelines of the Government Code sections noted in Section 8.0 of this Policy, but are invested by an outside investment manager under guidelines established by the City Council.

All City funds are listed in Attachment 1-A. The Investment Policy will also apply to all new funds created unless specifically exempted.

Except as otherwise noted, City funds are pooled for investment purposes. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles. Interest is allocated on a quarterly basis.

#### 3. PRUDENCE

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

The standard of prudence to be used by investment officials shall be the “**prudent person**” and/or “**prudent investor**” standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with 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. **INVESTMENT OBJECTIVES**

The primary objective of all City investments, in priority order, shall be:

##### 4.1 **SAFETY**

Safety of principal is the foremost objective of the investment program. City investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To attain this, the City will diversify its investments by investing funds in securities of various types and from various issuers offering independent returns.

##### 4.2 **LIQUIDITY**

Liquidity is the ability to change an investment into its cash equivalent on short notice at its prevailing market value. The City's investment portfolio shall remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrently with anticipated cash needs. Since all possible cash demands cannot be anticipated, the portfolio will maintain a liquidity "buffer" and invest primarily in securities with active secondary or resale markets.

##### 4.3 **RATE OF RETURN**

The City's investment portfolio shall be designed with the objective of attaining a benchmark rate of return throughout budgetary and economic cycles, taking into account safety and liquidity requirements. The benchmark may vary from time to time depending on the economic and budgetary conditions present. At no time shall funds be invested in any security that could result in zero interest accrual if held to maturity.

#### 5. **INVESTMENT AUTHORITY DELEGATION**

In accordance with the Santa Monica City Charter, Section 711, the City Council delegates to the City Treasurer the authority to invest City funds. The Director of Finance, as City Treasurer, delegates this authority to the Assistant City Treasurer. In the absence of the Director of Finance and the Assistant City Treasurer, authority to invest City funds may be delegated to the Treasury Administrator or Senior Treasury Analyst. Section 53607 of the State of California Government Code limits

the authorization of the legislative body to delegate investment authority to a one-year period, renewable annually.

#### 5.1 INVESTMENT PROCEDURES

The Director of Finance is responsible for conducting and reporting on all City investments. To facilitate this function, the Director of Finance or their designee will prepare and maintain an Investment Procedures Manual detailing procedures for the operation of the investment program consistent with this policy. The manual should include reference to safekeeping, banking services contracts, collateral/depository agreements, and repurchase agreements. The manual shall also include explicit delegation of authority to persons responsible for investment transactions. No person may engage in investment transactions except as provided under the terms of this policy and the procedures established by the Director of Finance. Additionally, the manual will explicitly include a current listing of all City of Santa Monica financial institution deposit and investment accounts, a current copy of State laws pertinent to City investments, a description of specific controls to ensure the proper execution of the City Investment Policy, and copies, with instructions, of all investment reports required by law or by City Investment Policy.

#### 5.2 INVESTMENT COMMITTEE

An Investment Committee (the Committee) shall be established consisting of the City Manager, the Assistant City Manager, the Director of Finance, the Assistant City Treasurer, one other department head serving one-year terms on a rotating basis, and one qualified citizen representative, appointed by the City Manager for a one-year term, who possesses strong skills and knowledge in the areas of finance and economics. The purpose of the Committee is to provide general oversight and act in an advisory capacity. The Committee will meet once each calendar quarter to review and evaluate previous investment activity, to review the current status of all funds held by the City, to discuss anticipated cash requirements and investment activity for the next quarter, and to discuss investment strategy.

### 6. ETHICS AND CONFLICTS OF INTEREST

The Director of Finance and other employees 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. The Director of Finance and other employees involved in the investment process shall disclose any material interests in financial institutions with which they conduct business within their jurisdiction, and they shall further disclose any material personal financial/investment positions that could be related to the performance of the City's investment portfolio and shall refrain from personal

investment transactions with the same individual or firm with whom business is conducted on behalf of the City.

The Director of Finance and other employees involved in the investment process are required to file annual disclosure statements as required by the Fair Political Practices Commission. During the course of the year, if there is an event subject to disclosure that could impair the ability of the Director of Finance or investment employees to make impartial decisions, the City Council will be notified in writing within ten (10) days of the event.

## 7. **AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS**

The City shall transact business only with issuers, banks, savings and loans, and registered securities dealers. The purchase of any investment, other than those purchased directly from the issuer, shall be purchased from either an institution licensed by the State as a broker/dealer as defined in Section 25004 of the Corporation Code, who is a member FINRA (Financial Industry Regulatory Authority, or a member of a federally regulated securities exchange, a national or state chartered bank, a federal or state association (as defined by Section 5102 of the Financial Code), or a brokerage firm designated as a primary dealer by the Federal Reserve Bank.

The Director of Finance's staff shall periodically conduct a "Request for Qualifications" process to investigate broker/dealers that wish to do business with the City in order to determine if they are adequately capitalized, make markets in securities appropriate to the City's needs, and agree to abide by the City's Investment Policy. All institutions that desire to become qualified bidders for investment transactions must complete City's "Broker/Dealer Request for Information" and "Broker/Dealer Certification".

The Director of Finance shall conduct periodic reviews of the financial condition and other qualifications of all approved financial institutions and broker/dealers to determine if they continue to meet the City's guidelines for qualification as defined in this section. Additionally, the City shall keep the current audited financial statements on file for each approved financial institution and broker/dealer with which the City conducts investment transactions. A listing of websites where these financial statements may be viewed may substitute for physical hard copies of the statements.

## 8. **AUTHORIZED AND SUITABLE INVESTMENTS**

Investments shall be made only in those instruments specifically authorized by California State laws, primarily Sections 53601, 53601.6, 53601.8, 16429.1, and 53684 et sq. of the Government Code and to no greater an extent than authorized

by those laws. These laws are summarized in Attachment 1-B. Additional City guidelines are as follows:

<u>Instruments</u>	<u>Additional City Guidelines</u>
U.S. Federal Agencies	No more than 50% of portfolio, per agency
Banker's Acceptances (BA)	Maximum of 10% of portfolio per issuer
Negotiable Certificates of Deposit (NCD)	Maximum of 10% of portfolio per issuer
Commercial Paper (CP)	Maximum of 15% of portfolio

It is recognized that legal or other events may occur that could require revision of certain guidelines.

In addition to following all legal guidelines, the portfolio will preserve principal, maintain adequate liquidity to meet all City obligations, contain an appropriate level of interest rate risk, and be diversified across types of investments, maturities, and institutions to minimize credit risk and maintain an appropriate return.

#### 8.1 REPURCHASE AGREEMENTS

Investments in repurchase agreements are allowable and shall be made only with financial institutions with which the City has an executed master repurchase agreement. The financial institution must be a primary dealer of the Federal Reserve Bank of New York.

#### 8.2 PROHIBITED INVESTMENTS AND TRANSACTIONS

Prohibited investments include as inverse floaters, range notes, interest only strips derived from a pool of mortgages (collateralized mortgage obligations), and any security that could result in zero interest accrual if held to maturity, as specified in Section 53601.6.

#### 8.3 INVESTMENTS HELD AND/OR MANAGED BY FISCAL AGENTS AND TRUSTEES

In addition the main pooled portfolio, the City may hold and invest certain other funds that are restricted as to use. One example is bond proceeds held by fiscal agents. Investments of bond or loan proceeds will be made in accordance with Government Code Section 53601 (m), which states that money from bond proceeds should be invested as specified by bond documents, and in accordance with specific bond covenants. In most cases these investments will be made under the same guidelines as other City investments. Another example is funds received from legal settlements that are restricted for a certain purpose, which will be invested in accordance with legal or escrow agreements that may be more restrictive than the City's Policy.

As noted previously in this Policy, Cemetery and Mausoleum Perpetual Care Funds are private funds held in trust by the City. These funds are invested by an outside investment manager under guidelines adopted by the City Council and do not fall under the guidelines of the Government Code sections noted in Section 8.0 of this Policy. The Director of Finance's staff monitors all investment activity of these funds to ensure guidelines are followed.

## 9. **INVESTMENT POOLS/MUTUAL FUNDS**

A thorough investigation of any pooled investment funds, including mutual funds, is required prior to investing, and on a continual basis. To accomplish this, a questionnaire will be used to evaluate the suitability of the pooled fund. The questionnaire will answer the following general questions:

- A description of eligible investment securities, and a written statement of investment policies and objectives.
- A description of interest calculations and how it is distributed, and how gains and losses are treated.
- A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced and the program audited.
- A description of who may invest in the program, how often, and what size deposit and withdrawal are allowed.
- A schedule for receiving statements and portfolio listings.
- Are reserves, retained earnings, etc., utilized by the pool/fund?
- A fee schedule, and when and how fees are assessed.
- Is the pool/fund eligible for bond proceeds and/or will it accept such proceeds?

For mutual funds, a fund prospectus can substitute for the questionnaire.

## 10. **COLLATERALIZATION**

California Government Code Sections 53652, et seq. requires depositories to post certain types of collateral for public funds above the Federal Deposit Insurance Corporation (FDIC) insurance amounts. The collateral requirements apply to bank deposits, both active (checking and savings accounts) and inactive (non-negotiable certificates of deposit).

Collateralization is also required for repurchase agreements. In order to anticipate market changes and provide a level of security for all funds, the collateralization level will be 102% of the market value of principal and accrued interest, and the value shall be adjusted no less than quarterly. Collateral will be in the form of U.S. Treasury Obligations or U.S. Agency Securities.

Collateral will always be held by an independent third party with whom the entity has

a current custodial arrangement. A clearly marked evidence of ownership (safekeeping receipt) must be available to be supplied to the City, if requested, and retained. The right of collateral substitution is granted.

11. **SAFEKEEPING AND CUSTODY**

In accordance with California Government Code Section 53601, all securities owned by the City shall be held in safekeeping by the City's custodial bank or a third party bank trust department, acting as an agent for the City under terms of the custody agreement. Collateral for repurchase agreements will be held by a third party custodian under terms of the Master Repurchase Agreement.

All securities will be received and delivered using a delivery vs. payment (DVP) basis, which ensures that securities are deposited with the third party custodian prior to the release of funds. Securities held by the third party custodian will be evidenced by safekeeping receipts and/or bank statements. Investments in the State Local Agency Investment Fund (LAIF) or money market mutual funds are undeliverable and are not subject to delivery or third party safekeeping.

Investment trades shall be verified against bank transactions and broker confirmation tickets. On a monthly basis, the custodial asset statement shall be reconciled with the month-end portfolio holdings.

12. **DIVERSIFICATION**

The City will diversify its investments by security type, institution, and maturity date. Concentration limits are set by the State Government Code (see Attachment B) and Section 8.0 (Authorized and Suitable Investments) of this policy.

13. **MAXIMUM MATURITIES**

To the extent possible, the City will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the City will not directly invest in securities with a final stated maturity date of more than five (5) years from the date of purchase settlement. Any investment of more than five years requires the advance approval of the City Council, in accordance with State law, and the City Manager. Further maturity limitations are shown in Attachment B. The weighted average maturity of the investment portfolio should be three years or less.

In order to minimize the impact of market risk, most investments will be purchased with the intent to hold to maturity. Investments may be sold prior to maturity for cash flow needs, portfolio rebalancing and/or appreciation purposes, or in order to mitigate portfolio risk by limiting potential losses. However, no investment shall be made based solely on earnings anticipated from capital gains. Due to the uncertain

nature of cash flow requirements, a portion of the portfolio should be continually invested in readily available funds.

14. **INTERNAL CONTROLS**

The Director of Finance shall be responsible for ensuring that all investment transactions comply with the City's Investment Policy and for establishing internal controls that are designed to prevent losses due to fraud, negligence, and third-party misrepresentation.

The Director of Finance will also establish internal control procedures addressing wire transfer controls, separation of duties and administrative controls, avoidance of collusion, separation of transaction authority from accounting procedures, documentation of investment transactions, and monitoring of results.

As part of its annual audit of the City, the City's external auditor will review compliance with statutes, policies, and procedures.

15. **PERFORMANCE STANDARDS**

The portfolio shall be designed with the objective of obtaining a rate of return throughout budgetary and economic cycles, commensurate with investment risk constraints and cash flow needs.

15.1 **MARKET YIELD (Benchmark)**

The City's overall investment strategy is passive. Given this strategy, the basis used by the Director of Finance to determine whether appropriate and suitable market yields are being achieved shall be to identify a comparable benchmark to the portfolio's investment duration, e.g. the Constant Maturing Two Year Treasury bill index. Benchmarks may change over time depending on the portfolio's duration.

16. **REPORTING**

In accordance with State law and the City Charter, monthly reports will be made to the City Council and the City Manager describing the present status of City investments and monies held by the City, as well as summarizing all investment transactions for the month. Schedules in the monthly report should include the following:

- A complete list of investments including the type of the investment, name of the issuer, maturity date, par value, book value, and market value
- The source of market value data



- The weighted average maturity and yield to maturity of the portfolio
- Coupon, discount, or earnings rate for each security
- Percentage of portfolio represented by each investment category
- A certification of compliance with the Investment Policy
- A statement denoting the City's ability to meet its anticipated expenditures requirements for the next six months
- Benchmark comparison

Records of all investment transactions will be kept and filed in the Finance Department in accordance with legal guidelines and records retention policies.

## 17. **SOCIALLY RESPONSIBLE INVESTING**

**RESTRICTIONS** – The direct investment of City funds are restricted as follows:

- a. Investments are to be made in entities that support clean and healthy environment, including following safe and environmentally sound practices.
- b. No investments will be made in fossil fuel companies as defined by the organization 350.org or in banking institutions that provide financing to said companies.
- c. No investments are to be made in tobacco or tobacco-related products.
- d. No investments are to be made to support the production of weapons, military systems, or nuclear power.
- e. Investments are to be made in entities that support equality of rights regardless of sex, race, age, disability or sexual orientation.
- f. Investments are to be made in entities that promote community economic development.

Funds invested with trustee and/or outside investment managers such as the Cemetery and Mausoleum Perpetual Care Funds will comply with this section of the policy.

## 18. **COMMUNITY REINVESTMENT ACT (CRA)**

The City will deposit funds only in those financial institutions, which have a CRA rating (as determined by the appropriate regulatory body) of "Outstanding" or "Satisfactory".

19. **INVESTMENT POLICY ADOPTION**

The City's investment policy shall be reviewed and adopted by the City Council annually. The Investment Committee will review the policy periodically to ensure its consistency with the overall objectives of preservation of principal, liquidity, and return, and its conformance with current law, financial and economic trends, and cash flow needs of the City.

**City of Santa Monica Funds for Cash Pooling**

The following listed City of Santa Monica funds shall have their cash balances pooled for investment purposes.

<u>FUND NUMBER</u>	<u>FUND NAME</u>
01	GENERAL FUND
04	SPECIAL REVENUE SOURCE FUND
06	CLEAN BEACHES AND OCEAN PARK PARCEL TAX FUND
11	BEACH RECREATION FUND
12	HOUSING AUTHORITY FUND
14	TENANT OWNERSHIP RIGHTS CHARTER AMENDMENT
15	LOW/MODERATE INCOME HOUSING ASSET FUND
19	COMMUNITY DEVELOPMENT BLOCK GRANT (CBDG) FUND
20	MISCELLANEOUS GRANTS FUND
21	ASSET SEIZURE FUND
22	CITIZENS OPTION FOR PUBLIC SAFETY FUND
25	WATER FUND
27	SOLID WASTE MANAGEMENT FUND
28	COMMUNITY BROADBAND FUND
29	RENT CONTROL FUND
30	PIER FUND
31	WASTEWATER FUND
33	AIRPORT FUND
34	STORMWATER MANAGEMENT FUND
37	CEMETERY FUND
41	BIG BLUE BUS FUND
42	TRAFFIC SAFETY FUND
43	GAS TAX FUND
44	SCAQMD AB2766 FUND
45	LOCAL RETURN FUND
53	PARKS AND RECREATION FACILITIES FUND
54	VEHICLE MANAGEMENT FUND
55	INFORMATION TECHNOLOGY REPLACEMENT AND SERVICES FUND
56	SELF INSURANCE-GENERAL LIAB/AUTO FUND
57	SELF INSURANCE-BUS FUND
58	SELF INSURANCE-ADMIN FUND
59	SELF INSURANCE WORKERS-COMPENSATION FUND
77	PARKING AUTHORITY FUND

<u>FUND NUMBER</u>	<u>FUND NAME</u>
80	GENERAL TRUST FUND
82	CEMETERY PERPETUAL CARE FUND
89	MAUSOLEUM PERPETUAL CARE FUND

## ATTACHMENT 1-B

### Summary of State of California Statutes Applicable to Municipal Investments

The following investments are authorized by California State Code, Title 5, Division 2, and Sections 53600, 53601, 53631.5 and 53635. See code sections for complete descriptions.

<u>Authorized Investment</u>	<u>Legal Limit (%)</u>	<u>Other Constraints</u>
Local Agency Bonds	No limit	Maximum maturity 5 years.
U.S. Treasury Obligations	No limit	Maximum maturity 5 years.
State Obligations - California and Others	No limit	Maximum maturity 5 years.
California Local Agency Obligations	No limit	Maximum maturity 5 years.
U.S. Agency Obligations	No limit	Maximum maturity 5 years.
Bankers Acceptance	40%	Eligible for purchase by the Federal Reserve System and not to exceed 180 days to maturity. No more than 30% may be in bankers' acceptances of any one commercial bank.
Commercial Paper – Non Pooled Funds	25%	"A -1 /P - 1/F - 1" rating; if the issuer has long-term debt, it must rated "A"; U.S. corporate assets over \$500,000,000; purchases may not represent more than 10% of outstanding paper and may not exceed 270 days to maturity
Commercial Paper – Pooled Fund	40%	"A -1 /P - 1/F - 1" rating; if the issuer has long-term debt, it must rated "A"; U.S. corporate assets over \$500,000,000; purchases may not represent more than 10% of outstanding paper and may not exceed 270 days to maturity.
Negotiable Certificates of Deposit	30%	Maximum maturity 5 years. State and Federally chartered banks and savings institutions, including U.S. branches of foreign

<u>Authorized Investment</u>	<u>Legal Limit (%)</u>	<u>Other Constraints</u>
		banks regulated by State regulatory authorities ("Yankee CD").
Deposit/CD Placement Services	30%	Maximum maturity 5 years. Deposits with any one private sector placement service are limited to 30% of the portfolio. This limit does not apply to placement service-assisted CD's.
Repurchase Agreement	No limit	Maximum maturity 1 year. Securities used as collateral for repo's must be investments allowable under Govt. Code (i.e., T-bills, Agencies, BAs, CDs, etc.); must be collateralized at 102% of market value or greater; securities must be safe kept by third party.
Reverse Repurchase Agreements/Securities Lending Agreements	20%	Must be made with primary dealers of the Federal Reserve Bank of New York and the securities used for the agreement must have been held by the local agency for at least 30 days. The maximum maturity is 92 days.
Medium-Term Corporate Notes	30%	Maximum maturity 5 years; bonds must be rated minimum of "A" by a nationally recognized rating service.
Mutual Funds and Money Market Mutual Funds	20%	No more than 10% may be invested in any one mutual fund. Funds are invested in securities and obligations authorized by subdivisions (a) through (m) of Section 53601 and 53635, (any of the authorized investments for local agencies) the investment company must be in highest ranking provided by not less than two of the three largest nationally recognized rating services OR must have the investment advisor registered with the SEC with no less than 5 yrs. experience and have assets under mgmt. in excess of \$500 million.

<u>Authorized Investment</u>	<u>Legal Limit (%)</u>	<u>Other Constraints</u>
Supra Nationals (International Bank for Reconstruction and Development. International Finance Corporation, Inter-American Development Bank	30%	Maximum maturity 5 years. Must be rated AA or better by a nationally recognized rating service. Must be senior unsubordinate obligations denominated in U.S. Dollars.
Money Market Funds	20%	The money market funds must have an average weighted maturity of 90 days or less and abide by SEC regulations; funds must receive the highest ranking by 2 of the 3 largest nationally recognized rating agencies OR retain an investment advisor who is registered, or exempt from registration, with the SEC and has at least 5 years' experience managing money market funds in excess of \$500 million.
Collateralized Certificate of Deposit	No limit	Maximum maturity 5 years. Banks: deposit not to exceed the total of paid-in capital surplus. S&Ls: deposit not to exceed the greater of total net worth or \$500,000. State and Federal credit unions: deposit shall not exceed the greater of the total of unpaired capital and surplus or \$500,000. Must be collateralized to 110% of the CD value by other eligible securities. Investments in certificates of deposits of state or federal credit unions if any member of the city's governing or managing officers (council, city manager, fiscal officers) serves on the credit union board or key committee positions is prohibited.
Mortgage Pass-Through	20%	Maximum maturity 5 years; bonds must be rated in top two rating categories by a nationally recognized rating service. Shall not exceed 95% of the mortgage security's fair market value. Issuer must have rating of "A" or higher on issuer's debt.
Bank/Time Deposits	No Limit	Maximum maturity of 5 years

<u>Authorized Investment</u>	<u>Legal Limit (%)</u>	<u>Other Constraints</u>
Local Agency Investment Fund (LAIF)	\$ 65 million**	Monies are invested in pooled state fund managed by State Treasurer. Maximum 15 transactions per month.
Joint Powers Authority Pool	No limit	
County Pooled Investment Funds	No limit	

\*\* Per LAIF account. Separate accounts can be established for different legal entities.

### Bond Proceeds

Bond proceeds may be invested in accordance with the State Code and bond indenture provisions.



**GLOSSARY**

**AGENCIES:** Federal agency securities and/or Government Sponsored Enterprises (GSE's).

**ASKED:** The price at which securities are offered for sale.

**BANKERS' ACCEPTANCE (BA):** A draft or bill of exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

**BASIS POINT:** A basis point equals one one-hundredth of 1% (.01%).

**BENCHMARK:** A comparative base for measuring the performance or risk tolerance of an investment portfolio. The benchmark should represent a close correlation to the level of risk and the average duration of the portfolio.

**BID:** The price offered for securities.

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

**CALLABLE SECURITY:** A security that can be redeemed by the issuer before the scheduled maturity date.

**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 City of Santa Monica. It includes basic financial 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.

**COMMERCIAL PAPER (CP):** An unsecured promissory note with a fixed maturity no longer than 270 days. Usually sold in discount form.

**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.

**DELIVERY VERSUS PAYMENT (DVP):** There are two methods of delivery of securities: delivery versus payment and delivery versus receipt (also called free). 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.

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

**DERIVATIVES:** (1) Financial instruments whose return profile is linked to, or derived from, the movement of one or more underlying indices or securities, and may include a leveraging factor, or (2) financial contracts based on notional amounts whose value is derived from an underlying index or security (interest rates, foreign exchange rates, equities, or commodities).

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

**DISCOUNT SECURITIES:** Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value (e.g., U.S. Treasury bills, commercial paper, Agency discount notes).

**DIVERSIFICATION:** Dividing investment funds among a variety of securities, issuers, and maturity dates offering independent returns.

**DURATION:** A measure of the timing of the cash flows, such as the interest payments and the principal repayment, to be received from a given fixed-income security. This calculation is based on three variables: term to maturity, coupon rate, and yield to maturity. The duration of a security is a useful indicator of its price volatility for given changes in interest rates.

**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:** Non-interest bearing deposits held by member banks at the Federal Reserve. Also used to denote "immediately available" funds in the clearing sense. "Fed

Funds" also used to refer to these funds.

**FEDERAL FUNDS RATE:** The rate of interest at which private banks lend funds to other private banks. The Federal Open Market Committee (FOMC) sets a target rate. This actual rate is currently pegged by the Federal Reserve through open-market operations.

**FEDERAL HOME LOAN BANKS (FHLB):** Government sponsored wholesale banks (currently 12 regional banks) which lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit unions, and insurance companies. The mission of the FHLB's is to liquefy the housing related assets of members who must purchase stock in their district Bank.

**FEDERAL HOME LOAN MORTGAGE CORPORATION (FHLMC):** A Government Sponsored Enterprise that provides liquidity to the mortgage markets, much like FNMA and FHLB. Also referred to as "Freddie Mac".

**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 & Urban Development, H.U.D. 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.

**GOVERNMENTAL 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 FHA, VA or FmHM mortgages. The term pass-throughs is often used to describe Ginnie Maes.

**INVERSE FLOATERS:** A structured note in which the coupon increase as interest rates decline and decrease as rates rise.

**LIQUIDITY:** Liquidity is the ability to change an investment into its cash equivalent on short notice at its prevailing market 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 AGENCY INVESTMENT FUND (LAIF):** 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.

**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 DEALERS:** A group of government securities dealers that 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-dealers, banks, and a few unregulated firms.

**PRIME RATE:** The rate at which banks lend to their best or "prime" customers.

**PRINCIPAL:** 1) the dollar cost of an issue excluding accrued interest. 2) The one who takes ownership in a transaction, as opposed to brokering or acting as agent.

**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 state (the so-called legal list). In other states, the trustee may invest in a security if it is one, which would be brought 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 compensating 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.

**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 or 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.

**REVERSE REPO:** An agreement whereby the dealer agrees to buy securities and the investor agrees to repurchase them at a later date.

**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.

**SEC RULE 15C3-1:** See uniform net capital rule.

**SECURITIES AND EXCHANGE COMMISSION:** Agency created by Congress to protect investors in securities transaction by administering securities legislation.

**STRUCTURED NOTES:** Notes issued by Government Sponsored Enterprises (FHLB, FNMA, SLMA, etc.) and Corporations which have embedded options (e.g. call features, step-up coupons, floating rate coupons, derivative based returns) into their debt structure. Their market performance is impacted by the fluctuation of interest rates, the volatility of the imbedded options, and shifts in the shape of the yield curve.

**STUDENT LOAN MARKETING ASSOCIATION (SLMA):** A U.S. Corporation and instrumentality of the U.S. government. Through its borrowings, funds are targeted for loans to students in higher education institutions. SLMA's securities are highly liquid and

are widely accepted.

**SETTLEMENT DATE:** The date on which a trade is cleared by delivery of securities against funds. This date may be the same as the trade date or later.

**SUPRA NATIONALS –** For purposes of this investment policy - obligations issued by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank.

**TENNESSEE VALLEY AUTHORITY (TVA):** A U.S. Corporation created in the 1930's, to electrify the Tennessee Valley area; currently a major utility headquartered in Knoxville Tennessee. TVA's securities are highly liquid and are widely accepted.

**TLGP:** Temporary Liquidity Guarantee Program is a temporary program established by the Federal Deposit Insurance Corporation that guarantees debt issued by banks.

**TRADE DATE:** The date on which the buyer and seller agree to a transaction. The trade date may or may not be the date on which the securities and money changes hands (settlement date).

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

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

**TREASURY NOTES:** Intermediate term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of from one to ten years.

**UNIFORM CAPITAL RULE:** Securities and Exchange Commission requirement that member firms as well as non-member broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called net capital rule and net capital ratio. Indebtedness covers all money owed to a firm including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

**YIELD:** The rate of annual income return on an investment, expressed as a percentage. (a) **INCOME YIELD** is obtained by dividing the current dollar income by the current market price for the security. (b) **NET YIELD** or **YIELD TO MATURITY** is the current income yield minus any premium above par or plus any discount from par in purchase price with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.

**YIELD TO MATURITY:** The rate of return yielded by a debt security held to maturity when both interest payments and the investor's capital gain or loss on the security are taken into account.