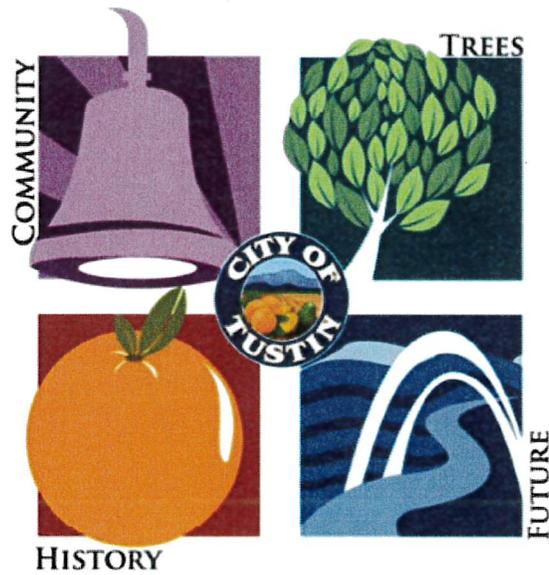


# City of Tustin



## Statement of Investment Policy for 2019

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## I. PURPOSE

This statement is intended to provide guidelines for the investment of the City's temporary idle cash, and to outline the policies for maximizing the efficiency of the City's Cash Management System. The goal is to enhance the economic status of the City while protecting its pooled cash. It is the intent of the City Council that all deposit and investment activities authorized by this policy shall be executed at the direction of the City Treasurer as to selection and appropriateness.

## II. SCOPE

This investment policy applies to the City of Tustin's pooled investment portfolio, which encompasses all monies under the direct oversight of the Treasurer. The funds covered by this policy are accounted for and incorporated in the City of Tustin's Comprehensive Annual Financial Report (CAFR) and include:

- General Fund
- Special Revenue Funds
- Capital Project Funds
- Proprietary Funds
- Successor Agency to the Dissolved Tustin Community Redevelopment Agency
- Other funds that may be created

Investment of bond proceeds will be made in accordance with applicable bond indentures. The scope of this policy excludes funds invested in the PARS investment trust, as these funds are subject to the IRS rules, the trust agreement, and PARS investment guidelines.

## III. PRUDENCE

The standard of prudence, according to California Code section 53600.3, to be used by the Treasurer and designated representative(s), shall be the "prudent investor" standard and shall be applied in the context of managing the overall portfolio. Persons authorized to make investment decisions on behalf of the City are trustees and therefore fiduciaries subject to the prudent investor standard which states, "When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the City, that a prudent person acting in the like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the City". Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law.

## IV. OBJECTIVES

The primary objectives of the City of Tustin's cash management and investment program, in priority order, shall be:

**Safety:** It is the primary duty and responsibility of the City, City Council, City

Treasurer (Treasurer), City Manager, and City Staff to diligently protect, preserve, and maintain intact the principal placed in trust with the City on behalf of the citizens of the community. Investments by the City Treasurer and/or designated representative(s) shall be undertaken in a manner that seeks to ensure the preservation of principal in the overall portfolio. To attain this objective, the City Treasurer will diversify investments by investing funds among a variety of security types, credit counterparties, and individual financial institutions. This will be done while continually assessing risks inherent in fixed income investing, including but not limited to: interest rate risk, default risk, reinvestment risk and inflation risk.

**Liquidity:** The City's investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated. The City will keep enough cash and cash equivalents on hand to ensure a minimum of six months of expenditures can be met.

**Return on Investments:** The City's investment portfolio shall have the objective of attaining a market rate of return throughout budgetary and economic cycles. Comparative performance measurements will be commensurate with the City's investment risk constraints as outlined in this investment policy and the City's cash flow requirements.

## **V. DELEGATION OF AUTHORITY**

California Government Code Section 53607 provides the authority for the legislative body of the City to invest funds of the City or to delegate that full responsibility to the Treasurer of the City. Under City of Tustin Ordinance No. 1612, the City Council has authorized the Treasurer to invest City funds in accordance with California Government Code.

The City of Tustin shall invest public funds in such a manner as to comply with state and local laws; ensure prudent money management; provide for daily cash flow requirements; and meet the objectives of the policy, in priority of Safety, Liquidity, and Return on Investment. Annually, City Treasurer shall review the policy with the Audit Commission and the Investment Sub-Committee and submit the policy to City Council for adoption.

## **VI. ETHICS AND CONFLICTS OF INTEREST**

The Treasurer shall refrain from personal business activity that could conflict with proper execution of the investment program or which could impair the ability to make impartial investment decisions. The Treasurer is governed by Government Code Section 1090 et seq and the City's gift regulation.

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

The Treasurer shall maintain a list of approved financial institutions authorized to provide investment related services to the City. The types of institutions include custodian banks, financial depositories, broker/dealers, and investment advisors. For authorized financial institutions providing depository and/or investment services to the City, the Treasurer or designated representative(s) shall perform an annual review of the financial condition and registrations of the authorized institutions, including their annual audited financial

statements. A current audited financial statement is required to be on file for each financial institution and broker/dealer through which the City invests its funds.

**A. Financial Institutions**

In selecting financial institutions (custodian banks or depositories), the Treasurer shall conduct a comprehensive review of prospective depositories' credit characteristics and financial history. Funds greater than the FDIC insured amount shall be invested (deposits and/or certificates of deposit) only in commercial banks and savings & loans with a bank financial strength rating of "A" by Moody's Investor Service or equivalent rating by another Nationally Recognized Statistical Rating Organization (NRSRO). Qualifications and minimum requirements for depositories that may be eligible for funds greater than the FDIC insured amount shall be established by the Treasurer and will be provided to any institution seeking to conduct business with the City. Banks and Savings & Loan Associations seeking to establish eligibility as a depository for the City's deposits shall make available annual audited financial statements, either via the Internet or upon request for review by the Treasurer. Any institution meeting the City's required criteria, including meeting the collateral requirements as stated in California Government Code Section 53652 and outlined in Section XII of this policy, will be eligible for placement of public deposits by the City, subject to approval by the Treasurer. As deemed necessary by the Treasurer, reviews of unaudited quarterly financial data may be conducted for institutions on the City's approved list. Any institution falling below the City's established minimum criteria shall be removed from the approved list, no new deposits may be placed with that institution, and all funds remaining shall be withdrawn as the deposits mature. The City Treasurer shall notify parties as part of the quarterly reporting process outlined in Section X. of this policy.

The financial institution providing the City with its primary banking and custodian services may have additional qualifications and minimum requirements based on the City's banking needs.

The City of Tustin has established the following minimum qualifications for a financial institution providing banking services, upon which additional qualifications may be required:

- Federal or State of California charter financial institution that is a member of the Federal Reserve;
- Qualified depository of public funds to ensure the collateralization requirements for governmental entities are met;
- Experience with providing banking services to similar sized and type governmental agencies to ensure the City's banking needs will be met, and must possess familiarity with reporting and other banking requirements for governmental agencies;
- Electronic capabilities to meet the City's current banking needs, which saves staff time. Currently, these include safekeeping, positive pay, payroll direct deposit, lock box service, bill concentration, electronic fund transfers, electronic blocks and filters, electronic receivables, credit card processing, and remote deposit;
- Access to all Federal Reserve Bank services including direct clearing with the Federal Reserve Bank.

**B. Broker/Dealers**

All brokers and dealers that desire to become authorized to do business with the City as qualified bidders for investment transactions must complete and sign a "Broker/Dealer Questionnaire" and submit related documents relative to eligibility. This includes current audited financial statements, proof of State of California registration, proof of FINRA (Financial Industry Regulatory Authority) registration, and written acknowledgement that they have received and read the City's investment policy. Eligible firms may include primary dealers or regional dealers that qualify under the Securities & Exchange Commission Rule 15c3-1 (uniform net capital rule). The firm, and individuals covering the City's account must be knowledgeable and experienced in public agency investing, familiar with California Government Code as it relates to investments, and capable of executing transactions according to institutional trading practices. Investments shall be transacted only with authorized broker/dealers which have been reviewed and approved by the Treasurer for reliability, credit worthiness, and trustworthiness.

**C. Investment Advisors**

The Treasurer may engage the services of outside professionals for evaluation and advice regarding the City's investment program. An authorized investment advisor may provide investment management services, which may also include facilitating trade executions under the direction of the Treasurer or designated representative(s). Advisors shall be registered by the Securities & Exchange Commission and licensed to do business in the State of California. Authorized advisors are subject to the provisions of this investment policy and must act in the best interest of the City in the capacity of a fiduciary.

**VIII. AUTHORIZED INVESTMENTS**

The City of Tustin is provided a broad spectrum of eligible investments under California Government Code Sections 53600 – 53609 (authorized investments), 53630 – 53686 (deposits and collateral), and 16429.1 (Local Agency Investment Fund). If a type of investment is added to the California Government Code, it can only be added to the City's Authorized and Permitted Investment List with an amendment to this investment policy *and approval* by the City Council. If a type of investment permitted by the City should be removed from the California Government Code, it shall be deemed concurrently removed from the City's Authorized and Permitted Investment List, except for existing holdings which may be held until they mature.

Security purchases, deposits, and holdings shall be maintained within statutory limits imposed by California Government Code and shall include only the following. Please refer to the table on page 11 for holding limitations by security class, type, and issuer.

**A. Municipal Bonds including:**

- a. Bonds issued by the local agency (City of Tustin bonds), including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency or by a department, board, agency, or authority of the local agency. (Legal Authority – Government Code Section 53601(a)).
- b. Registered state warrants (State of California) of treasury notes or bonds of this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a

- department, board, agency, or authority of the state. (Legal Authority – Government Code Section 53601(c)).
- c. Registered treasury notes or bonds of any of the other 49 states in addition to California, including bonds payable solely out of the revenue from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the other 49 states, in addition to California. (Legal Authority – Government Code Section 53601(d)).
  - d. Bonds, notes, warrants, or other evidences of indebtedness of any local agency within the State of California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a local agency, or by a department, board, agency, or authority of the local agency. (Legal Authority – Government Code Section 53601(e)).
- B. Securities of the U.S. Government Obligations issued by the United States Treasury and backed by the “full faith and credit” of the Federal government. These securities are in the form of U.S. Treasury notes, bills, certificates of indebtedness, and bonds. (Legal Authority – Government Code Section 53601(b)).
- C. Federal agency or United States government-sponsored enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises. (Legal Authority – Government Code Section 53601(f)).
- D. Bankers’ Acceptances – Bankers’ acceptances are short-term debt instruments issued by a company that is guaranteed by a commercial bank. Bankers Acceptances limited to banks with a bank financial strength rating of “A” by Moody’s Investor Service or equivalent rating by another Nationally Recognized Statistical Rating Organization. (Legal Authority – Government Code Section 53601(g)).
- E. Commercial Paper – Commercial paper is issued by corporations to meet short term funding needs with a maturity date of less than 270 days from the issue date. Investments are restricted to only “prime” quality commercial paper with the highest ranking or of the highest letter and numerical rating as provided for by a NRSRO. (Legal Authority – Government Code Section 53601(h)).
- a. Per California Government Code Section 53601(h), the entity that issues the commercial paper shall meet all the following conditions in either A or B below:
    - A. The entity shall (1) be organized and operating in the United States as a general corporation, (2) have total assets in excess of five hundred million dollars (\$500,000,000), and (3) have debt other than commercial paper, if any, that is rated “A” or higher by a NRSRO.
    - B. The entity shall (1) be organized within the United States as a special purpose corporation, trust, or limited liability company, (2) have program wide credit enhancements, including, but not limited to, over collateralization, letter of credit, or surety bonds, and (3) have commercial paper that is rated “A-1” or higher, or the equivalent, by a NRSRO.
- F. Negotiable Certificates of Deposit – Certificates of deposit issued by a nationally or state-chartered bank or a federal association, a state or Federal credit union, or by a federally licensed or state licensed branch of a foreign bank. The term of negotiable certificates of deposit is restricted to a maximum of five years. (Legal

Authority – Government Code Section 53601(i)).

- G. Repurchase Agreements – Investment in repurchase agreements may be made when the term of the agreement does not exceed one year. The market value of securities that underlie a repurchase agreement shall be valued at 102 percent or greater. Since the market value of the underlying securities is subject to daily market fluctuations, the investments in repurchase agreements shall be in compliance if the value of the underlying securities is brought back up to 102 percent no later than the next business day. The purchase of a security pursuant to a repurchase agreement requires the counter party to deliver the underlying security by book entry or by a third-party custodial agreement. Repurchase Agreements may only be made with banks and primary dealers with which the City has entered into a Master Repurchase Agreement modeled after the Public Securities Associations' Master Repurchase Agreement. (Legal Authority – Government Code Section 53601(j)).
- H. Corporate or Medium-Term Notes – Corporate or medium-term notes are obligations of a domestic corporation or depository institution with a minimum credit rating of "A" or better by a NRSRO at the time of purchase. If the credit rating of a security is subsequently downgraded below the minimum rating level for a new investment of that security, the Treasurer shall evaluate the downgrade on a case-by-case basis to determine if the security should be held or sold. The Treasurer will apply legal constraints and the general objectives of safety, liquidity, and return when making the decision. (Legal Authority – Government Code Section 53601(k)).
- I. Money Market Mutual Funds – Money market mutual funds qualifying for City investment must restrict their portfolios to issues approved by the same state investment statute that defines investment alternatives. In addition, these money market mutual funds must adhere to Federal statutes regarding the size of the money market mutual fund and its safety, must attain the highest ranking of two of the three highest ranking NRSRO, and must retain an investment advisor registered with the Securities and Exchange Commission with not less than five years of experience investing assets of at least five hundred million dollars. The money market mutual funds must invest solely in investments, which the City itself could legally purchase. (Legal Authority – Government Code Section 53601(l)).
- J. JPA Investment Pools – Shares of beneficial interest issued by a joint powers' authority organized pursuant to Section 6509.7 that invests in the securities and obligations authorized in subdivisions (a) to (q), inclusive. Each share shall represent an equal proportional interest in the underlying pool of securities owned by the joint powers' authority. (Legal Authority – Government Code Section 53601(p)).
- K. Bonds of Supranationals – U.S. dollar denominated senior unsecured unsubordinated obligations issued by or unconditionally guaranteed by one of the three supranational banking groups: International Bank for Reconstruction and Development (World Bank or IBRD), International Finance Corporation (IFC), and Inter-American Development Bank (IADB). Supranational banks are formed by a group of countries through an international treaty with specific objectives such as fighting poverty or promoting economic development and have been incorporated into U.S. Federal Law by Congressional Acts. Investments shall be rated "AA" or

better by an NRSRO and have a remaining maturity of five years or less. (Legal Authority – Government Code Section 53601(q)).

- L. Collateralized Bank Deposits – All active (checking and savings accounts) and inactive (time or certificate of deposits) above FDIC insured limits must be collateralized pursuant to Government Code. (Legal Authority – California Government Code Section 53652; 53653; 53635.2).

California Code also allows for the use of placement services to purchase FDIC insured CD's, not to exceed 30% of total holdings. The City may utilize these services at the discretion of the Treasurer. (Legal Authority – California Government Code Sections 53601.8 and 53635.8).

- M. Orange County Investment Pool (OCIP) – Investment in OCIP is allowable according to the guidelines in Government Code. (Legal Authority – Government Code Section 53684).

- N. Local Agency Investment Fund (LAIF) – The Local Agency Investment Fund (LAIF) is a special fund in the California State Treasury created and governed pursuant to Government Code Sections 16429.1 et seq. Investments in LAIF are limited to the maximum amount as specified by LAIF. Principal amount withdrawal of \$10 million or greater needs 24-hour notice, and less than \$10 million may be withdrawn the same day. The fees charged by LAIF are limited by statute. (Legal Authority – Government Code Section 16429.1).

- O. Investment Contracts – In addition to investments as outlined in the table on page 11, bond proceeds may be placed in investment contracts if authorized by borrowing documents. Guarantors of such contracts shall have at least two "AA" ratings by two NRSROs. Contracts shall contain market value protection in case of downgrade by including delivery of cash or Treasury securities at the election of the City.

## **IX. PROHIBITED INVESTMENTS**

In accordance with California Code Section 53601.6, the City shall not invest in inverse floaters, range notes, or mortgage-derived, interest-only strips, or in any security that could result in zero interest accrual if held to maturity. This limitation shall not apply to local agency investments in shares of beneficial interest issued by diversified management companies registered under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1 et seq.) that are authorized for investment pursuant to subdivision (l) of Section 53601.

Additionally, the City shall not invest funds directly in reverse repurchase agreements.

Securities shall not be purchased on margin, credit, or for other than full cash payment, and shall not be pledged as collateral. All securities shall be purchased on a delivery versus payment (DVP) basis.

## **X. REVIEW OF INVESTMENT PORTFOLIO**

The Treasurer shall render a quarterly report to the City Council, City Manager, and

external auditors, which states its relationship to the current Investment Policy. The report shall include, at the minimum, required elements as detailed in Section XVIII of this policy.

The two Audit Commissioners serving on the Investment Sub-Committee shall receive monthly reports from the Treasurer for review. Any issues or concerns may be forwarded to City Council. The Audit Commission's responsibility will be limited to the review of types and limits of investments for compliance with the investment policy, and not for the review of appropriateness of individual investments or rates of return. The Audit Commission Chair or his designee and the City Treasurer shall sign the quarterly investment reports submitted to the City Council.

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

An investigation of any investment pool or money market mutual fund is required prior to investing and on an annual basis. The investigation shall, at a minimum, obtain the following information:

- A description of eligible investment securities, and a written statement of investment policy and objectives;
- A description of interest calculations and how it is distributed, and how gains and losses are distributed;
- A description of how securities are safeguarded (including the settlement process) and how often the securities are marked to market and how often an audit is conducted;
- A description of who may invest in the program, how often, what size deposits and withdrawals are permitted;
- A schedule for receiving statements and portfolio listings;
- A description of the process for maintaining a reserve or retaining earnings, if applicable. Or understanding if all income, after expenses, is distributed to participants;
- A fee schedule describing when and how fees are assessed;
- A description of eligibility for bond proceeds.

For money market mutual funds, the prospectus and statement of information is acceptable and may be obtained electronically.

**City of Tustin Allowable Investments**

<b>Investment Type</b>	<b>Maximum Maturity</b>	<b>Maximum % Holdings</b>	<b>Maximum % per Issuer*</b>	<b>Minimum Rating**</b>
Municipal Bonds	5 year	30%	5%	N/A
U.S. Treasuries and General Obligations	5 year	100%	100%	N/A
Federal Agency or US government sponsored enterprise	5 year	100%	50%	N/A
Bankers' Acceptance	180 days	30%	5%	N/A
Commercial Paper***	270 days	25%	5%	A-1/P-1 plus A long term
Negotiable Certificates of Deposit	5 year	30%	5%	N/A
Repurchase Agreements (102% Collateralized)	1 year	30%	5%	N/A
Medium-Term (Corporate) Notes	5 year	20%	5%	A
Money Market Mutual Funds	N/A/2(A)7 Eligible	20%	10%	AAA/AAA
Shares of beneficial interest by a JPA	5 year	100%	50%	N/A
Supranationals (IBRD, IFC and IADB)	5 year	15%	5%	AA
Collateralized Bank Deposits	5 year	100%	30%	N/A
Orange County Investment Pool	N/A	Max permitted by County Treasurer	Max permitted by County Treasurer	N/A
Local Agency Investment Fund	N/A	Max permitted by State Treasurer	Max permitted by State Treasurer	N/A

\*In compliance if within limits at time of purchase; Combine issuer types to determine maximum counterparty risk.

\*\*Rating categories are inclusive of rating modifiers such as "+/-" or numbers from one NRSRO unless two ratings are noted.

\*\*\*A-1 or equiv plus A long term; total assets in excess of \$500MM; no more than 10% outstanding from a single issuer

**XII. COLLATERALIZATION**

Collateral requirements are addressed in California Government Code Section 53652. All active and inactive deposits must be secured at all times with eligible securities in securities pools pursuant to Sections 53656 and 53657. Eligible securities held as collateral shall have a market value more than the total amount of all deposits of a depository as follows:

- Government securities at least 110 percent.
- Mortgage backed securities at least 150 percent.

### **XIII. SAFEKEEPING AND CUSTODY**

All security transactions, including collateral for repurchase agreements, shall be conducted on a delivery versus payment (DVP) basis. Securities will be held by a third-party custodial bank designated by the Treasurer. Securities shall be held in the name of the City and the City shall receive confirmations as evidenced by safekeeping receipts.

### **XIV. DIVERSIFICATION**

Assets held in the investment portfolio shall be diversified to eliminate the risk of loss resulting from over-concentration of assets in a specific class of securities.

Refer to the table on page 11 for diversification limits. In addition to limits shown, no more than a combined total of the following classes may exceed 30% of the total assets at the time of purchase: municipal bonds, bankers' acceptance, commercial paper, repurchase agreements, medium-term notes, and supranationals.

### **XV. MAXIMUM MATURITIES**

Unless previously authorized by City Council, no investment may have a term final stated maturity longer than five (5) years. Such approval must be issued no less than three months prior to the purchase of any security exceeding the five-year maturity limit.

Please refer to the table on page 11 for maturity limits. Percentages apply at the time of purchase. In addition to the maximum maturity limits, the weighted average maturity of the portfolio shall not exceed 36 months. At the time of purchase, the short-term portion of the total investment portfolio shall have sufficient cash and maturities to cover the next six months of anticipated use of funds.

### **XVI. INTERNAL CONTROLS**

The Finance Department shall establish a system of internal controls which shall be reviewed annually with the independent Auditor. The controls shall be designed to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent action by employees or officers of the City of Tustin. The Finance Department will maintain the City's Investment Records in compliance with Government Accounting Standards Board Rule 31 (GASB 31).

The City attempts to invest 100% of all available funds through daily and projected cash flow determinations and after consideration of bank requirements for clearings and services. Management of idle cash and investment transactions is the responsibility of the Treasurer. The City's investment philosophy is to ensure that money is safe and available when needed.

The Treasurer shall annually review the City's Investment Policy with the City of Tustin Audit Commission. Proposed amendments will be brought to the City Council for final action upon the recommendation of the Treasurer.

## **XVII. PERFORMANCE STANDARDS**

The investment portfolio will be designed to obtain a market-average rate of return during budgetary and economic cycles, considering the City's investment risk constraints and cash flow needs. The market-average rate of return is defined as the U.S. Treasury security yield which most closely matches the portfolio's weighted average maturity (WAM) as stated on the quarterly investment report, using a 12-month moving average.

## **XVIII. REPORTING**

Reports shall be produced according to standards outlined in California Code section 53646. The purpose for these reports will be to formulate suggestions for improved future performance, and to verify that authorized treasury personnel have acted in accordance with the investment policy and written investment procedures.

In addition, the City Treasurer shall produce monthly transaction and quarterly investment reports. The required elements of the quarterly report are as follows:

- a. Type of investment
- b. Issuer
- c. Date of maturity
- d. Par value and dollar amount invested
- e. Listing of all investments and monies held by the City
- f. Amount of deposit or cost of the security
- g. Description of all funds that are under contract with other parties
- h. Rate of interest/discount and yield
- i. Statement relating the report to the Statement of Investment Policy
- j. Statement that there are enough funds to meet the City's anticipated cash flow needs for at least the next six months
- k. The current book value
- l. The current market value
- m. Average portfolio life
- n. Average portfolio yield
- o. Current treasury yield that most closely matches average portfolio life
- p. Ratings of all corporate bonds, medium-term notes, municipal and state securities, commercial bank time drafts, and commercial paper to be shown
- q. Summary of investments with total percentage by type of investment
- r. Reflect historical rates of returns

Reports of the State Treasurer's Local Agency Investment Fund (LAIF) or other qualified funds shall be accepted in lieu of subparagraphs a. through l. to support City deposits in the funds. Quarterly reports shall state portfolio compliance to the statement of investment policy, or the way the portfolio is not in compliance.

## **XIX. INVESTMENT POLICY ADOPTION**

The Treasurer shall annually review the City's Investment Policy with the City of Tustin Audit Commission. Proposed amendments will be brought to the City Council for final action upon the recommendation of the Treasurer.

Each year after review and report by the Audit Commission, the Treasurer shall submit to the City Council a proposed Statement of Investment Policy for Council consideration and adoption as submitted, or as revised by the City Council.

## **XX. CONTINUING EDUCATION AND TRAINING**

The City of Tustin and the Treasurer's office value professionalism and accountability in the execution of the investment program. To ensure the highest level of professional standards, investment staff responsible for the day-to-day management of the portfolio are encouraged to complete at least 12 hours per year of continuing education in the areas of cash and investment management.

## GLOSSARY

**AGENCIES:** Federal agency securities and/or Government-sponsored enterprises.

**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.

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

**BOOK RETURN:** Book return is calculated by summing interest received, accrued interest earned, amortization of premiums and discounts, and realized gains and losses; then dividing the sum by the average balance of the portfolio.

**BOOK VALUE MEASUREMENT (also see BOOK RETURN):** The incorporation of book value measurement allows us to estimate the expected earnings on the portfolio when securities are held to maturity. Because the calculation does not incorporate unrealized gains or losses, measuring book value alone does not give a complete picture of the portfolio's assumed risk.

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

**CERTIFICATE OF DEPOSIT (CD):** A time deposit with a specific maturity evidenced by a Certificate. Large denomination (over \$250,000) CDs are typically negotiable.

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

**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.

**DERIVATIVES:** (1) Financial instruments whose return profile is linked to, or derived from, the movement of one or more underlying index or security, and may include a leveraging factor, or (2) financial contracts based upon 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 maturity when quoted at lower than face value. A security selling below original offering price shortly after the initial sale is also referred to as trading 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.)

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

**DURATION:** A measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years. Rising interest rates mean falling bond prices, while declining interest rates mean rising bond prices.

**FAIR MARKET VALUE MEASUREMENT (also see TOTAL RETURN):** The incorporation of fair market value reporting tells us that portfolios are performing in a manner that is consistent with interest rate changes. Fair Market Value reporting is particularly important in rising rate interest rate environments as it provides the ability to explain to stakeholders why there are unrealized losses in the portfolio.

**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 entity.

**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):** 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 FHLBs is to liquefy the housing related assets of its members who must purchase stock in their district Bank.

**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 FHA mortgages. The term "pass-throughs" is often used to describe Ginnie Maes.

**LIQUIDITY:** The term liquidity is used when referring to how easily an investment can be converted into cash. It is also used when describing the pool of money an agency keeps in overnight or short-term investments to meet immediate cash needs. A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money markets, 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 a State or County Treasurer for investment and reinvestment.

**MARKET VALUE:** The price at which a security is quoted 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.

**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-dealers, 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 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 the current income return.

**REPURCHASE AGREEMENT (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.

**REVERSE REPURCHASE AGREEMENT (REVERSE REPO):** A reverse-repurchase agreement (reverse repo) involves an investor borrowing cash from a financial institution in exchange for securities. The investor agrees to repurchase the securities at a specified date for the same cash value plus an agreed upon interest rate. Although the transaction is similar to a repo, the purpose of entering into a reverse repo is quite different. While a repo is a straightforward investment of public funds, the reverse repo is a borrowing.

**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.

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

**SEC RULE 15(C)3-1:** See Uniform Net Capital Rule.

**STRUCTURED NOTES:** Notes issued by Government Sponsored Enterprises (FHLB, FNMA, FFCB, etc.) and Corporations, which have imbedded 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.

**TOTAL RETURN:** Total return is calculated by summing up interest received, accrued interest earned, realized gains and losses and unrealized gains and losses. By incorporating unrealized gains and losses, total return identifies the marked-to-market risks of a portfolio.

**TREASURY BILLS:** A 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 BONDS:** Long-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of more than 10 years.

**TREASURY NOTES:** Medium-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from 2 to 10 years.

**UNIFORM NET CAPITAL RULE:** Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called 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 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.