	POLICIES AND PROCEDURES	
	Subject	**Investment Policy**
	Policy #	**301**
	Date	**Issued: 01/21/1985 Amended: 04/07/2015 (reviewed annually; no change in 2019, 2020 or 2021)**
	Approved by	**City Council**
	Authored by	**Administrative Services Department-Finance**

1. POLICY STATEMENT AND PURPOSE

It is the policy of the City of Walnut Creek (City) to invest public funds in a manner which will provide the highest investment return with the maximum security, while meeting the City's safety, liquidity and daily cash flow requirements and conforming to all State statutes (California Government Code (Gov. Code) §53600, et seq.) and City ordinances governing the investment of public funds.

2. SCOPE

This Investment Policy applies to all invested financial assets of the City of Walnut Creek, unless specifically exempted or covered by other investment criteria, such as in a bond or trust covenant or indenture. These funds are accounted for in the City's Comprehensive Annual Financial Report (CAFR) and include the General Fund, Special Revenue Funds, Capital Project Funds, Enterprise and Internal Service Funds, and Trust and Agency Funds.

Except for cash held in separate restricted funds, the City will pool cash balances from all funds for investment to maximize earnings and efficiencies with regard to investment pricing, safekeeping and administration. Investment income will be allocated to the City's Funds based upon their respective cash balances and in accordance with Generally Accepted Accounting Principles (GAAP).

3. DEFINITIONS

Refer to Investment Policy Glossary at the end of this document.

4. RESPONSIBILITY

<u>DELEGATION OF AUTHORITY AND INTERNAL CONTROLS</u>

4.1 Authority to manage the City of Walnut Creek's investment program is derived from Gov. Code §53601. Pursuant to Gov. Code §53607, management responsibility for the investment program is hereby delegated to the City Treasurer, the Administrative Services Director and the Finance Manager. The Investment Officers shall be responsible for all transactions undertaken and establish a system of internal controls to regulate activities and procedures of the investment officers and their subordinate staff.

4.2 The Investment Officers shall establish and adhere to written investment procedures and internal controls established for the operation of the investment program which are consistent with the Investment Policy. Such procedures should address safekeeping, wire transfer agreements, contracts and collateral depository agreements and banking services and should 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 Investment Officers.

4.3 The internal controls shall be reviewed on an annual basis by an independent auditor. This review will provide internal control by assuring compliance with policies and procedures.

5. PROCEDURE

A. <u>PRUDENCE</u>

A.1 Investments shall be made with judgment and care, not for trading or speculation, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, while considering the probable safety of their capital as well as the probable income to be derived.

A.2 The standard of prudence to be used by investment officials shall be the "prudent person" standard as defined by Gov. Code §53600.3, and shall be applied in the context of managing an overall portfolio. City Investment Officers responsible for adhering to this standard include the City Treasurer, Administrative Services Director, and Finance Manager.

A.3 Investment Officers acting in accordance with the Investment Policy and written procedures, 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.

B. INVESTMENT POLICY GUIDELINES AND ADOPTION

B.1 All investments shall be registered in the name of the City.

B.2 Any investment currently held that does not meet the guidelines of this policy shall be exempted from the requirements of this policy. At maturity or liquidation, such funds shall be reinvested only as provided by this policy.

B.3 The City's Investment Policy shall be adopted by resolution of City Council. The policy shall be reviewed at least annually by the City Treasurer and City investment officers, and any modifications must be approved by City Council.

C. OBJECTIVES / PERFORMANCE STANDARDS

The primary objectives of the City's investment activities, in priority order, shall be as follows:

C.1 Safety: Safety of principal is the foremost objective of the investment program. Investments of the City shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio by minimizing credit risk and interest rate risk. To attain this objective, the City will diversify its investments by investing funds among a variety of securities and financial institutions.

The City will minimize credit risk, which is the risk of loss due to the failure of the security issuer or backer, by: a.) limiting investments to the types of securities listed in section D of this policy; b.) prequalifying investment institutions that the City will do business with in accordance with section G and; c.) diversifying the investment portfolio in accordance with section E.

The City will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market rates, by: a.) structuring the portfolio so that securities mature to meet cash requirements for ongoing operations, thereby minimizing the need to sell securities on the open market prior to maturity (i.e. static liquidity); and b.) investing operating funds primarily in shorter-term securities, money market funds, or similar investment pools and thereby limiting the average maturity of the portfolio.

C.2 Liquidity: The City's investment portfolio is to be kept sufficiently liquid to enable the City to meet all operating requirements which might reasonably be anticipated. Investments in investment pools with same day liquidity or securities with active secondary or resale markets are highly recommended (i.e. dynamic liquidity). Emphasis should be on marketable securities with low sensitivity to market risk. Maturities of investments for which there is limited opportunity for resale (i.e. certificates of deposit held by banks, credit unions and savings and loans) shall be staggered to maximize liquidity.

C.3 Return on Investments (Market Yield/Benchmark): The City's investment strategy is active. Given this strategy, the City's investment portfolio shall be designed with the objective of exceeding the average six-month U. S. Treasury Bill rates throughout budgetary and economic cycles, commensurate with the City's investment risk constraints and the cash flow characteristics of the portfolio. These indices are considered benchmarks for low risk investments and, therefore, comprise a reasonable standard against which to measure the portfolio's rate of return.

The City intends to hold its investments to maturity in order to maximize its return on its investments and minimize its exposure to potential losses resulting from temporary declines in the market values of its investments. However, if a decline in the market value of a security is deemed by Staff to be permanent, the security may be sold early to minimize the loss of principal. Although there may be opportunities to resell securities, this type of regular trading is not recommended.

D. AUTHORIZED & SUITABLE INVESTMENTS

This policy and Gov. Code §§53601 & 53651 restricts the City to only invest in the security types below:

D.1 U. S. Government United States Treasury Bills, Notes, and Bonds backed by the full faith and credit of the United States Government and considered to be the most secure securities.

D.2 U.S. Government Sponsored Enterprise Debt (GSEs) (known as Agencies) Obligations, participations, or other instruments of, or issued by, a federal agency or U. S. Government sponsored enterprise. Such agencies include, but are not limited to: Federal National Mortgage Association (FNMA); Federal Home Loan Bank (FHLB); Government National Mortgage Association (GNMA); Community Development Corporation (CDC), Small Business Association (SBA), Tennessee Valley Authority (TVA) and Federal Home Loan Mortgage Corporation (FHLMC).

D.3 Local Agency Debt – Bonds or notes of any local agency within California, including bonds payable solely out of the revenues from revenue producing property owned, controlled or operated by the local agency, and which has been rated "A" or better by Moody's or Standard and Poor's. In addition, the City may invest in its own bonds of any rating, including bonds issued by the City's Redevelopment Agency and Financing Authority.

D. 4 Money Market Funds. The criteria for investing in a money market fund would be that the fund is regulated by the SEC, have over $500 million in total assets and that it invests in only U.S. Government Securities and money market securities of issuers rated in the highest rating category by at least two nationally recognized rating services.

D.5 Bankers Acceptances (BAs) Bills of exchange or time drafts drawn on, and accepted by, commercial banks in the top 100 of the world, which are eligible for purchase by the Federal Reserve System. Acceptance of the draft obligates the bank to pay the bearer the face amount of the draft at maturity. In addition to the guarantee by the accepting bank, the transaction is secured with a specific commodity. The sale of the underlying goods will generate the funds necessary to liquidate the indebtedness. BAs are usually created to finance the import and export of goods, the shipment of goods within the United States and the storage of readily marketable staple commodities. BAs are sold at a discount from par and the amount and maturity date are fixed.

D.6 Commercial Paper Unsecured promissory notes issued to finance short term credit needs. The paper must be of "prime" quality of the highest ranking, or of the highest letter and numerical rating as provided by Moody's or Standard & Poor's. Eligible paper is further limited to issuing corporations that are organized and operate within the United States, have total assets in excess of $500 million, and have an 'A1-P1' rating for the issuer's debt as provided by Moody's or Standard & Poor's.

D.7 Negotiable Certificates of Deposit (NCDs) Large dollar amount short-term debt instruments that are supported only by the strength of the institution issuing them. Allowable NCDs are issued by a nationally or state chartered bank or savings and loan association, or by a state licensed branch of a foreign bank.

D.8 Local Agency Investment Fund (LAIF) LAIF was created in the California State Treasury by Gov. Code §16429. LAIF holds local government funds in trust in a state investment pool in order to provide safety, liquidity and the benefits of the investment pool yield for local government entities invested in LAIF. LAIF may hold a broader range of securities that would not be eligible under the City investment criteria. Since LAIF is subject to different statutory investment provisions, any such variances in the LAIF pool holdings are appropriate exceptions for City purposes.

D.9 Certificates of Deposit (non-negotiable) (CDs) and CD Placement Service
Receipts for funds deposited in a bank or savings and loan association for a specified period of time at a specified rate of interest. The first $250,000 is guaranteed by the Federal Deposit Insurance Corporation (FDIC) for banks, the Federal Savings and Loan Insurance Corporation (FSLIC) for savings and loan associations and the National Credit Union Share Insurance Fund (NCUSIF) for credit unions. CD's with a face value in excess of $250,000 must be collateralized at 110% of market value with pledged securities of the banking institution.

Government Code §§53601.8 and 53635.8, adopted in 2007, allow for the use of private CD placement services by local agencies. This investment policy allows for the use of a placement service called the Certificate of Deposit Account Registry Service (CDARS), operated by Promontory Interfinancial Network, LLC working in conjunction with Bank of New York which acts as the master custodian for the placement of these CDs. Through the use of this placement service, local banks that work with CDARS place one investment by the City and divide the deposit into individual CDs not to exceed $250,000, so that each individual CD is fully insured by the FDIC

D.10 **Medium Term Notes (MTNs)** Medium term notes as defined in Gov. Code §53601(k) are unsecured, corporate and depository institution debt obligations. Allowable medium term notes must be issued by corporations organized and operating within the United States (U.S.) or by depository institutions licensed by the U.S. or any state and operating within the U.S. MTNs must be rated "A" or better by Moody's or Standard and Poor's.

D.11 **California Asset Management Program (CAMP)** CAMP is a money market portfolio rated AAAm by Standard and Poors and created for California Public Agencies. Similar to LAIF, CAMP provides daily liquidity, money market returns and unlimited number of deposits and withdrawals. CAMP may hold a broader range of securities that would not be eligible under the City investment criteria. Since CAMP is subject to different statutory investment provisions, any such variances in their holdings are acceptable under this policy.

D.12 In accordance with Gov. Code §53601.6, no investment shall be made by the City in any of the following instruments: inverse floaters, range notes, interest only strips derived from a pool of mortgages (i.e. Collateralized Mortgage Obligations), and any security that could result in zero interest accrual, such as straight floaters or floating rate notes. In addition, no investments shall be made in repurchase agreements. In a diversified portfolio, it must be recognized that occasional measured losses are inevitable, and must be considered within the context of the overall portfolio's investment return.

E. DIVERSIFICATION / INVESTMENT LIMITATIONS / MAXIMUM MATURITIES

E.1 In order to reduce portfolio risk, the City's portfolio will be diversified by type and institution. The following represent the maximum maturities for and maximum % or $ amount that can be invested in specific investment types:

Investment Type	Maximum % or $	Maximum Maturity
U.S. Treasuries/Agencies	None	5 years
Money Market Funds	20% (10% with one mutual fund)	N/A
Bankers Acceptances	40% ($2 million with one bank)	180 days
Commercial Paper	15% ($2 million with one firm)	270 days

Negotiable CDs	30% (see below) ($2 million with one bank)	5 years (see below)
LAIF/ CAMP	LAIF $120 Million, CAMP None	N/A
CDs - non-negotiable / CD Placement Service	20% ($2 million with one bank)	5 years
Local Agency Debt	Lesser of 5% or $5 million ($2 million with one agency)	5 years
Medium Term Notes	30% ($5million with one firm)	5 years

E.2 For Negotiable Certificates of Deposit (NCDs), no more than 10% of the City's portfolio may have NCDs with a maturity beyond 90 days.

E.3 To the extent possible, the City will attempt to match its investments with anticipated cash flow requirements. The City will maintain an average weighted maturity of 3 years or less, with no securities having a maturity date that exceed five years from the date of purchase.

E.4 As specified in Gov. Code §53601, the City Council must expressly authorize the investment of funds that mature in excess of five years. Placement of such investments cannot occur until three months have lapsed from the date of authorization. Bond covenants may allow for a longer term investment for bond reserves held with a fiscal agent.

F. SAFEKEEPING & CUSTODY

F.1 All security transactions entered into by the City shall be conducted on a delivery versus payment (DVP) basis as evidenced by safekeeping receipts in the City's name.

F.2 To protect against fraud and embezzlement, the investment securities of the City shall be held in the City's safe or held by a third-party custodian according to established safekeeping procedures. Custody will be evidenced by safekeeping receipts.

G. AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS

G.1 A list will be maintained by Finance of approved security broker/dealers selected for credit worthiness who are authorized to provide investment services in the State of California as authorized by Gov. Code §53608 & Finance Code (Fin. Code) §5102. These may include primary dealers or such dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule) and that meet the standards used in evaluating broker/dealers and banks in the City's *Request for Information* form. No public deposit shall be made except in a qualified public depository as established under State Statute.

G.2 All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must complete the *Request for Information* form, provide written certification of having read and agreed to abide by the City's Investment Policy and depository contracts and provide the following information:

- Audited financial statements, proof of State registration and trading resolution.
- Proof of National Association of Securities Dealers (NASD) certification.

G.3 The City Treasurer, or designees, shall consider the credit worthiness of institutions. The following guidelines are recommended:

- Institution to be located in California, with total assets of at least $100 million.
- Net worth of at least 3% of assets and profitable in most recent financial statement.
- Foreclosure/delinquencies at or below 2% of assets and in business for 5 years.
- Meet federal regulatory capital requirements.

G.4 The first $250,000 of any monies deposited with a bank or credit union must be guaranteed by the Federal Deposit Insurance Corporation (FDIC), the Federal Savings and Loan Insurance Corporation (FSLIC) or the National Credit Union Share Insurance Fund (NCUSIF). Banks, savings and loan associations, and credit unions must be able to collateralize any deposits over $250,000 (see Section I).

G.5 In selecting Security Broker/Dealers, the following guidelines are recommended:

- Financial statements to be reviewed and accepted by staff.
- References to be obtained from other municipalities.
- Safekeeping arrangements made with third party correspondent bank.
- Insurance provided on securities in firm's custody.

G.6 A competitive bid process will be used to place investment purchases based upon investment offerings provided by the City's list of authorized investment brokers.

G.7 An annual review of the financial condition and registrations of qualified bidders may be conducted by the City Treasurer or designee. As part of any review performed, a current audited financial statement will be obtained for those financial institutions and brokers/dealers subject to review.

H. <u>ADDING INVESTMENT POOLS/MONEY MARKET MUTUAL FUNDS</u>

H.1 A thorough investigation of the pool/fund is required prior to investing and on a regular basis, and information should be obtained from the pool/fund regarding the following items:

- Authorized Investments
- Investment Policy and Objectives
- Interest Calculations / Distributions
- Investment Limitations

- Fee Schedule / Who May Invest
- Frequency of Statements
- Safeguarding of Investments
- Deposit / Withdrawal Limitations
- Eligibility for holding Bond Proceeds
- Treatment of Gains and Losses
- Settlement Process
- Utilization of Reserves by Fund

I. COLLATERALIZATION

I.1 Collateralization will be required on Certificates of Deposit (non-negotiable) in excess of $250,000 per Gov. Code §53652(a). The City chooses to limit collateral to eligible securities authorized by Gov. Code §53651, other than the class described in subdivision (p) (letters of credit).

I.2 Collateral pledged with a U. S. Treasury Bill or Note must be at least 110% of the face value of the investment. Collateral pledged with first mortgages must be at least 150% of the face value of the investment. The right of collateral substitution may be granted by the City.

I.3 Collateral will always be held by an independent third party with whom the financial institution has a current custodial agreement. These parties are limited to only those trust companies and trust departments, or the Federal Home Loan Bank of San Francisco, which have been approved by the California State Superintendent of Banks. [Gov. Code §53656(b)]

J. REVIEW AND REPORTING ON INVESTMENTS

J.1 Quarterly Reports

The City Treasurer and Administrative Services Department shall provide the City Council with quarterly investment reports which provide a status report of the current investment portfolio. The management report should include comments on the fixed income markets and economic conditions, discussions regarding restrictions on percentage of investment by categories, possible changes in the portfolio structure going forward and thoughts on investment strategies. This report will describe all investments outstanding as of the end of the quarter by authorized investment category, and shall show:

- Issuer
- Type of investment
- Date of maturity / weighted average maturity (wam)
- Total portfolio return
- Percentage of portfolio in each Category
- Par, Book and Market Values
- Purchase date
- Rating of security
- Effective interest rate
- Call date, if applicable

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 31, “Accounting and Financial Reporting for Certain Investments”, as of June 30th of each Fiscal Year the City will report all investments in excess of one year at market value. Any change in the value of the investments will be recognized on an annual basis, as a component of interest income.

J.2 The report shall include the source for the reported market values for investments.

J.3 The quarterly report shall state compliance of the portfolio with the City's investment policy, or the manner in which the portfolio is not in compliance.

J.4 The quarterly report shall include a statement denoting the ability of the City to meet its expenditure requirements for the next six months, or provide an explanation as to why sufficient money shall, or may, not be available.

J.5 The quarterly report shall be submitted to the City Manager and City Council within 30 days following the end of the quarter, or as soon as practicable after the data is available to the City

K. <u>ETHICS AND CONFLICTS OF INTEREST</u>

K.1 Investment Officers shall not engage in any employment, activity or enterprise which is inconsistent, incompatible or in conflict with their duties under the City's Investment Policy. Prohibited employment, activity or enterprise shall include the performance of any act other than in their capacity as an Investment Officers which may be later subject to influence, control, inspection, review, audit or enforcement by the Investment Officers or Administrative Services Department.

K.2 Investment Officers shall not conduct personal investment transactions, directly or indirectly, with individual brokers who do business with the City. Investment Officers and other employees involved with the investment process shall also refrain from other personal business activity that could conflict with the proper execution and management of the City's investment portfolio or that would impair their ability to make impartial investment decisions.

K.3 Employees and Investment Officers shall disclose any material financial interest in financial institutions that conduct business within the City's jurisdiction, and any personal financial/investment positions that could be related to the performance of the City. This shall include complying with the disclosure and disqualification requirements as established by the Fair Political Practices Commission and Conflict of Interest Codes of the City of Walnut Creek. A copy of each Investment Officer's Statement of Economic Interest, which is required to contain disclosure of any material financial interests in financial institutions doing business in the City, shall be filed annually with the City Clerk.

K.4 In order to avoid either the reality or appearance of inappropriate influence, Investment Officers shall not accept meals, refreshments, parking privileges, trips, honoraria, gratuities, free or discounted tickets (or passes) to events, gifts (even if relatively low intrinsic value), or any other consideration, directly or indirectly, from either principals or employees of underwriters, financial advisers, brokers, dealers, bankers, bond counsel, or any other individuals or entities in a position to benefit from the financial business of the City.

6. POLICY HISTORY AND CITATIONS

This policy and procedure was last reviewed on February 16, 2021 by formal action of the City Council at its regular meeting via Resolution No. 21-08. This policy is updated annually although no changes have been made to the policy from 2016-present.

Amended: April 1, 2014 via Resolution No. 14-14; April 7, 2015 via Resolution No. 15-22.

Investment Policy Glossary

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

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: One basis point is one hundredth of one percent (.01%)

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.

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

BOOK ENTRY: The system maintained by the Federal Reserve, by which most money market securities are delivered to an investor's custodial bank. The Federal Reserve maintains a computerized record of the ownership of these securities and records any changes in ownership corresponding to payments made over the Federal Reserve wire (delivery versus payment).

BOOK VALUE: The value at which a debt security is shown on the holder's balance sheet. Book value is acquisition cost less amortization of any premium or discount.

BROKER: A broker assists in the buying and selling of investments together for a commission.

CALLABLE BOND: A bond issue in which all or a part of its outstanding principal amount may be redeemed before maturity by the issuer under specified conditions

CALL PRICE: The price at which an issuer may redeem a bond before maturity

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a Certificate. Large-denomination 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.

COMMERCIAL PAPER: Unsecured promissory notes issued to finance short term credit needs.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report for the City. 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 and (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 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.*, banks,, small business firms, students, farmers, farm cooperatives, and exporters.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits, 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): 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 HOME LOAN MORTGAGE CORPORATION (FHLMC or Freddie Mac): A United States government sponsored corporation.

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

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 AGENCY INVESTMENT POOL (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 on a specific date.

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. Rule 2a-7 of the Investment Company Act applies to Money Market Funds, which mandates these funds to maintain certain standards, including a 13 month maturity limit and a 90 day average maturity on investments, to help maintain a constant net asset value of $1.00.

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.

NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS (NSROs): Credit rating agencies whose ratings are permitted to be used for regulatory purposes such as those imposed by the Securities and Exchange Commission.

NEGOTIABLE CERTIFICATE OF DEPOSIT (NCD): A large denomination certificate of deposit which can be sold in the open market prior to maturity.

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.

PREMIUM: The amount by which the price paid for a security exceeds the security's par value.

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 the Securities and Exchange Commission (SEC), registered securities broker-dealers, banks, and a few unregulated firms.

PRINCIPAL: The face value or par value of a debt instrument, or the amount of capital invested in a given security.

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 it is 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 Federal Reserve 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.

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

SETTLEMENT DATE: The date on which a trade is cleared by delivery of securities against funds

STRUCTURED NOTES: Notes issued by Government Sponsored Enterprises (FHLB, FNMA, FHLB, 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.

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 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 two 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.

WEIGHTED AVERAGE MATURITY (WAM): The average maturity of all the securities that comprise a portfolio that is typically expressed in days or years

YIELD (Yield to Maturity or Yield to Call): 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 or call 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 or call of the bond.

YIELD CURVE: The yield on bonds, notes or bills of the same type and credit risk at a specific date for maturities up to thirty years.

ZERO COUPON SECURITY: A security that is issued at a discount and makes no periodic interest payments. The rate of return consists of a gradual accretion of the principal of the security and is payable at par upon maturity.