



## ZONE 7 WATER AGENCY POLICY AND PROCEDURE

<b>POLICY TITLE: INVESTMENT POLICY</b>	<b>NUMBER: Z7AF-141-17</b>	<b>PAGE: 1 of 23</b>
<b>APPROVED BY: ZONE 7 BOARD</b>	<b>REVISION: N/A</b>	<b>EFFECTIVE DATE: MAY 17, 2018</b>

This policy is intended to provide guidelines for the prudent investment of surplus cash, reserves, trust funds and restricted monies and to outline a policy for maximizing the efficiency of the Agency's cash management system.

### **1.0 POLICY**

It is the policy of the Board of Directors of the Zone 7 Water Agency ("Agency") to invest public funds in a manner which conforms to the four fundamental criteria in order of importance, as listed:

- Safety of Principal
- Liquidity
- Return on Investment, or Yield
- Diversity

### **2.0 INVESTMENT AUTHORITY**

In accordance with Section 53600, *et. seq.*, of the Government Code of the State of California, the authority to invest Agency public funds has been delegated to the Agency Treasurer/Assistant General Manager – Finance.

### **3.0 DELEGATION OF AUTHORITY**

Responsibility for the investment program is specifically delegated by the Board to the Board-appointed Treasurer or, if no such appointment has been made, to the General Manager, hereafter referred to as Treasurer who will establish procedures for the investment program, consistent with this Investment Policy. The Treasurer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities, including procedures to execute investment transactions in the absence of the Treasurer.

### **4.0 STATEMENT OF OBJECTIVES**

Per Section 53600.5 of the California Government Code, the primary objective of the Treasurer shall be to safeguard the principal of the funds under his or her control when investing public funds. The secondary objective will be to maintain liquidity as required by the Agency and the third objective is to obtain a return on investment of these funds.

In order of priority, the four fundamental criteria shall be followed in the investment of funds:

- 4.1 Safety of Principal** – Investments shall be undertaken in a manner which first seeks to ensure the preservation of principal in the portfolio. Each investment transaction shall be entered only after taking into consideration the quality of the issuer, the underlying security or collateral, and diversification of the portfolio. Cash flow analysis will be conducted and utilized to avoid the need to sell securities prior to maturity. The Agency shall seek to preserve principal by mitigating both credit and market risk.
- 4.2 Liquidity** – Every effort shall be made to ensure that the Agency’s portfolio is sufficiently liquid to meet current and anticipated operating requirements. Cash flow analysis should be performed on an ongoing basis. Investments shall be made to ensure maturities are compatible with anticipated cash flow requirements.
- 4.3 Return on Investment, or Yield** – Investments shall be undertaken to produce an investment return consistent with the primary objectives of Safety of Principal and Liquidity, and the Prudent Investor Standard.
- 4.4 Diversity** – The objective is to avoid over concentration or exposure to any one issuer, instrument or maturity sector as specified in the Summary Table of Investment Guidelines and Eligible Securities herein, so that no single investment or class of investments can have a disproportionate impact on the total portfolio. This restriction does not apply to U.S. Treasury securities.

The investment portfolio shall be diversified and designed to attain a market average rate of return, taking into account cash flow requirements, striving to maintain an average portfolio maturity of approximately twenty-four (24) months. The Treasurer shall have an overall investment objective of holding investments to maturity and not investing with the objective of actively trading or trading for speculative purposes. However, the Treasurer may, from time to time, swap or sell securities in order to re-position securities to current coupon issues, maintain proper asset allocation limits, or to realize profits from market value appreciation.

The Treasurer may sell securities in order to protect the overall quality of the portfolio under the following circumstances:

- i) To raise cash to meet unanticipated cash-flow requirements
- ii) To swap old securities for current coupon securities
- iii) Maintain portfolio allocation limits
- iv) To avoid further erosion and loss of investment principal due to deterioration in credit-worthiness, as well as to respond to rapidly changing interest rate environments

## **5.0 SCOPE**

The Investment Policy applies to all funds of the Agency including Water Enterprise Operations Funds, Renewal/Replacement & System-Wide Improvement Fund, State Water Facilities Fund, Water Enterprise Capital Expansion Fund, Flood Control Operations Fund, Flood Protection Development Impact Fee Fund, Water Facilities Fund, Water Supply and Reliability Fund, Vehicle/Equipment Replacement Reserve Fund, Endowments, and all other funds held by the Agency. This investment policy does not apply to proceeds of notes, bonds or similar external financings which would be invested pursuant to bond indentures or State of California Government Code Section 53600, *et. seq.*, as applicable.

## **6.0 PRUDENT INVESTOR STANDARD**

All investments and evaluation of such investments shall be made with the Prudent Investor Standard as set forth in the California Government Code, Sections 53600.3 and 27000.3, which is defined as a standard of conduct whereby any person authorized to make investment decisions on behalf of the Agency acts 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 Agency with the aim to safeguard principal and meet the liquidity needs of the Agency.

## **7.0 PORTFOLIO ADJUSTMENTS**

Portfolio percentage limitations for each category of investment are applicable only at the date of purchase. Should an investment percentage be exceeded due to instances such as the fluctuation in overall portfolio size, or market valuation changes, the Treasurer is not required to sell the affected securities.

Should a security held in the portfolio be downgraded below the minimum rating criteria specified in this Investment Policy, the Treasurer shall sell such security in a manner designed to minimize losses. If the security is downgraded to a level that is less than investment grade, the Treasurer shall perform a credit analysis of such security to determine whether hold or sell the security. The Treasurer may elect to sell the security immediately to minimize losses in the event that an orderly disposition with minimal losses cannot be achieved. If the security matures within sixty (60) days of the rating decline, the Treasurer may choose not to sell the affected security.

The Treasurer shall note in a quarterly report securities which have been downgraded below investment grade and the status of disposition.

## **8.0 SAFEKEEPING AND CUSTODY**

All securities transactions entered into by the Agency shall be conducted on a delivery-versus-payment (DVP) basis pursuant to a custodial safekeeping agreement. All securities owned by the Agency shall be held in safekeeping by an independent custodian designated by the Treasurer. Financial institutions providing safekeeping services shall provide reports or receipts which verify securities held in safekeeping.

## **9.0 REPORTING**

The Treasurer shall submit a quarterly report within 30 days following the end of the quarter covered by the report to the Agency Board of Directors pursuant to California Government Code Section 53646 (b)(1). The report shall at a minimum provide information on compliance to this policy and on the composition of the portfolio for each fund with:

- Types of investment
- Issuer
- Maturity dates
- Par and dollar amount
- Market values including source of the valuation
- Rates of Interest
- Expected yields to maturity

In addition, the quarterly report shall also include a statement denoting the ability to meet the Agency's expenditure requirements for the next six (6) months.

## **10.0 INVESTMENT GUIDELINES AND ELIGIBLE SECURITIES**

Section 53600, *et seq.*, of the Government Code of the State of California prescribes the statutory requirement relating to investments by local treasurers, providing guidance on:

- i) Allowable Investments
- ii) Portfolio diversification requirements including proportional limits on investment types, maximum maturity, and minimum credit rating criteria.

The maximum maturity of any investment in the portfolios shall not exceed five (5) years except when specifically authorized by the Agency Board of Directors through resolution. When practical, the Treasurer shall solicit more than one quotation on each trade for the purpose of awarding investment trades on a competitive basis. The Agency will conform to the legal provisions set forth in the Government Code with further and more specific requirements about allowable investments and restrictions as detailed below:

### **10.1 US Treasury Bonds, Bills and Notes**

Bills, notes and bonds issued by the U.S. Treasury which are direct obligations of the federal government.

- Maximum limit: 100% of the portfolio
- Maximum maturity of five (5) years
- Credit Requirement: N.A.

### **10.2 Federal Agency Bonds and Notes**

Notes and bonds of federal agencies, government-sponsored enterprises and international institutions. Not all are direct obligations of the U. S. Treasury but may involve federal sponsorship and/or guarantees, in some instances.

- Maximum limit: 100% of the portfolio
- Maximum maturity of five (5) years
- Credit Requirement: N.A.

### **10.3 Banker's Acceptances**

Bills of exchange or time drafts drawn on and accepted by a commercial bank, typically created from a letter of credit issued in a foreign trade transaction.

- Maximum limit: forty percent (40%) of the portfolio
- Issued by banks with total deposits of over one billion dollars (\$1,000,000,000)
- Maximum maturity of one-hundred eighty (180) days
- Twenty-five percent (25%) limitation to any one issuer
- Credit requirement: Ratings of A1, P1 or F1 or better by two of the three nationally-recognized rating agencies: S&P, Moody's, or Fitch, respectively. No rating may be lower than any of the rating listed above.
- Issued by banks from offices in the USA.

#### **10.4 Commercial Paper**

Commercial paper is defined as short-term, unsecured promissory notes issued by financial and non-financial companies to raise short-term cash. Financial companies issue commercial paper to support their consumer and/or business lending; non-financial companies issue for operating funds.

- Maximum limit: Twenty-five percent (25%) of the portfolio
- Maximum Maturity of two hundred seventy (270) days
- Maximum Issuer Exposure: Ten percent (10%) limitation on outstanding commercial paper to any one issuer
- Credit requirement: Ratings of A1, P1 or FI or better by two of the three nationally-recognized rating agencies: S&P, Moody's, or Fitch, respectively. No rating may be lower than any of the rating listed above.
- Limited to paper issued by corporations organized and operating in the U.S. with total assets in excess of five hundred million (\$500,000,000), and having "A" or higher ratings for the issuer's debt, other than commercial paper, if any, as provided by national recognized rating agency.

#### **10.5 Medium Term Corporate Notes**

Corporate Bonds, Corporate Notes and Deposit Notes. Issuers are banks and bank holding companies, thrifts, finance companies, insurance companies and industrial corporations. These debt obligations that are generally unsecured.

- Maximum limit: Thirty percent (30%) of the portfolio
- Maximum maturity of five (5) years
- Maximum Issuer Exposure: No more than 5% of the portfolio shall be invested in any single issuer
- Credit Requirement: Must be rated A3, A- or AA or better by two of the three nationally-recognized rating agencies: S&P, Moody's, or Fitch, respectively. No rating may be lower than any of the ratings listed above.
- Eligibility: Limited to corporations organized and operating within the United States or depository institutions licensed by the United States or any State and operating within the United States.

#### **10.6 Negotiable Certificates of Deposit**

Issued by commercial banks and thrifts, and foreign banks (Yankee CD's).

- Maximum limit: Thirty percent (30%) of the portfolio, with five percent (5%) per issuer
- Maximum maturity of five (5) years
- Credit Requirement: Rated A, A2 or A (S&P, Moody's or Fitch, respectively)
- Issued by banks with total deposits of one billion dollars (\$1,000,000,000) or more

#### **10.7 Certificates of Time Deposit**

Time deposits, which are non-negotiable, are issued most commonly by commercial banks, savings and loans and credit unions with federal deposit insurance available for amounts up to two hundred-fifty thousand (\$250,000).

- Maximum limit: Thirty percent (30%) of the portfolio for all deposits
- Maximum maturity five (5) years
- On uncollateralized deposits, limited to FDIC insured amount of two hundred-fifty thousand (\$250,000)
- Amounts over FDIC insured amount must be fully collateralized
- Credit Requirement: For federally-insured deposits of two hundred-fifty thousand (\$250,000) or less, no minimum credit rating required. For deposits over two hundred-fifty thousand (\$250,000): Ratings of A, A2, or A or better by two of the three nationally-recognized rating agencies: S&P, Moody's, or Fitch, respectively.

Pursuant to Government Code 53637, the Agency is prohibited from investing in certificate of deposits of a state or federal credit union if a member of the legislative body or decision-making authority serves on the board of directors or committee.

### **10.8 Money Market Mutual Funds**

Regulated by the SEC, these funds operate under strict maturity and diversification guidelines. These funds have no federal guarantee but are viewed as a very safe short-term cash investment.

- Maximum Maturity: N/A
- Maximum limit: Twenty percent (20%) of the portfolio
- Rating Requirement: Top ranking or highest letter and numerical rating provided by at least two nationally recognized statistical rating organizations
- Daily liquidity
- Net Asset Value (NAV) requirement: one dollar (\$1.00)
- Funds must be invested in securities and obligations permitted under the California Government Code

### **10.9 State of California, Local Agency Investment Fund (LAIF).**

LAIF is a pooled investment fund overseen by the State Treasurer, which operates like a money market fund, but is for the exclusive benefit of governmental entities within the state. The maximum investment amount currently authorized by Local Agency Investment Fund (LAIF) is sixty-five million (\$65 million), which is subject to change. The LAIF is in trust in the custody of the State of California Treasurer. The Agency's right to withdraw its deposited monies from LAIF is not contingent upon the State's failure to adopt a State Budget.

- Maximum limit: 100% of the portfolio
- Maximum Maturity: N/A

### **10.10 Municipal Bonds and Notes**

Municipal obligations issued by a municipality within the State of California and any other of the states in the union. This may include bonds, notes, warrants, or other evidences of indebtedness of a local agency within the state.

- Maximum limit: Forty percent (40%) of the portfolio
- Maximum maturity of five (5) years

- Must be issued by State of California or California local agency
- Credit Requirement: Prudent person standard applies

### **10.11 Repurchase Agreement**

A repurchase agreement is a purchase of authorized securities with terms including a written agreement by the seller to repurchase the securities on a future date and price.

- Maximum limit: Twenty percent (20%) of the portfolio
- Maximum maturity of two hundred seventy (270) days
- Master Repurchase Agreement must be on file
- Limited to primary dealers or financial institutions rated “A” or better by Moody’s or equivalent.
- Fully collateralized at market value of at least one hundred two percent (102%) with US government or federal agency securities

### **10.12 California Asset Management Program (CAMP)**

- Maximum limit: Ten percent (10%) of the portfolio
- Rated highest short term rating by largest nationally recognized rating services

## **11.0 CREDIT RATING**

Credit rating requirements for eligible securities as specified in this policy shall mean alpha numeric designations assigned by the following rating agencies:

- Moody’s Investors Service
- Standard & Poor’s Rating Services
- Fitch IBCA, Inc.
- Thompson Bank Watch

Please see Rating Description table herein, below.

## **12.0 MONITORING SAFETY AND LIQUIDITY**

The Treasurer shall monitor on an ongoing basis investments for exposure to risk and credit deterioration to ensure primary objectives of safety of principal and liquidity are adhered to. Such matters shall be reported to the Agency Board of Directors as part of the Treasurer’s quarterly and/or annual report.

## **13.0 ADMINISTRATION**

The Treasurer may, at any time, establish more restrictive requirements for securities approved for investment as deemed appropriate in this Investment Policy. These restrictions may include, but are not limited to, higher credit ratings, lower percentage limits by security type or issuer, shorter maturities and additional collateral requirements for collateralized investments.



## **14.0 PURCHASING ENTITIES**

Investments not purchased directly from the issuer will be purchased from institutions licensed by the State of California as a broker/dealer, including:

- National or California State Chartered Banks
- Federal or California Chartered Savings Institutions
- Brokerage firms designated as a primary government dealer by the Federal Reserve Bank
- Member of a federally-regulated securities exchange
- Institutions licensed by the State of California as a broker/dealer
- Federal or state savings institutions or associations as defined in Finance Code Section 5102

The Treasurer or designee will maintain a current and eligible list of reputable primary and regional dealers, brokers and financial institutions with whom securities trading and placement of funds are authorized. A strong capital base credit worthiness, and, where applicable, a broker/dealer staff experienced in transactions with California local governments are the primary criteria for inclusion on the Agency's approved list.

Approved dealers and brokers shall be limited to primary dealers or regional dealers that qualify under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule) and which provide: proof of Financial Industry Regulatory Authority (FINRA) certification; proof of California State registration; and a completed Agency broker/dealer questionnaire. In addition, prior to approval and for every two years thereafter, approved dealers and brokers must provide: an audited financial statement; certification of receipt, review of and willingness to comply with the current Investment Policy; and certification of compliance with Rule G-37 of the Municipal Securities Rulemaking Board regarding limitations on political contributions to the Board of Directors of the Agency or to any candidate for these offices.

The Treasurer may remove a firm from the approved list at any time due to: any failure to comply with any of the above criteria; any failure to successfully execute a transaction; any change in broker/dealer staff; or any other action, event or failure to act which, in the sole discretion of the Treasurer is materially adverse to the best interests of the Agency.

## **15.0 INVESTMENT SECURITY**

To ensure a high degree of internal control, the Agency shall comply with the following;

- All securities purchased from dealers and brokers shall be held in safekeeping by the Agency's custodial bank, a national bank, a State chartered bank or trust company, established for this purpose as someone other than the selling party of the security. Securities purchased will be covered by a trust or safekeeping receipt in a manner that establishes the Agency's ownership. All transactions completed on a delivery versus pay basis (DVP).
- All trade confirmation shall be received directly and reviewed for conformity to the original transaction by an individual other than the person originating the transaction. All trade confirmation must be an original; copies of confirmations are not allowed. Any discrepancies will be brought to the attention of the Treasurer.



## **16.0 FUND WIRE PROCEDURES**

Payment for securities purchased from broker dealers that are ineligible for safekeeping will be made through the Agency's custodial bank. Funds will only be transferred subsequent but immediately following the custodial bank's acknowledgement that they are prepared to make settlement on the terms and conditions specified by the Agency. Payment for securities purchased from bank investment departments that will be safely kept with the trust department of the bank will be made immediately upon confirmation of the trade.

## **17.0 PERFORMANCE REVIEW AND INTERNAL CONTROL**

The Treasurer or designee shall maintain a system of internal controls designed to ensure compliance with the Investment Policy and to prevent losses due to fraud, employee error, and misrepresentations by third parties or unanticipated changes in financial markets. The internal control includes; the activities of any subordinate officials acting on behalf of the Agency. Procedures should include references to individuals authorized to execute transactions or transfers, safekeeping agreements, repurchase agreements, wire transfer agreements, collateral/depository agreements and banking services contracts, as appropriate. As part of the Comprehensive Annual Financial Report (CAFR) audit, the Agency's external auditor will perform a review of investment transactions to verify compliance with policies and procedures.

## **18.0 ETHICS AND CONFLICT OF INTEREST**

All officers and employees involved in the investment process shall refrain from engaging in any personal business activity which could conflict with proper execution of investments subject to this Policy. Any material financial interests in financial institutions which do business with the Agency should be disclosed to the General Manager of the Agency. All individuals involved in the investment process are required to report all gifts and income in accordance with California State Law.

**SUMMARY TABLE OF  
INVESTMENT GUIDELINES AND ELIGIBLE SECURITIES**

Authorized Investments	Maximum % Holdings	Purchase Restrictions	Maximum Maturity	Credit Quality
US Treasury Bonds, Bills and Notes	100%	N/A	5 Years	N/A
Federal Agency Bonds & Notes	100%	N/A	5 Years	<i>Full backing by the federal government of the United States of America</i>
Bankers Acceptance	40%	25% limitation to a single issuer	180 days	<i>"A-1/P-1" rated by S&amp;P and Moody's or equivalent for domestic banks</i>
Commercial Paper	25%	10% limitation to single issuer	270 days	<i>"A-1/P-1" rated by S&amp;P and Moody's or equivalent</i>  <i>"AA" rated by S&amp;P or equivalent for US branch of foreign banks</i>
Medium Term Corporate Notes	30%	5% limitation to a single issuer. Limited to US licensed and operating corporations	5 years	<i>"A3" rated by at least one nationally recognized rating service</i>
Negotiable CD	30%	National or state chartered bank, S&L, or branch of foreign bank	5 years	<i>"A" rated by one or more nationally rated credit rating agencies</i>
Certificates of Time Deposit	30%	See California Government Code Section 53637	5 Years	<i>Limit to FDIC Insured amount \$250,000, Fully collateralized on amounts over the insured amount in accordance with California Government Code</i>
Money Market Mutual Funds	20%	Must maintain constant NAV of \$1.00	Daily Liquidity	<i>Top ranking or highest letter and numerical by 2 of the 3 nationally recognized rating services</i>

Authorized Investments	Maximum % Holdings	Purchase Restrictions	Maximum Maturity	Credit Quality
				<i>Fund must be invested in securities and obligation permitted under Government Code</i>
State of California, Local Agency Investment Fund (“LAIF”)	100%	None	N/A	<i>Subject to California Government Code Section 16429.1 limitations</i>
Municipal Bonds & Notes	40%	State of California or California agencies	5 Years	<i>Prudent person standard</i>
Repurchase Agreements (“REPO”)	20%	Limited to primary dealers or financial institutions rated “A” or better by Moody’s	270 days	<i>Fully collateralized (min 102% of funds borrowed with daily mark to market) with US Government or federal agency securities with maximum 5 year maturities</i>
California Asset Management Program (“CAMP”)	10%	N/A	Daily Liquidity	<i>Highest short term rating by S&amp;P, Moody’s and/or Fitch</i>

### RATING DESCRIPTION TABLE

<b>Long Term Debt Ratings</b>			
<b>Credit Quality</b>	<b>Moody's</b>	<b>S&amp;P</b>	<b>Fitch</b>
<b>Strongest Quality</b>	Aaa	AAA	AAA
<b>Strong Quality</b>	Aa1/Aa2/Aa3	AA+/AA/AA-	AA
<b>Good Quality</b>	A1/A2/A3	A+/A/A-	A
<b>Medium Quality</b>	Baa1/Baa2/Baa3	BBB+/BBB/BBB-	BBB
<b>Speculative</b>	Ba1/Ba2/Ba3	BB+/BB/BB-	BB
<b>Low</b>	B1/B2/B3	B+/B/B-	B
<b>Poor</b>	Caa	CCC+	CCC
<b>Highly Speculative</b>	Ca/C	CCC/CCC-/CC	CC
<b>Short Debt Ratings</b>			
<b>Credit Quality</b>	<b>Moody's</b>	<b>S&amp;P</b>	<b>Fitch</b>
<b>Strongest Quality</b>	P-1	A-1+	F1
<b>Strong Quality</b>		A-1	
<b>Good Quality</b>	P-2	A-2	F2
<b>Medium Quality</b>	P-3	A-3	F3

Note: Investment Grade ratings applies to securities with at least a medium credit quality or higher by one of the nationally recognize rating organization, anything below the medium credit quality is non-investment grade.

**EXHIBIT A****GLOSSARY**

**ACCRETION:** Adjustment of the difference between the prices of a bond bought at an original discount and the par value of the bond.

**AGENCIES:** Federal agency securities and/or Government-sponsored enterprises (GSEs), also known as U.S. Government instrumentalities. Securities issued by Government National Mortgage Association (GNMA) are considered true agency securities, backed by the full faith and credit of the U.S. Government. GSEs are financial intermediaries established by the federal government to fund loans to certain groups of borrowers, for example homeowners, farmers and students and are privately owned corporations with a public purpose. The most common GSEs are Federal Farm Credit System Banks, Federal Home Loan Banks, Federal Home Loan Mortgage Association, and Federal National Mortgage Association.

**AMORTIZATION:** Accounting procedure that gradually reduces the cost value of a limited life or intangible asset through periodic charges to income. For fixed assets, the term used is “depreciation”. It is common practice to amortize any premium over par value paid in the purchase of preferred stock or bond investments.

**APPRECIATION:** Increase in the value of an asset such as a stock bond, commodity or real estate.

**ASKED PRICE:** The price a broker/dealer offers to sell securities.

**ASSET BACKED:** A type of security that is secured by receivables, such as credit card and auto loans. These securities typically pay principal and interest monthly.

**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. This money market instrument is used to finance international trade.

**BASIS POINT:** One-hundredth of one percent (i.e., 0.01%).

**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 investment.

**BID PRICE:** The price a broker/dealer offers to purchase securities.

**BOND:** A financial obligation for which the issuer promises to pay the bondholder a specified stream of future cash flows, including periodic interest payments and a principal repayment.

**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 premium or accretion of discount.

**BROKER:** A broker acts as an intermediary between a buyer and seller for a commission and does not trade for his/her own risk and account or inventory.

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

**CASH EQUIVALENTS (CE):** Highly liquid and safe instruments or investments that can be converted into cash immediately. Examples include bank accounts, money market funds, and Treasury bills.

**CASH FLOW:** An analysis of all changes that affect the cash account during a specified period.

**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.

**COLLATERALIZED MORTGAGE OBLIGATION (CMO):** A type of mortgage-backed security that creates separate pools of pass-through rates for different classes of bondholders with varying maturities, called tranches. The repayments from the pool of pass-through securities are used to retire the bonds in the order specified by the bonds' prospectus.

**COMMERCIAL PAPER:** Short-term, unsecured, negotiable promissory notes of corporations.

**COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR):** The official annual financial report for the Agency. It includes combined statements and basic financial statements for each individual fund and account group prepared in conformity with Generally Accepted Accounting Principles (GAAP).

**CORPORATE NOTE:** Debt instrument issued by a private corporation.

**COUPON:** The annual rate at which a bond pays interest.

**CREDIT RATINGS:** A grade given to a debt instrument that indicates its credit quality. Private independent rating services such as Standard & Poor's, Moody's and Fitch provide these

**CREDIT RISK:** The risk that an obligation will not be paid and a loss will result due to a failure of the issuer of a security.

**CUSIP:** Stands for Committee on Uniform Securities Identification Procedures. A CUSIP number identifies most securities, including: stocks of all registered U.S. and Canadian companies, and U.S. government and municipal bonds. The CUSIP system—owned by the American Bankers Association and operated by Standard & Poor’s—facilitates the clearing and settlement process of securities. The number consists of nine characters (including letters and numbers) that uniquely identify a company or issuer and the type of security.

**CURRENT YIELD:** The annual interest on an investment divided by the current market value. Since the calculation relies on the current market value rather than the investor’s cost, current yield is unrelated to the actual return the investor will earn if the security is held to maturity.

**CUSTODIAN:** A bank or other financial institution that keeps custody of stock certificates and other assets.

**DEALER:** A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his/her own risk and account or inventory.

**DEBENTURES:** A bond secured only by the general credit of the issuers.

**DELIVERY VERSUS PAYMENT (DVP):** Delivery of securities with a simultaneous exchange of money for the securities.

**DERIVATIVES:** A financial instrument that is based on, or derived from, some underlying asset, reference date, or index.

**DIRECT ISSUER:** Issuer markets its own paper directly to the investor without use of an intermediary.

**DISCOUNT:** The difference between the cost of a security and its value at maturity when quoted at lower than face value.

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

**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. Duration measures the price sensitivity of a bond to changes in interest rates.

**FACE VALUE:** The principal amount owed on a debt instrument. It is the amount on which interest is computed and represents the amount that the issuer promises to pay at maturity.



**FAIR VALUE:** The amount at which a security could be exchanged between willing parties, other than in a forced or liquidation sale. If a market price is available, the fair value is equal to the market value.

**FANNIE MAE:** Trade name for the Federal National Mortgage Association (FNMA), a U.S. Government sponsored enterprise.

**FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC):** A federal agency that provides insurance on bank deposits, guaranteeing deposits to a set limit per account, currently \$250,000.

**FEDERAL FARM CREDIT BANK (FFCB):** Government-sponsored enterprise that consolidates the financing activities of the Federal Land Banks, the Federal Intermediate Credit Banks and the Banks for Cooperatives. Its securities do not carry direct U.S. government guarantees.

**FEDERAL FUNDS RATE:** The rate of interest at which Federal funds are traded. This rate is considered to be the most sensitive indicator of the direction of interest rates, as it is currently pegged by the Federal Reserve through open-market operations.

**FEDERAL GOVERNMENT AGENCY SECURITIES:** 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.

**FEDERAL HOME LOAN BANKS (FHLB):** Government sponsored enterprise (currently made up of 12 regional banks) that regulates and lends funds and provides correspondent banking services to member commercial banks, thrift institutions, credit unions and insurance companies. Although the banks operate under federal charter with government supervision, the securities are not guaranteed by the U. S. Government.

**FEDERAL HOME LOAN MORTGAGE CORPORATION (FHLMC):** Government sponsored enterprise that helps maintain the availability of mortgage credit for residential housing. FHLMC finances these operations by marketing guaranteed mortgage certificates and mortgage participation certificates. Its discount notes and bonds do not carry direct U.S. government guarantees.

**FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA):** Government sponsored enterprise that is the largest single provider of residential mortgage funds in the United States. FNMA 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.

**FEDERAL OPEN MARKET COMMITTEE (FOMC):** A committee of the Federal Reserve Board, which establishes monetary policy and executes it through temporary and permanent changes to the supply of bank reserves.

**FEDERAL RESERVE SYSTEM:** The central bank of the U.S. which consists of a seven member Board of Governors, 12 regional banks and about 5,700 commercial banks that are members.

**FED WIRE:** A wire transmission service established by the Federal Reserve Bank to facilitate the transfer of funds through debits and credits of funds between participants within the Fed system.

**FREDDIE MAC:** Trade name for the Federal Home Loan Mortgage Corporation (FHLMC), a U.S. government sponsored enterprise.

**GINNIE MAE:** Trade name for the Government National Mortgage Association (GNMA), a direct obligation bearing the full faith and credit of the U.S. Government.

**GOVERNMENT ACCOUNTING STANDARDS BOARD (GASB):** A standard-setting body, associated with the Financial Accounting Foundation, which prescribes standard accounting practices for governmental units.

**GUARANTEED INVESTMENT CONTRACTS (GICS):** An agreement acknowledging receipt of funds, for deposit, specifying terms for withdrawal, and guaranteeing a rate of interest to be paid.

**INTEREST RATE:** The annual yield earned on an investment, expressed as a percentage.

**INTEREST RATE RISK:** The risk of gain or loss in market values of securities due to changes in interest-rate levels. For example, rising interest rates will cause the market value of portfolio securities to decline.

**INVESTMENT AGREEMENTS:** A contract providing for the lending of issuer funds to a financial institution which agrees to repay the funds with interest under predetermined specifications.

**INVESTMENT GRADE (LONG TERM RATINGS):** The minimum, high quality ratings for long term debt such as corporate notes. Investment Grade ratings are as follows: A3 (Moody's), A- (S&P), and A- (Fitch).

**INVESTMENT PORTFOLIO:** A collection of securities held by a bank, individual, institution or government agency for investment purposes.

**LIQUIDITY:** A liquid asset is one that can be converted easily and rapidly into cash with minimum risk of principal.

**LOCAL AGENCY INVESTMENT FUND (LAIF):** An investment pool sponsored by the State of California and administered/managed by the State Treasurer. Local government units, with consent of the governing body of that agency, may voluntarily deposit surplus funds for the purpose of investment. Interest earned is distributed by the State Controller to the participating governmental agencies on a quarterly basis.

**LOCAL AGENCY INVESTMENT POOL:** A pooled investment vehicle sponsored by a local agency or a group of local agencies for use by other local agencies.

**MARKET RISK:** The risk that the value of securities will fluctuate with changes in overall market conditions or interest rates. Systematic risk of a security that is common to all securities of the same general class (stocks, bonds, notes, money market instruments) and cannot be eliminated by diversification (which may be used to eliminate non-systematic risk).

**MARKET VALUE:** The price at which a security is currently being sold in the market. See FAIR VALUE.

**MASTER REPURCHASE AGREEMENT:** A written contract covering all future transactions between the parties to repurchase agreements and reverse repurchase agreements that establish 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 that the principal or stated value of a debt instrument becomes due and payable.

**MEDIUM-TERM CORPORATE NOTES (MTNs):** Unsecured, investment-grade senior debt securities of major corporations which are sold in relatively small amounts either on a continuous or an intermittent basis. MTNs are highly flexible debt instruments that can be structured to respond to market opportunities or to investor preferences.

**MODIFIED DURATION:** The percent change in price for a 100 basis point change in yields. This is a measure of a portfolio's or security's exposure to market risk.

**MONEY MARKET:** The market in which short term debt instruments (Treasury Bills, Discount Notes, Commercial Paper, Banker's Acceptances and Negotiable Certificates of Deposit) are issued and traded.

**MORTGAGED BACKED SECURITIES:** A type of security that is secured by a mortgage or collection of mortgages. These securities typically pay principal and interest monthly.

**MUNICIPAL BONDS:** Debt obligations issued by states and local governments and their agencies, including cities, counties, government retirement plans, school Agencies, state universities, sewer agency, municipally owned utilities and authorities running bridges, airports and other transportation facilities

**MUTUAL FUND:** An entity that pools money and can invest in a variety of securities which are specifically defined in the fund's prospectus.

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

**NET PORTFOLIO YIELD:** Calculation in which the 365-day basis equals the annualized percentage of the sum of all Net Earnings during the period divided by the sum of all Average Daily Portfolio Balances.

**NATIONALLY RECOGNIZED RATING ORGANIZATION (NRSRO):** is a credit rating agency that issues credit rating that U.S Securities and Exchange Commission permits other financial firms to use for certain regulatory purposes.

**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.

**PAR VALUE:** The amount of principal which must be paid at maturity. Also referred to as the face amount of a bond. See FACE VALUE.

**PORTFOLIO:** The collection of securities held by an individual or institution.

**PREMIUM:** The difference between the par value of a bond and the cost of the bond, when the cost is above par.

**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. These dealers are authorized to buy and sell government securities in direct dealing with the Federal Reserve Bank of New York in its execution of market operations to carry out U.S. monetary policy. Such dealers must be qualified in terms of reputation, capacity, and adequacy of staff and facilities.

**PRIME (SHORT TERM RATING):** High quality ratings for short term debt such as commercial paper. Prime ratings are as follows: P1 (Moody's), A1 (S&P), and F1 (Fitch).

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

**PRIVATE PLACEMENTS:** Securities that do not have to be registered with the Securities and Exchange Commission because they are offered to a limited number of sophisticated investors.

**PROSPECTUS:** A legal document that must be provided to any prospective purchaser of a new securities offering registered with the Securities and Exchange Commission that typically includes information on the issuer, the issuer's business, the proposed use of proceeds, the experience of the issuer's management, and certain certified financial statements (also known as an "official statement").

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

**PUBLIC DEPOSIT:** A bank that is qualified under California law to accept a deposit of public funds.

**PURCHASE DATE:** The date in which a security is purchased for settlement on that or a later date. Also known as the "trade date".

**RATE OF RETURN:** 1) The yield which can be attained on a security based on its purchase price or its current market price. 2) Income earned on an investment, expressed as a percentage of the cost of the investment.

**REALIZED GAIN (OR LOSS):** Gain or loss resulting from the sale or disposal of a security.

**REGIONAL DEALER:** A financial intermediary that buys and sells securities for the benefit of its customers without maintaining substantial inventories of securities and that is not a primary dealer.

**REPURCHASE AGREEMENT (RP or REPO):** A transaction in which a counterparty or the holder of securities (e.g. investment dealer) sells these securities to an investor (e.g. the Agency) with a simultaneous agreement to repurchase them at a fixed date. The security "buyer" (e.g. the Agency) in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate the "buyer" 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 REPURCHASE AGREEMENT (REVERSE REPO):** The opposite of a repurchase agreement. A reverse repo is a transaction in which the Agency sells securities to a counterparty (e.g. investment dealer) and agrees to repurchase the securities from the counterparty at a fixed date. The counterparty in effect lends the seller (e.g. the Agency) money for the period of the agreement with terms of the agreement structured to compensate the buyer.

**RISK:** Degree of uncertainty of return on an asset.

**SAFEKEEPING:** A service which banks offer to clients for a fee, where physical securities are held in the bank's vault for protection and book-entry securities are on record with the Federal Reserve Bank or Depository Trust Company in the bank's name for the benefit of the client. As agent for the client, the safekeeping bank settles securities transactions, collects coupon payments, and redeems securities at maturity or on call date, if called.

**SECURITIES AND EXCHANGE COMMISSION (SEC):** Agency created by Congress to protect investors in securities transactions by administering securities legislation.

**SECONDARY MARKET:** A market for the repurchase and resale of outstanding issues following the initial distribution.

**SECURITIES:** Investment instruments such as notes, bonds, stocks, money market instruments and other instruments of indebtedness or equity.

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

**SPREAD:** The difference between two figures or percentages. It may be the difference between the bid (price at which a prospective buyer offers to pay) and asked (price at which an owner offers to sell) prices of a quote, or between the amount paid when bought and the amount received when sold.

**STRUCTURED NOTE:** A complex, fixed income instrument, which pays interest, based on a formula tied to other interest rates, commodities or indices. Examples include "inverse floating rate" notes which have coupons that increase when other interest rates are falling, and which fall when other interest rates are rising and "dual index floaters", which pay interest based on the relationship between two other interest rates, for example, the yield on the ten-year Treasury note minus the Libor rate. Issuers of such notes lock in a reduced cost of borrowing by purchasing interest rate swap agreements.

**SUPRANATIONALS:** are international institutions that provide development financing, advisory services and/or financial services to their member countries to achieve the overall goal of improving living standards through sustainable economic growth. The Government Code allows local agencies to purchase the United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for

Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank.

**TIME DEPOSIT:** A deposit with a California bank or savings and loan association for a specific amount and with a specific maturity date and interest rate. Deposits of up to \$250,000 are insured by FDIC. Deposits over \$250,000 are collateralized above the insurance with either government securities (at 110% of par value), first trust deeds (at 150% of par value), or letters of credit (at 105% of par value).

**TOTAL RATE OF RETURN:** A measure of a portfolio's performance over time. It is the internal rate of return which equates the beginning value of the portfolio with the ending value, and includes interest earnings and realized and unrealized gains and losses on the portfolio. For bonds held to maturity, total return is the yield to maturity.

**TRUSTEE OR TRUST COMPANY OR TRUST DEPARTMENT OF A BANK:** A financial institution with trust powers which acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond contract.

**UNDERWRITER:** A dealer which purchases a new issue of municipal securities for resale.

**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.

**U.S. GOVERNMENT AGENCY SECURITIES:** Securities issued by U.S. government agencies, most of which are secured only by the credit worthiness of the particular agency. See AGENCIES.

**U.S. TREASURY OBLIGATIONS:** Securities issued by the U.S. Treasury and backed by the full faith and credit of the United States. Treasuries are the benchmark for interest rates on all other securities in the U.S. The Treasury issues both discounted securities and fixed coupon notes and bonds. The income from Treasury securities is exempt from state and local, but not federal, taxes.

**TREASURY BILLS:** Securities issued at a discount with initial maturities of one year or less. The Treasury currently issues three-month and six-month Treasury bills at regular weekly auctions. It also issues very short-term "cash management" bills as needed to smooth out cash flows.

**TREASURY NOTES:** Intermediate-term coupon-bearing securities with initial maturities of one year to ten years.



**TREASURY BOND:** Long-term coupon-bearing securities with initial maturities of ten years or longer.

**UNREALIZED GAIN (OR LOSS):** Gain or loss that has not become actual. It becomes a realized gain (or loss) when the security in which there is a gain or loss is actually sold. See REALIZED GAIN (OR LOSS).

**VOLATILITY:** Characteristic of a security, commodity or market to rise or fall sharply in price within a short-term period.

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

**YIELD:** The annual rate of return on an investment expressed as a percentage of the investment. See CURRENT YIELD; YIELD TO MATURITY.

**YIELD CURVE:** Graph showing the relationship at a given point in time between yields and maturity for bonds that are identical in every way except maturity.

**YIELD TO MATURITY:** Concept used to determine the rate of return if an investment is held to maturity. It takes into account purchase price, redemption value, time to maturity, coupon yield, and the time between interest payments. It is the rate of income return on an investment, minus any premium or plus any discount, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond, expressed as a percentage.