

City of Long Beach

INVESTMENT POLICY



Effective January 1, 2006

INVESTMENT POLICY

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City of Long Beach Investment Policy
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1.1 Scope

- 1.1.1 In accordance with Resolution No. C-22401, the City Treasurer is authorized to invest the City's funds in accordance with the State of California Government Code, Section 53600, et seq. The objective of this policy is to ensure that the temporarily idle funds of the City of Long Beach are prudently invested to preserve capital and provide necessary liquidity, while maximizing earnings.
- 1.1.2 Investments may only be made as authorized by the State of California Government Code, Section 53600, et seq., the ("Code") and this policy. This policy conforms to the Code as well as to customary standards of prudent investment management. Should the provisions of the Code become more restrictive than those contained herein, such provisions will be considered as immediately incorporated in this policy.
- 1.1.3 This policy sets forth the City's guidelines for the investment of surplus funds in the Treasurer's Pooled Fund. Excluded from this policy are guidelines for the investment of Debt Service and Reserve and Deferred Compensation Funds. The investment of debt proceeds is governed by each transaction's indenture. Employees select the Investments for their deferred compensation accounts.
- 1.1.4 All investment managers may be governed by Portfolio Guidelines, which on an individual basis may differ from the total fund guidelines outlined herein. The City Treasurer is responsible for monitoring and ensuring that the total funds subject to this policy remain in compliance with this policy, and shall report to the City Council regularly on compliance.

1.2 Investment Objectives

- 1.2.1 The primary objectives, in priority order, of the City's investment activities shall be:
- A. Safety: Safety of principal is the foremost objective of the investment program. The City's investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The City shall seek to ensure that capital losses are avoided whether from institutional default, broker-dealer default, or erosion of market value.
 - B. Liquidity: The City's investment portfolio will remain sufficiently liquid to meet all operating requirements that might be reasonably anticipated.
 - C. Yield: The City shall manage its funds to maximize the return on investments consistent with the two primary objectives of safety and liquidity. The investment goals are to maximize interest income through the prudent implementation of the Investment Policy and developed guidelines.

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- 1.2.2 It is the City's policy to hold investments until market value equals or exceeds (historical) cost. However, if the City's liquidity needs require that investments be sold at a loss, or because of a downgrade of credit quality, national or public issues, or to take advantage of market conditions which will result in a gain on reinvestment of the sale proceeds, the security may be sold and the decline in value shall be recorded as a loss.
- 1.2.3 Investments shall be made in the context of the "Prudent Investor" standard which states: "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 in the context of managing an overall portfolio".
- 1.2.4 Investment officials in the management of the City's funds shall use the "Prudent Investor" standard. Investment officers acting in accordance with this investment policy, written portfolio guidelines and 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 the quarterly investment report to the City Council, and appropriate action is taken to control adverse developments.

1.3 Delegation of Authority

- 1.3.1 The City Council shall be the trustee of funds received by the City. In accordance with the Code, Section 53607, and Resolution C-22401, the City Council hereby delegates the authority to invest or reinvest the City's funds, to sell or exchange securities so purchased and to deposit securities for safekeeping to the City Treasurer.
- 1.3.2 The City Treasurer shall establish written procedures for the operation of the investment program consistent with this investment policy, including establishment of appropriate written agreements with financial institutions. The City Treasurer may engage independent investment managers to assist in the investment of the City's financial assets.
- 1.3.3 No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the City Treasurer.
- 1.3.4 Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution of the investment program or which could impair their ability to make impartial investment decisions. All investment personnel shall comply with the reporting requirements of the Fair Political Practices Committee and include an annual filing of a Statement of Economic Interests.

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1.4 Permitted Investments

- 1.4.1 All City funds which are not required for immediate cash expenditures shall be invested in income producing investments or accounts, in conformance with the provisions and restrictions of this investment policy as outlined in Appendix A and as specifically authorized by the Code, Section 53600, et seq.

In order to reduce overall portfolio risk, investments shall be diversified among types of investments, maturities of those investments, issuers and depository institutions. See Appendix A for specific concentration limits by type of investment.

- 1.4.2 Maturities of individual investments shall be diversified to meet the following objectives:

- A. Investment maturities will be first and foremost determined by the City's anticipated cash flow requirements.
- B. No investment instrument shall be purchased which matures more than five years from the date of purchase, unless the instrument is specifically approved by the City Council or is approved by the City Council as part of an investment program and such approval must be granted no less than three months prior to the investment.
- C. The maximum weighted average maturity of managed funds subject to this policy shall be three (3) years.

- 1.4.3 This Investment Policy specifically prohibits the investment of any funds subject to this policy in the following securities:

Derivative securities, as defined in Section 53601.6 of the Code as any security that derives its value from an underlying instrument, index, or formula, are prohibited. The derivative universe includes, but is not limited to, structured and range notes, securities that could result in zero interest accrual if held to maturity, variable rate, floating rate or inverse floating rate investments, and mortgage derived interest or principal only strips.

1.5 Selection of Depository Institutions, Investment Managers and Broker-Dealers

- 1.5.1 To minimize the risk to the City's overall cash and investment portfolio, prudence and due diligence as outlined below shall be exercised with respect to the selection of financial institutions in which the City's funds are deposited or invested.

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- A. In selecting Depositories pursuant to the Code, Section 53600, et seq., the credit worthiness, financial stability, and financial history of the institution, as well as the cost and scope of services and interest rates offered shall be considered. No funds will be deposited in an institution unless that institution has been evaluated by a nationally recognized independent rating service as satisfactory or better.
 - B. Deposits of \$100,000 or less which are insured pursuant to federal law by the Federal Deposit Insurance Corporation (FDIC), or the National Credit Union Administration (NCUA) may be excluded from the independent rating service evaluation requirement above and from the collateralization requirements of Section 1.6.3 of this Policy, at the City Treasurer's discretion.
- 1.5.2 In selecting external investment managers and brokers, past performance, stability, financial strength, reputation, area of expertise, and willingness and ability to provide the highest investment return at the lowest cost to the City within the parameters of this Investment Policy and the Code shall be considered. External investment managers must be registered with the Securities and Exchange Commission (SEC) under the Investment Advisor Act of 1940.
- 1.5.3 Pursuant to Code, Section 53601.5, the City and its investment managers shall only purchase statutorily authorized investments either from the issuer, from a broker-dealer licensed by the state, as defined in Section 25004 of the Corporations Code, from a member of a federally regulated securities exchange, a national or state-chartered bank, a federal or state association (as defined by Section 5102 of the Financial Code), or from a brokerage firm designated as a primary government dealer by the Federal Reserve Bank.
- A. Internal investment managers will only purchase or sell securities from broker-dealers defined in section 1.5.3 of the City's Investment Policy and meet the minimum requirements of being registered and licensed by the National Association of Securities Dealers (NASD) and possess an active Series 7 license, an active Series 66 license (or Series 63), submission of a NASD form U4 (employment history) and a current NASD form U5 Disclosure Statement and have completed the City's broker/dealer questionnaire.
 - B. Internal investment managers will only use broker-dealers that have a minimum of three years experience working for a primary dealer or five years working for a non-primary dealer.
 - C. External investment managers may purchase or sell securities from non-Primary Dealers qualified under U.S. Securities and Exchange Commission Rule 15C3-1, the Uniform Net Capital Rule, and provided that

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the dealer is a certified member of the National Association of Securities Dealers. External investment managers shall submit to the City at least quarterly, a list of the non-Primary Dealers used during the period.

- D. External investment managers must certify in writing that they will purchase securities in compliance with this Investment Policy, City Procedures, and applicable State and Federal laws.

1.5.4 Depositories, and external investment managers, who do business with the City, shall sign a Certification of Understanding (see Appendix B). All broker-dealers who do business with the City's internal investment managers shall acknowledge receipt of the City's Investment Policy (see Appendix C).

1.6 Custody and Safekeeping of Securities and City Funds

1.6.1 For investments in Repurchase Agreements, securities and collateral shall be purchased and maintained for the benefit of the City in the Trust Department or safekeeping department of a bank as established by a written third party safekeeping agreement between the City and the bank.

1.6.2 All investment transactions shall be settled "delivery vs. payment", with the exception of deposits, mutual fund investments, and Local Agency Investment Fund or other Local Government Investment Pools. Delivery may be physical, via a nationally recognized securities depository such as the Depository Trust Company, or through the Federal Reserve Book Entry system.

1.6.3 Funds deposited by the City shall be secured by a Depository in compliance with the requirements of the Code, Section 53652. Such collateralization shall be designated and agreed to in writing.

1.6.4 Investment securities in bearer form such as Negotiable Certificates of Deposit and Bankers' Acceptances shall be held in a qualified safekeeping institution.

1.7 Reports and Communications

1.7.1 The City Treasurer is responsible for ensuring compliance with all applicable Local, State, and Federal laws governing the reporting of investments made with public funds. All investment portfolios will be monitored for compliance. Non-compliance issues will be included in the quarterly City Council report as stated in Section 1.7.3 of this Policy.

1.7.2 The City Treasurer shall annually submit a statement of investment policy to the City Council for approval. The existing approved policy will remain in effect until the City Council approves the recommended statement of investment policy.

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1.7.3 The City Treasurer shall render a quarterly cash, investment, and transaction report to the City Manager (referred to as the Chief Executive Officer by the Code, Section 53646, b), the City Auditor and the City Council within 30 days following the end of the quarter covered by the report. The report shall include a description of the City's funds, investments, or programs that are under the management of the contracted parties, including lending programs. The report shall include at a minimum:

- A. The type of investment, name of the issuer, date of maturity, par value and cost in each investment.
- B. Investments and moneys held by the City.
- C. List and describe any of the City's funds, investments, or programs that are under the management of contracted parties, including any lending programs.
- D. Current Market value as of the date of the report, and shall include the source of this same valuation.
- E. Statement of compliance of the investment portfolio to the Investment Policy, or manner in which the portfolio is not in compliance.
- F. Statement denoting the ability of the City to meet its pool's expenditure requirements for the next six months, or provide an explanation as to why sufficient money shall, or may not, be available.

1.7.4 Investment managers shall monitor investments and market conditions and report on a regular and timely basis to the City Treasurer.

1.8 Portfolio Guidelines

1.8.1 Portfolio Guidelines are the operating procedures used to implement the Investment Policy approved by the City Council. The City Treasurer may impose additional requirements or constraints within the parameters set by the Investment Policy.

1.9 Internal Control

1.9.1 The City Treasurer shall establish a system of internal controls designed to prevent losses of public funds arising from fraud, employee or third party error, misrepresentation of third parties, unanticipated changes in financial markets, or imprudent actions by City employees or agents.

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2.0 Purchasing Guidelines

2.0.1 Investment managers shall purchase and sell securities at the price and execution that is most beneficial to the City. The City's liquidity requirements shall be analyzed and an interest rate analysis shall be conducted to determine the optimal investment maturities prior to requesting bids or offers. Investments shall be purchased and sold through a competitive telephone bid/offer process. Bids/offers for securities of comparable maturity, credit and liquidity shall be received from at least three financial institutions, if possible.

2.0 Benchmarks

2.0.1 Investment performance shall be compared and evaluated against the following benchmarks:

- Short Maturity Portfolios: Three-month Treasury Bill
- Long Maturity Portfolios: Merrill Lynch AAA U.S. Treasury/Agency 1-3 yr Index

Summary of Authorized Investment Types & Restrictions*

• See California Government Code Section 53601 for further clarification with regard to securities permitted herein.

| # | Type of Investment | % of Portfolio Authorized* | Other Restrictions |
|----|--|----------------------------|--|
| 1. | Bonds issued by the City or agency of the City. | 30 % | Maximum maturity of five (5) years unless a longer maturity is approved by the City Council, either specifically or as part of an investment program, at least three (3) months prior to purchase. |
| 2. | United States Treasury notes, bonds, bills or certificates of indebtedness or those for which the full faith and credit of the United States are pledged for the payment of principal and interest. | 100 % | Same as above. |
| 3. | Registered state warrants or treasury notes or bonds of the State of California. | 30 % | Such obligations must be rated A1, SP-1 or equivalent or better short term; or Aa/AA or better long term, by a national rating agency. |
| 4. | Bonds, notes, warrants, or other evidences of indebtedness of any local agency within the State of California. | 30 % | Same as above. |
| 5. | Obligations issued by banks for cooperatives, federal land banks, federal intermediate credit banks, the Federal Home Loan Banks, the Tennessee Valley Authority, or in obligations, participations or other instruments of or issued by, a federal agency or a United States Government-sponsored enterprise. | 100 % | No more than 10% of the portfolio may be invested in any one Federal Agency issue or government-sponsored issue. |
| 6. | Bill of exchanges or time drafts drawn on and accepted by a commercial bank, | 40% | Purchases of bankers' acceptances may not exceed |

Summary of Authorized Investment Types & Restrictions*

• See California Government Code Section 53601 for further clarification with regard to securities permitted herein.

| # | Type of Investment | % of Portfolio Authorized* | Other Restrictions |
|----|---|----------------------------|--|
| | otherwise known as bankers' acceptances. | | 180 days maturity. No more than 30% of the portfolio may be invested in any one bank or corporate issuer. |
| 7. | Commercial paper of "prime" quality of the highest ranking or of the highest letter and numerical rating as provided for by Moody's Investors Service, Inc., or Standard & Poor's Corporation. Eligible paper is further limited to issuing corporations that are organized and operating within the United States and having total assets in excess of five hundred million dollars (\$500,000,000) and having an "A" or higher rating for the issuer's debentures, other than commercial paper, if any, as provided for by Moody's Investor's Service, Inc. or Standard & Poor's Corporation. | 25%. | Purchases of eligible commercial paper may not exceed 270 days maturity nor represent more than 10% of the outstanding paper of an issuing corporation. No more that 10% of the portfolio may be invested in any one Corporate or bank issuer. |
| 8. | Negotiable certificates of deposits issued by a nationally or state-chartered bank or a state or federal savings and loan association or by a state-licensed branch of a foreign bank. | 30% | Maximum maturity of five (5) years unless a longer maturity is approved by the City Council, either specifically or as part of an investment program, at least three (3) months prior to purchase. No more than 10% of the portfolio may be invested in any one bank name. |
| 9. | Time Certificates of Deposit. | 100% | The city may invest in non-negotiable time deposits collateralized in accordance with the California Government Code, in those banks and savings and loan associations which meet the requirements for investment in negotiable certificates of deposit. |

Summary of Authorized Investment Types & Restrictions*

• See California Government Code Section 53601 for further clarification with regard to securities permitted herein.

| # | Type of Investment | % of Portfolio Authorized* | Other Restrictions |
|-----|---|---|--|
| 10. | <p>Investments in repurchase agreements. The repurchase agreement must be covered by a master written agreement in the form of the current Public Securities Association agreement.</p> <p>Repurchase agreements shall be collateralized at all times. Collateral shall be limited to obligations of the United States and Federal Agencies with a market value of 102 percent or greater of the funds borrowed against those securities at all times. Collateral shall be delivered to a third party custodian in all cases. Collateral for term repurchase agreements shall be valued daily by the City's investment manager (for internal funds) or external investment manager. The City shall obtain a first lien and security interest in all collateral.</p> | 100% | <p>See California Government Code Section 53601, (l)</p> <p>Term of repurchase agreement cannot exceed 90 days.</p> <p>Repurchase agreements shall be executed through Primary Broker-Dealers.</p> |
| 11. | Reverse Repurchase Agreements. | <p>20%</p> <p>Security to be sold in the Reverse Repurchase Agreement must be owned and fully paid for by the agency for a minimum of 30 days prior to the sale.</p> <p>Term of agreement cannot exceed</p> | <p>The City may enter into a reverse repurchase agreement under the following situations:</p> <ol style="list-style-type: none"> 1. Immediate payment of an unanticipated cash outflow. In such a case, the term of the reverse repurchase agreement shall not exceed 92 days, and shall be matched to a known cash inflow of sufficient size to repay the principal and interest of the reverse repurchase agreement. 2. To enhance the return on the City's portfolio. Reverse repurchase agreements |

Summary of Authorized Investment Types & Restrictions*

• See California Government Code Section 53601 for further clarification with regard to securities permitted herein.

| # | Type of Investment | % of Portfolio Authorized* | Other Restrictions |
|-----|--|--|---|
| | | 92 days. | used for this purpose shall not exceed 92 days to maturity, and must be matched as to maturity and dollars invested with its corresponding reinvestment. No more than 20% of the market value of the portfolio may be invested in reverse repurchase agreements. |
| 12. | Securities Lending Program. | 20% Restriction is limited by Reverse Repurchase Agreement Limits | City may enter into securities lending agreements for the purpose of increasing income to the portfolio with banks registered to do business in the United States and rated A or better by Moody's or Standard and Poor's rating services. |
| 13. | Medium-term notes issued by corporations organized and operating within the United States, or by any state within the United States. | 30% | Maximum five (5) year maturity. Notes must be rated "A" or its equivalent or better by a nationally recognized rating service. No more than 10% of the portfolio may be invested in one bank or corporate name. If rated by more than one rating service, both ratings must meet the minimum credit standards. |
| 14. | Shares of beneficial interest issued by diversified management companies investing in the securities and obligations as authorized by the State of California Code 53601 and 53630 et seq. | 20% maximum in any one or more money market fund, | Companies must have either 1) the highest ranking or the highest letter and numerical rating provided by not less than two of the nationally recognized |

Summary of Authorized Investment Types & Restrictions*

• See California Government Code Section 53601 for further clarification with regard to securities permitted herein.

| # | Type of Investment | % of Portfolio Authorized* | Other Restrictions |
|-----|---|---|--|
| | | with no more than 10% of the total in any one bond mutual fund. | rating services, or (2) retained an investment advisor registered or exempt with the Securities and Exchange Commission, with no less than five years experience investing in A) Bond Funds: the securities and obligations authorized by State Code 53601 a-j inclusive and l or m; or B) Money Market Mutual Funds: money market mutual funds; both with assets under management in excess of five hundred million dollars (\$500,000,000). The purchase price may not include any commissions charged by these companies. |
| 15. | State of California Local Agency Investment fund (LAIF), or other Local Government Investment Pools (LGIP) established by public California entities. | See note, right. | Maximum investment in individual Local Government Investment Pools of \$40 million per account. Limit does not include funds required by law, ordinance, or statute to be invested in pool. Each pool must be evaluated and approved by the City Treasurer and Investment committee, as to credit worthiness, security, and conformity to state and local laws. |
| 16. | Asset-backed securities. | 20% combined with any mortgage-backed securities. | Limited to senior class securities with legal stated final maturities of no more than 5 years. Further limited to securities rated in a rating category of "AAA", and issued |

Summary of Authorized Investment Types & Restrictions*

• See California Government Code Section 53601 for further clarification with regard to securities permitted herein.

| # | Type of Investment | % of Portfolio Authorized* | Other Restrictions |
|-----|--|---|--|
| | | | by an issuer having an "A" or higher rating for the issuer's debt as provided for by a nationally recognized rating service. Further limited to fixed rate, publicly offered, generic credit card and automobile receivables only. Deal size must be at least \$250 million, and tranche size must be at least \$25 million. |
| 17. | Mortgage-backed securities. | 20% combined with any asset-backed securities | <p>Pass-Through securities: Limited to Government Agency or Government Sponsored issuers, fixed rate, final stated legal maturity of 5 years.</p> <p>CMOS: Limited to Government Agency or Government Sponsored Issuers "AAA" rated Planned Amortization Classes (PAC) only. The following are prohibited: ARMS, floaters, interest or principal (IOs, POs), Targeted Amortization Classes, companion, subordinated, collateral classes, or zero accrual structures.</p> |
| 18. | Financial Futures and Financial Options. | N/A | Not allowed under this policy. |

APPENDIX B

CITY OF LONG BEACH

CERTIFICATION OF UNDERSTANDING

The City of Long Beach Investment Policy as approved by the City Council requires that all Financial Institutions and Investment Managers doing business with the City sign a Certification of Understanding acknowledging that:

1. You have read and are familiar with the City's Investment Policy and Guidelines as well as applicable Federal and State laws.
2. You meet the requirements as outlined in the City's Investment Policy.
3. You agree to make every reasonable effort to protect the assets of the City from loss.
4. You agree to notify the City in writing of any potential conflicts of interest.
5. You agree to notify the City in writing of any changes in personnel with decision-making authority over the City's funds within 24 hours of such event.

Failure to submit a Certification of Understanding shall result in the withdrawal by the City of all funds held by the financial institution or investment manager and the immediate revocation of any rights to act as an agent of the City for the purchase of securities or investment of funds on behalf of the City.

The City Council is committed to the goals of the Community Reinvestment Act (CRA). As part of the certification process for depository institutions, it is requested that you remit evidence of your most recent CRA rating.

SIGNED: _____ DATE: _____
Print Name and Title: _____

After reading and signing this Certification of Understanding please return with any supporting documentation to:

City of Long Beach
City Treasurer's Office
333 W. Ocean Blvd.
Long Beach, CA 90802

City of Long Beach use only:
Approved: _____ Disapproved: _____ Date: _____
Signature: _____

Date Notification sent: _____ Sent by: _____

APPENDIX C

CITY OF LONG BEACH

BROKER-DEALER RECEIPT OF INVESTMENT POLICY

We are in receipt of the City of Long Beach's Investment Policy.

We have read the policy and understand the provisions and guidelines of the policy. All salespersons covering the City's account will be made aware of this policy and will be directed to give consideration to its provisions and constraints in selecting investment opportunities to present to the City.

Signed:

Name

Name

Title

Title

Firm Name

Date

After reading and signing this Receipt of Investment Policy, please return with supporting documentation to:

City of Long Beach
City Treasurer's Office
Attention: Investment Manager
333 West Ocean Boulevard
Long Beach, CA 90802

City of Long Beach use only:

Approved: _____ Disapproved: _____ Date: _____

Signature: _____

Date notification sent: _____ Sent by: _____

11. Which of the following instruments are offered regularly by your local desk?

- T-Bills Treasury Notes/Bonds Discount Notes NCD's
- Agencies (specify) _____
- BA's (Domestic) BA's (Foreign) Commercial Paper
- Medium-Term Notes Repurchase Agreements

12. Does your Firm specialize in any of the instruments listed above?

13. Please identify your comparable government agency clients in the City of Long Beach's geographical area.

| <u>Entity</u> | <u>Contact Person</u> | <u>Telephone No.</u> | <u>Client Since</u> |
|---------------|-----------------------|----------------------|---------------------|
| | | | |
| | | | |
| | | | |

14. What reports, confirmations, and other documentation would the City receive?

15. Please include samples of research reports or market information that your firm regularly provides to government agency clients.

16. What precautions are taken by your Firm to protect the interests of the public when dealing with government agencies as investors? _____

17. Have you or your Firm been censored, sanctioned or disciplined by a Regulatory State or Federal Agency for improper or fraudulent activities, related to the sale of securities within the past five years? Yes No

18. If yes, please explain _____

19. Attach certified documentation of your capital adequacy and financial solvency. In addition, an audited financial statement must be provided currently, and within 120 days of your fiscal year-end.

20. Please indicate the current licenses of the City's representatives:

Agent: _____ License or registration: _____

21. Is your firm a member of the NASD? Does it subscribe to the rules of fair practice?

APPENDIX E
CITY OF LONG BEACH
INVESTMENT POLICY GLOSSARY

ADJUSTABLE RATE MORTGAGE (ARM): A mortgage that features predetermined adjustments of the loan interest rate at regular intervals based on an established index. The interest rate is adjusted at each interval to a rate equivalent to the index value plus a predetermined spread, or margin, over the index, usually subject to per-interval and to life-of-loan interest rate and/or payment rate caps.

ASKED: The price at which securities are offered from a seller.

ASSET BACKED SECURITIES: Securities issued by corporations organized and operating in the United States that are collateralized with some class of assets; credit cards, mortgages, etc. Examples of some issuers are Citibank, Chase Manhattan Bank, American Express.

BANKERS' ACCEPTANCE (BA): Time drafts that a bank "accepts" as its financial responsibility as part of a trade finance process. These short-term notes are sold at a discount, and are obligations of the drawer (or issuer- the bank's trade finance client) as well as the bank. Once accepted, the bank is irrevocably obligated to pay the BA upon maturity if the drawer does not.

BID: The price offered by a buyer of securities.

BOND: A debt security. It is usually issued by government agencies, municipalities and corporations. The purchaser actually lends the entity money and is considered the creditor. The entity is the seller and is considered the debtor or issuer. The issuer agrees to repay the principal amount of the loan at a specified time (maturity). Interest bearing bonds pay interest periodically at a predetermined time. A discounted bond such as a Zero Coupon bond pays no interest. It is sold at a discount from face value (par value) and the investor receives a rate of return through price appreciation and the bond is redeemed at face value.

BOOK VALUE: The original cost of the investment, plus accrued interest and amortization of any premium or discount.

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

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination CDs are typically negotiable (marketable or transferable).

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

COLLATERALIZED MORTGAGED OBLIGATION SECURITIES (CMOS): are mortgaged securities consisting of "pools" of real estate properties. These securities are broken into individual pools or sectors by maturity date called **TRANCHES**.

COMMERCIAL PAPER (CP): Unsecured promissory notes issued by companies and government entities at a discount. Commercial paper is negotiable, although it is typically held to maturity. The maximum maturity is 270 days, with most CP issued for terms of less than 30 days.

CUSTODY or 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.

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

DELIVERY VERSUS PAYMENT: Delivery of securities with a simultaneous exchange of money for the securities.

DRAFT or TIME DRAFT: financial instrument used in international trade, such as a Bankers Acceptance.

FEDERAL AGENCIES AND U.S. GOVERNMENT SPONSORED ENTERPRISES (AGENCIES): U.S. Government related organizations, the largest of which are government financial intermediaries assisting specific credit markets (housing, agriculture). They include:

- Federal Home Loan Banks (FHLB)
- Federal Home Loan Mortgage Corporation (FHLMC or "Freddie Mac")
- Federal National Mortgage Association (FNMA or "Fannie Mae")
- Federal Farm Credit Banks (FFCB)
- Student Loan Marketing Association (SLMA or "Sallie Mae")
- Tennessee Valley Authority (TVA)

FINANCIAL FUTURES AND FINANCIAL OPTIONS: A financial future is a contract to buy or sell a specific standard financial instrument during a specific future month at a price determined in a central, regulated marketplace, such as the Chicago Board of Trade (CBOT), etc. Futures contracts are available for a wide variety of financial instruments. Financial Options on financial futures contracts provide a purchaser the right (but not the obligation) to purchase or sell a given futures contract within a specified time period.

INTEREST ONLY (I.O.) SECURITIES: Securities that consist of the interest coupon of a bond. See Principal Only (P.O.).

LOCAL AGENCY INVESTMENT FUND (LAIF): The State of California created the Local Agency Investment Fund as an alternative investment for local agencies. The current restrictions are a maximum of \$40 million per account and ten transactions

per month. The funds are protected under Section 16429.3 of the State of California Government Code and cannot be attached or seized by the State.

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

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase/reverse repurchase agreements that establish each party's rights in the transactions. A master agreement will 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.

MEDIUM TERM NOTES (MTN): Interest bearing, continuously offered debt, issued in the nine-month to ten-year maturity range. Deposit notes, like Certificates of Deposit, actually represent an interest bearing deposit at a bank or other depository institution.

MORTGAGED-BACKED SECURITIES: A bond or security that is secured by a lien on property, equipment or other real assets.

NEGOTIABLE CERTIFICATE OF DEPOSIT: A large denomination (generally \$1 million or more) Certificates of Deposit that can be sold in the secondary market but cannot be cashed in before maturity.

OFFER: The price asked by a seller of securities.

PAR VALUE: The face value or principal amount payable at maturity.

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.

PRINCIPAL ONLY (P.O.) SECURITIES: A Security that has the interest coupons stripped from the body of the bond. The bond is a non-interest investment and is treated as a discounted/zero security.

RANGE NOTES: A security whose interest rate coupon is calculated on a formula that only pays interest if the value of the coupon falls within a prescribed "range" of interest rates.

REPURCHASE AGREEMENT (RP OR REPO): A purchase of securities under a simultaneous agreement to sell these securities back at a fixed price on some future date. This is in essence a collateralized investment, whereby the security "buyer" in effect lends the "seller" money for the period of the agreement, and the difference between the purchase price and sale price determining the earnings. Dealers use RP extensively to finance their positions.

REVERSE REPURCHASE AGREEMENTS: The opposite or "reverse" of a repurchase agreement. The City puts up securities as collateral to borrow funds. The collateral is "marked to market" by the lending institution daily and if the market value falls below the amount of funds borrowed, the City is required to put up additional funds; either cash and/or securities with a market value equal to or greater than the loan amount. The State of California Government Code limits the maturity term of this investment to 92 days. An additional restriction is a maximum of 20% of the City's funds can be invested in Reverse Repurchase Agreements.

SECURITIES AND EXCHANGE COMMISSION (SEC): An agency by Congress to protect investors in securities transactions by administering securities legislation.

SECURITIES LENDING: An activity that places investment securities with a contracted counterparty (dealer) who will lend the securities temporarily to another party against a commission. The borrower party is legally obligated to return the same type and amount of securities at the end of a specified period. This action is similar to a reverse repurchase transaction.

TRANCHE: see CMOs

TREASURY BILLS (T-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 NOTES AND BONDS: Long-term U.S. Treasury securities having initial maturities of 2 to 30 years.

VARIABLE RATE SECURITIES: A security whose coupon interest rate is not fixed but is adjusted periodically according to a prescribed formula or index.

WARRANTS: A short-term obligation of a governmental body (as a municipality or state) issued in anticipation of revenues.

YIELD: The rate of annual income return on an investment expressed as a percentage.

YIELD TO MATURITY (YTM): is the rate of return earned on an investment considering all cash flows and timing factors: interest earnings, discounts, and premiums above par.