CITY OF FULLERTON

STATEMENT OF INVESTMENT POLICY

November 2024

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STATEMENT OF INVESTMENT POLICY
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STATEMENT OF INVESTMENT POLICY

SECTION 1. PURPOSE

This Investment Policy is intended to provide guidelines for the prudent investment of the City of Fullerton and the Fullerton Successor Agency's temporarily idle cash. Throughout this policy the term City or City of Fullerton shall refer to both the City of Fullerton and the Fullerton Successor Agency, unless otherwise indicated. Also outlined are the policies for maximizing the effectiveness of the City's cash management system. Bond proceeds shall be invested in accordance with the requirements and restrictions outlined in the bond documents. Bond proceeds and other funds or assets that are not part of the general pool shall not be subject to this Investment Policy. This Policy conforms to all existing requirements of State law governing the investment of public funds.

SECTION 2. POLICY

The investment practices and policies of the City of Fullerton are based upon state law and prudent money management. The primary goals of these practices are:

A. To assure compliance with all federal, state, and local laws governing the investment of public funds under the control of the City Treasurer.

B. To protect the principal monies entrusted to this office.

C. To achieve a reasonable rate of return within the parameters of prudent risk management while minimizing the potential for capital losses arising from market changes or issuer default.

SECTION 3. SCOPE

This policy shall apply to all funds that are under the City Treasurer's control including but not limited to the governmental, fiduciary, enterprise, and internal service, and trust and successor agency funds. These funds are accounted for in the City's Annual Comprehensive Financial Report. The City's 115 Pension and OPEB Trust funds and Deferred Compensation Plan shall be excluded from the scope of this policy.

Except for cash in certain restricted and special funds, the City will consolidate cash and reserve balances from all funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping, and administration. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

SECTION 4. OBJECTIVE

The cash management system of the City is designed to monitor and forecast expenditures and revenues, thus enabling the investment of funds to the fullest extent possible. It shall be the policy of the City to obtain a market rate of interest without assuming undue risk to principal, in accordance with State law (Government Code Section 53600.3 and 53600.5).

1). The primary objectives of the City Treasurer, in priority order, shall be:

A. **Safety** - To avoid potential loss of principal, interest, or combination thereof, safety shall be the highest priority for City investments. It shall be the responsibility of the City Treasurer to see that this Investment Policy is followed to ensure the safety of the City's portfolio. The City Treasurer shall certify in a quarterly report that all funds in the City's portfolio are being invested in accordance with this Investment Policy.

B. **Liquidity** - Shall be the second priority for City investments to assure provision of cash for City operations as needed, with a negligible chance of any loss. Liquidity remains an essential investment consideration in view of the possible need for unexpected or emergency City expenditures.

C. **Yield** - Only after safety and liquidity needs for investments are met will the yield be considered. Sometimes yield is described as the rate of return. The objective of Fullerton's portfolio shall be to attain a market-average rate of return through economic cycles. The market-average rate of return is defined as the average return on a six-month U.S. Treasury Bill.

D. **Diversification** – The City's investment portfolio will be diversified to avoid concentrating investments in specific security types or in individual financial institutions.

SECTION 5. PRUDENCE

Investments made by the City Treasurer in the name of the City of Fullerton shall be made with judgment and care 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. The standard of prudence to be used by the City Treasurer shall be the prudent investor standard, as defined in Government Code Section 53600.3 and shall be applied in managing the overall investment portfolio. The City Treasurer, acting in accordance with this Investment Policy and exercising due diligence, shall have a duty to report in a timely manner to the City Manager and City Council in the event of adverse developments affecting the City's investments.

SECTION 6. INVESTMENT PROCEDURES

The City Treasurer will prepare written investment procedures consistent with this policy. The procedures will include: safekeeping, wire transfer instructions and agreements, permitted and prohibited instrument features, banking service contracts, authorized dealers/brokers, collateral/ depository agreements, internal controls and delegation of authority to persons responsible for investment transactions.

SECTION 7. ETHICS AND CONFLICTS OF INTEREST

In addition to state and local statutes relating to conflicts of interest, all persons involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program or which could impair their ability to make impartial investment decisions. Employees and investment officers are required to file annual disclosure statements as required for "public officials who manage public investments" (as defined and required by the Political Reform Act and related regulations, being Government Code Sections 81000 and the Fair Political Practices Commission [FPPC]).

SECTION 8. AUTHORIZED INVESTMENTS

A summary and description of authorized investment instruments is listed below:

Security Type	Minimum Rating Requirement	Maturity Limits	Maximum Allocation Limit	Maximum Issuer Limit
A. United States Treasury Securities	None	5 years	100%	100%
B. U.S. Government Agencies	None	5 Years	100%	40%
B. U.S. Federal Instrumentalities	None	5 Years	100%	40%
C. Bankers Acceptances	Prime	180 Days	40%	5%
D. Commercial Paper	Prime	270 Days	25%*	5%
E. Asset-Backed Commercial Paper	Prime	270 Days	25%*	5%
F. Negotiable Certificates of Deposit	"A"	5 Years	30%	5%
F. Collateralized Certificates of Deposit	None	5 Years	25%	10%
G. Repurchase Agreements	None	1 Year	25%	20%
H. LAIF	None	None	Lesser of 50M or 60%	N/A
I. Orange County Investment Pool	None	None	0%	0%
J. Medium Term Notes	"A"	5 Years	30%	5%
K. Asset Backed Securities	"AA"	5 Years	20%	5%
L. Municipal Bonds	"A"	5 Years	20%	5%
M Supranational Debt	"AA"	5 Years	30%	5%
N. Money Market Funds	AAAm	N/A	20%	10%
O. Joint Power Authority Pools	AAA	N/A	40%	40%

* The 25% limitation applies in the aggregate to both commercial paper and asset-backed commercial paper such that no more than 25% of the City's total portfolio may be invested in any combination of securities authorized by Section 8.D and 8.E of this Policy.

The City's investments are governed by the California Government Code. Investments may be made in the following types of securities and permitted percentages within an investment type:

A. **United States Treasury Securities**: Highly liquid and guaranteed as to principal and interest by the United States government with a final maturity not exceeding five years from the date of trade settlement. There is no percentage limit for this category.

B. **Federal Agency or United States Government-Sponsored Enterprise (GSE) Obligations:** Obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or US government-sponsored enterprises with a final maturity not exceeding five years from the date of trade settlement. There is no limit to the amount of the City's portfolio that may be invested in Federal Agency or GSE securities, except that the aggregate investment in federal agency mortgage-backed securities shall not exceed 20% of the City's total portfolio. Furthermore, the aggregate investment in any one federal agency or GSE issuer shall not exceed 40% of the City's total portfolio.

C. **Bankers Acceptances:** Negotiable time drafts which are drawn on foreign or domestic banks to finance the export, import, shipment, and storage of goods. The drafts are sold at a discount and redeemed by the accepting bank at maturity for full face value. Maturities range from 1 to 180 days. Bankers Acceptances can only be purchased if the issuing bank is rated P-1 (Moody's) or A-1 (Standard & Poor's). Purchases may not exceed forty percent (40%) of the City of Fullerton and Fullerton Successor Agency's combined portfolio, and no more than five percent 5%) of the combined portfolio may be invested in the Bankers Acceptances of any one commercial bank.

D. **Commercial Paper:** Issued by corporations and financial institutions. Commercial paper must be rated P-1 by Moody's Investors Service or A-1 by Standard and Poor's. Purchases of this category shall not exceed 270 days to maturity or twenty-five percent (25%) of the City of Fullerton and Fullerton Successor Agency's combined portfolio and no more than five percent (5%) of the combined portfolio may be invested in the outstanding commercial paper of any single issuer. The diversification requirements of this section shall be considered in combination with amounts held in Section 8.E (Asset-Backed Commercial Paper) of this Policy.

E. **Asset-Backed Commercial Paper:** Issued by entities organized within the United States as a special purpose corporation, trust, or limited liability company and of "prime" credit quality. The entity that issues the asset-backed commercial paper must meet all of the following conditions: (a) is rated "A-1" (or the equivalent) or higher by at least one nationally recognized statistical rating organization; and (b) has program wide credit enhancements including, but not limited to, overcollateralization, letters of credit, or a surety bond. Purchases of this category shall not exceed 270 days to maturity or twenty-five percent (25%) of the City of Fullerton and Fullerton Successor Agency's combined portfolio and no more than five percent (5%) of the combined portfolio may be invested in the outstanding asset-backed commercial paper of any single issuer. The diversification requirements of this section shall be considered in combination with amounts held in Section 8.D (Commercial Paper) of this Policy.

F. **Certificates of Deposit:**

1. Negotiable certificates of deposit (NCD's) are money market instruments issued by a nationally or state-chartered bank, a savings association or a federal association (as defined by Section 5102 of the Financial Code), a state or federal credit union, or by a federally licensed or state-licensed branch of a foreign bank. The maturity of NCD's shall not exceed five years, and purchases of NCD's shall not exceed thirty percent (30%) of the portfolio. Securities in this category exceeding federal deposit insurance limits shall be issued by institutions with a long-term debt rating of at least "A" by a nationally recognized rating organization, as designated by the Security and Exchange Commission and shall be evaluated in terms of the credit worthiness of the issuer.

2. Certificates of Deposit (CD's) are unsecured direct obligations of a U.S. bank or a savings and loan association. CD's are secured by collateral such as U.S. government securities or mortgages and allow selection of the exact amount and date of maturity, as well as the exact depository. Federal Deposit Insurance Corporation (FDIC) coverage is provided for government deposits, but limited to the first $250,000 on deposit on behalf of a given entity at a single financial institution. However, California law requires that deposits of public funds shall be collateralized if not insured. Therefore, all City deposits in excess of FDIC insurance shall be collateralized. Purchases of this category shall not exceed five years and shall not exceed twenty five percent (25%) of the portfolio nor shall the City deposit more than 10% of its total portfolio in the collateralized certificates of deposit in any one bank.

3. Notwithstanding Section 53601 or any other provision of California code, The City has the authority under law to invest funds, at its discretion, and may invest a

portion of its surplus funds in certificates of deposit at a commercial bank, savings bank, savings and loan association, or credit union that uses a private sector entity that assists in the placement of certificates of deposit, provided that the purchases of certificates of deposit pursuant to this section, Section 53635.8, and subdivision (i) of Section 53601 do not, in total, exceed 30 percent of the agency's funds that may be invested for this purpose.

G. **Repurchase Agreements (Repo's):** A Repurchase Agreement consists of two simultaneous transactions. One is the purchase of securities by an investor from a bank, the other is the commitment by the bank to repurchase the securities at the same price at a mutually agreed upon future date. The investor receives an agreed upon rate of interest, generally at money market rates. Repo's shall be collateralized and written against U.S. Treasury, federal agency or government sponsored enterprises permitted by this statement of investment policy. The purchased securities (the "collateral") shall have a minimum market value of 102% of the dollar value of the funds invested. Purchases in this category shall not have a final termination date exceeding (360) from the date of trade settlement. No more than twenty five percent (25%) of the City's portfolio shall be invested in repurchase agreements.

H. **State of California Local Agency Investment Fund (LAIF):** Provides high liquidity allowing deposits to be credited to the City's checking account within twenty-four (24) hours. State Pool funds are operated directly by the Office of the State Treasurer, who commingles state and local funds. No more than sixty percent (60%), or $75 million, whichever is less, of each of the City's and Successor Agency's monies may be invested with the State of California Local Agency Investment Fund.

I. **Orange County Investment Pool (OCIP):** The OCIP may be considered as a future investment option once the Pool is restructured and the Orange County Treasurer offers cities the opportunity to participate again. However, prior to such investment, that option shall be re-evaluated by the Treasurer and Investment Advisory Committee (see Section 15), and returned to Council for approval.

J. **Medium-Term Corporate Notes:** Issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States. Such securities must be rated in a rating category of "A" or higher by a nationally recognized rating service at the time of purchase. In the event the corporation falls below an "A" credit rating, an evaluation shall be conducted to determine its credit risk. The decision to sell the investment or hold till maturity will be assessed depending upon its credit risk. The maturity of medium-term corporate notes shall not exceed five years, and purchases shall not exceed thirty percent (30%) of the portfolio. No more than five percent (5%) of the combined portfolio may be invested in the outstanding debt of any single corporate issuer.

K. **Asset Backed Securities:** A mortgage passthrough security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable passthrough certificate, or consumer receivable-backed bond. Securities not issued or guaranteed by an agency or issuer identified in subdivision 53601(b) or 53601(f), the following limitations apply: eligible for investment under this subdivision shall be rated in a rating category of "AA" or its equivalent or better by an NRSRO, these securities shall have a maximum remaining maturity of five years or less, and the purchase of securities authorized by this subdivision shall not exceed 20 percent of the agency's surplus moneys that may be invested pursuant to this section. No more than five percent (5%) of the combined portfolio may be invested in any single asset backed issuer.

L. **Municipal Bonds**: issued by the State of California and any local agency within the State, including bonds payable solely out of revenues from a revenue producing property owned, controlled or operated by a State or by a department, board, agency or authority of any of the other 49 United States, in addition to California. Such securities must be rated in a rating category of "A" or higher by a nationally recognized rating service at the time of purchase. In the event the municipality falls below an "A" credit rating, an evaluation shall be conducted to determine its credit risk. The decision to sell the investment or hold till maturity will be assessed depending upon its credit risk. The maturity of municipal bonds shall not exceed five years, and purchases shall not exceed twenty percent (20%) of the portfolio. No more than five percent (5%) of the combined portfolio may be invested in the outstanding commercial paper of any single issuer.

M. **Supranational Debt**: the debt of an international or multi-lateral financial agency used to finance economic and infrastructure development, environmental protection, poverty reduction and renewable energy around the world. The City may invest in U.S. 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. Obligations eligible for investment under this subdivision shall be rated "AA" or its equivalent or better by a NRSRO and may not exceed thirty (30%) of the City's investment portfolio. No more than five percent (5%) of the combined portfolio may be invested in the outstanding debt of any single supranational issuer.

N. **Money Market Funds.** Shares of beneficial interest issued by diversified management companies that are money market funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940. To be eligible for investment pursuant to this subdivision these companies shall either:

(1) attain the highest ranking letter or numerical rating provided by not less than two of the three largest NRSRO's; or

(2) have an investment advisor registered or exempt from registration with the SEC with not less than five years of experience managing money market mutual funds and with assets under management in excess of $1 billion.

Furthermore, no more than 10% of the City's total portfolio may be invested in any one money market fund.

O**.** **Joint Power Authority Pools.** Shares of beneficial interest issued by a joint powers authority organized pursuant to Section 6509.7 that invests in the securities and obligations authorized in subdivisions (a) to (q), inclusive of California Code 53601. Each share shall represent an equal proportional interest in the underlying pool of securities owned by the joint powers authority. To be eligible under this section, the joint powers authority issuing the shares shall have retained an investment adviser that meets all of the following criteria:

(1) The adviser is registered or exempt from registration with the Securities and Exchange Commission.

(2) The adviser has not less than five years of experience investing in the securities and obligations authorized in subdivisions (a) to (q), inclusive of California Code 53601.

(3) (3) The adviser has assets under management in excess of five hundred million dollars ($500,000,000)

The purchase price of shares shall not exceed 40% of the City's total portfolio and shall not include any commission that the companies may charge.

SECTION 9. PROHIBITED INVESTMENTS

It shall be the policy of the City to not invest any funds in inverse floaters, range notes, or mortgage-derived interest only strips, or any security that could result in zero interest accrual if held to maturity, and other similar derivative products. No investment prohibited by California Government Section 53601.6 shall be permitted herein.

Notwithstanding the prohibition noted above, the City may invest in securities issued by, or backed by, the United States government that could result in zero- or negative-interest accrual if held to maturity, in the event of, and for the duration of, a period of negative market interest rates. A local agency may hold these instruments until their maturity dates.

It shall be the policy of the City of Fullerton to not invest directly in Reverse Repurchase Agreements. Further, the City shall not be permitted to invest in any pool which has more than ten percent (10%) of its total portfolio in Reverse Repurchase Agreements.

In the event of a ratings downgrade of a security in the City's portfolio by any of the nationally recognized statistical rating organizations (NRSRO) to a rating category below the minimum required for purchase, the City Treasurer will document such downgrade in writing. The City Treasurer will also communicate to the Director of Administrative Services a recommended course of action for said security.

However, callable securities, which otherwise meet the quality, maturity, and percent limitations assigned to their respective security category, are considered to be an acceptable investment.

SECTION 10. SAFEKEEPING AND CUSTODY

All security transactions shall be conducted on a delivery-versus-payment (DVP) basis. Securities shall be held in third-party safekeeping of the City's bank or other designated third-party trust, in the City's name and evidenced by purchase confirmation and safekeeping receipts.

SECTION 11. DIVERSIFICATION

The portfolio shall consist of a mix of securities purchased through various issuers, with varying maturities. The primary purpose for diversifying a portfolio is to reduce risk in terms of maturity, instrument types and issuer, while attaining an average market rate of return.

SECTION 12. AUTHORIZED FINANCIAL BROKERS AND INSTITUTIONS

The City Treasurer shall maintain a listing of financial institutions and broker/dealers authorized to provide investment and depository services and who maintain an office in the State of California. All financial institutions and brokers/dealers who desire to become bidders for investment transactions must supply the City with the following: audited financial statements, proof of National Association of Security Dealers' certification, completed authorization to trade agreement, proof of California registration, and shall acknowledge by written receipt of having read this Investment Policy. The City shall annually send a copy of the current investment policy to all financial institutions and broker/dealers approved to do business with the City.

Should the City contract with a third-party investment management firm to manage all or a portion of the City's investment portfolio, the investment management firm is herein authorized to utilize its own list of approved broker dealers and shall provide such list to the City annually or upon the City's request.

SECTION 13. DEPOSITORY SERVICES

Public deposits shall only be made in qualified public depositories as established by California law. 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.

Under the provisions of the California Government Code, banks and savings and loan associations must secure public funds deposits with eligible securities having a market value of 110% of the total amount of the deposits. State law also allows as an eligible security, first trust deeds having a value of one hundred fifty percent (150%) of the total amount of the deposits. A third class of collateral is letters of credit drawn on the Federal Home Loan Bank (FHLB).

Deposits of $250,000 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.

The City Treasurer may waive, at his/her discretion, security for that portion of a deposit which is insured pursuant to federal law. Currently, the first two hundred, fifty thousand dollars ($250,000) of a deposit is federally insured. It is to the City's advantage to waive this collateral requirement for the first $250,000 to achieve a higher interest rate.

SECTION 14. INVESTMENT MATURITY

State law (Government Code Section 53601) provides that city treasurers may not invest funds in securities which have a term remaining to maturity in excess of five years from the date of investment, unless the City Council "...grants express authority to make that investment either specifically or as a part of an investment program approved by the City Council no less than three months prior to the investment."

It shall be the duty of the City Treasurer, to the extent possible; to match the investments with anticipated cash flow requirements. The prescribed method of the City of Fullerton shall be referred to as "layering" the investments. Monies not needed to cover immediate operating costs may be invested up to a five-year maturity. The duration of the long-term portfolio(s) shall be managed in a range of +/- 25% of the benchmarks set forth in Section 16 (b) and (c), below. Portfolio duration may deviate from these ranges at the City's discretion based upon changes in the City's circumstances.

SECTION 15. PORTFOLIO ADJUSTMENTS

The diversification requirements set forth in Section 8 relating to the maximum allowable percentage for a particular issuer or investment type shall apply at the time of purchase. Due to fluctuations in the aggregate invested balance, these maximum percentages may be exceeded from time to time and shall not require liquidation to realign the portfolio. However, consideration should be given to this matter when future purchases are made and the Treasurer shall consider rebalancing the portfolio after evaluating the expected length of time that it will be imbalanced.

The credit rating requirements set forth in Section 8 shall apply at the time of purchase. Should the credit rating of a security owned by the City be downgraded to a level below that required by this Investment Policy, the City will review the credit situation and determine if such securities should be sold or retained in the portfolio based upon its remaining term to maturity, the credit outlook for the issuer, and other relevant facts and circumstances. If the decision is made to retain a downgraded security, it will be closely monitored by the City and reported on quarterly to the Investment Committee.

Should any investment fall out of compliance with any other guidelines of this policy after its purchase, the City will review the situation and determine if such securities should be sold or retained in the portfolio based upon its remaining term to maturity, the credit outlook for the issuer, and other relevant facts and circumstances. If the decision is made to retain such a security, it will be closely monitored by the City and reported on quarterly to the Investment Committee.

SECTION 16. PERFORMANCE STANDARD

In order to assist in the evaluation of the Portfolio's performance, the City will use performance benchmarks for the short-term and long-term portfolios. The use of benchmarks will allow the City to measure its returns against other investors in the same markets. A benchmark should not be chosen which would induce the individual making the investment to take on undue risk in order to outperform the benchmark.

(a) The 3 month Treasury bill or the average of the monthly LAIF rate will be used as a benchmark for comparison with the Portfolio's net book value rate of return for current operating funds (short-term portfolio). The duration of the index should be similar to that of the short-term portfolio for performance comparison.

(b) Investment performance of funds designated as Core Funds and other non-operating funds that have a longer-term investment horizon (long-term portfolio) will be compared to the BofA Merrill Lynch 1-3 Year Government/Credit Index. The appropriate index will have a duration and asset mix that approximates that of the Investment Portfolio and will be utilized as a benchmark to be compared to the Investment Portfolio's total rate of return.

(c) Investment performance of funds designated as Reserve Funds and other non-operating funds that have a longer-term investment horizon (reserve portfolio) will be compared to the BofA Merrill Lynch 1-5 Year Government/Credit Index. The appropriate index will have a duration and asset mix that approximates that of the Investment Portfolio and will be utilized as a benchmark to be compared to the Investment Portfolio's total rate of return.

SECTION 17. REPORTING

The Treasurer shall submit on a quarterly basis a report to the City Council showing the type of investment, issuer, date of maturity, amount of deposit, current market value for all securities, rate of interest, interest earned, and such other information as may be required by the City Council.

SECTION 18. DELEGATION OF AUTHORITY

The City Council, consistent with Section 53607 of the Government Code, delegates the authority to make investments on the City's behalf to the City Treasurer. The City Treasurer shall assume full responsibility for all investment transactions made under this delegation of authority, and report these transactions quarterly to the City Council.

SECTION 19. INVESTMENT ADVISORY COMMITTEE

To strengthen sound investment strategies and provide control over the City's investments, an Investment Advisory Committee has been established to review and make recommendations on investment policy and strategy of the City of Fullerton and the Fullerton Successor Agency. City Council will adopt a resolution to set Committee membership and meeting frequency and update the resolution when warranted. ~~The Committee is comprised of the following members:~~

~~1. One City Council member (appointed by Council).~~

~~Three Fullerton citizens, appointed by the City Council, with professional financial management experience in either financial planning, commercial banking, investment banking, or a related field. The citizens chosen by City Council to serve on the Investment Advisory Committee shall serve four-year terms, and shall be removable from the Committee at the will of the Council.~~

~~The Director of administrative Services / City Treasurer and City Manager shall act in an advisory capacity to the Investment Advisory Committee.~~

The Committee shall meet ~~quarterly~~ to:

a. Review the City's investments which are currently held.

b. Recommend modifications of this Investment Policy to the City Council.

c. Develop and carry out the ongoing investment strategy in accordance with this Investment Policy.

The Committee will follow City Council procedures and Rules of Decorum, including minute taking. ~~During the meetings, action minutes will be taken and available for public review.~~

The Committee shall not inhibit the daily operations performed by the City Treasurer, but rather provide guidelines for the investment of the City's portfolio. Individual trades need not be approved by the Committee provided they fall within the scope of this Investment Policy.

SECTION 20. INVESTMENT POLICY ADOPTION

The City of Fullerton's Investment Policy shall be submitted to the City Council as needed for review and approval of any modifications. The basic premise underlying this Investment Policy is to ensure that idle funds are safe, available when needed, and invested at the highest yield possible after safety and liquidity standards are met.

SECTION 21. GLOSSARY

Because this policy is to be available to the public as well as the governing body, it is important that a glossary of related terminology be part of the policy. Please refer to Attachment A for the terms.

ATTACHMENT A
GLOSSARY OF INVESTMENT TERMS

Accrued Interest. Interest earned but which has not yet been paid or received.

Agency. See "Federal Agency Securities."

Ask Price. Price at which a broker/dealer offers to sell a security to an investor. Also known as "offered price."

Asset Backed Securities (ABS). A fixed-income security backed by notes or receivables against assets other than real estate. Generally issued by special purpose companies that "own" the assets and issue the ABS. Examples include securities backed by auto loans, credit card receivables, home equity loans, manufactured housing loans, farm equipment loans and aircraft leases.

Average Life. The average length of time that an issue of serial bonds and/or term bonds with a mandatory sinking fund feature is expected to be outstanding.

B of A Merrill Lynch 1-3 Year U.S. Corporate/Government Bond Index AA or Better. This index includes publicly issued U.S. Treasury debt, U.S. government agency debt, taxable debt issued by U.S. states and territories and their political subdivisions, debt issued by U.S. and non-U.S. corporations, non-U.S. government debt and supranational debt. This index will be utilized as a performance benchmark for the City's core portfolio.

Bankers' Acceptance (BA's). A draft or bill of exchange drawn upon and accepted by a bank. Frequently used to finance shipping of international goods. Used as a short-term credit instrument, bankers' acceptances are traded at a discount from face value as a money market instrument in the secondary market on the basis of the credit quality of the guaranteeing bank.

Basis Point. One hundredth of one percent, or 0.01%. Thus 1% equals 100 basis points.

Bearer Security. A security whose ownership is determined by the holder of the physical security. Typically, there is no registration on the issuer's books. Title to bearer securities is transferred by delivery of the physical security or certificate. Also known as "physical securities."

Benchmark Bills: In November 1999, FNMA introduced its Benchmark Bills program, a short-term debt securities issuance program to supplement its existing discount note program. The program includes a schedule of larger, weekly issues in three- and six-month maturities and biweekly issues in one-year for Benchmark Bills. Each issue is brought to market via a Dutch (single price) auction. FNMA conducts a weekly auction for each Benchmark Bill maturity and accepts both competitive and non-competitive bids through a web based auction system. This program is in addition to the variety of other discount note maturities, with rates posted on a daily basis, which FNMA offers. FNMA's Benchmark Bills are unsecured general obligations that are issued in book- entry form through the Federal Reserve Banks. There are no periodic payments of interest on Benchmark Bills, which are sold at a discount from the principal amount and payable at par at maturity. Issues under the Benchmark program constitute the same credit standing as other FNMA discount notes; they simply add organization and liquidity to the short-term Agency discount note market.

Benchmark Notes/Bonds: Benchmark Notes and Bonds are a series of FNMA "bullet" maturities (non-callable) issued according to a pre-announced calendar. Under its Benchmark Notes/Bonds program, 2, 3, 5, 10 and 30- year maturities are issued each quarter. Each Benchmark Notes new issue has a minimum size of $4 billion, 30- year new issues having a minimum size of $1 billion, with re-openings based on investor demand to further enhance liquidity. The amount of non-callable issuance has allowed FNMA to build a yield curve in Benchmark Notes and Bonds in maturities ranging from 2 to 30 years. The liquidity emanating from these large size issues has facilitated favorable financing opportunities through the development of a liquid overnight and term repo market. Issues under the Benchmark program constitute the same credit standing as other FNMA issues; they simply add organization and liquidity to the intermediate- and long-term Agency market.

Benchmark. A market index used as a comparative basis for measuring the performance of an investment portfolio. A performance benchmark should represent a close correlation to investment guidelines, risk tolerance and duration of the actual portfolio's investments.

Bid Price. Price at which a broker/dealer offers to purchase a security from an investor.

Bond Market Association (BMA). The bond market trade association representing the largest securities markets in the world. In addition to publishing a Master Repurchase Agreement, widely accepted as the industry standard document for Repurchase Agreements, the BMA also recommends bond market closures and early closes due to holidays.

Bond. Financial obligation for which the issuer promises to pay the bondholder (the purchaser or owner of the bond) a specified stream of future cash flows, including periodic interest payments and a principal repayment.

Book Entry Securities. Securities that are recorded in a customer's account electronically through one of the financial markets electronic delivery and custody systems, such as the Fed Securities wire, DTC and PTC (as opposed to bearer or physical securities). The trend is toward a certificate-free society in order to cut down on paperwork and to diminish investors' concerns about the certificates themselves. The vast majority of securities are now book entry securities.

Book Value. The value at which a debt security is reflected on the holder's records at any point in time. Book value is also called "amortized cost" as it represents the original cost of an investment adjusted for amortization of premium or accretion of discount. Also called "carrying value." Book value can vary over time as an investment approaches maturity and differs from "market value" in that it is not affected by changes in market interest rates.

Broker/Dealer. A person or firm transacting securities business with customers. A "broker" acts as an agent between buyers and sellers, and receives a commission for these services. A "dealer" buys and sells financial assets from its own portfolio. A dealer takes risk by owning inventory of securities, whereas a broker merely matches up buyers and sellers. See also "Primary Dealer."

Bullet Notes/Bonds. Notes or bonds that have a single maturity date and are non-callable.

California Local Agency Bonds: Bonds that are issued by a California county, city, city and county, including a chartered city or county, school district, community college district, public district, county board of education, county superintendent of schools, or any public or municipal corporation.

Call Date. Date at which a call option may be or is exercised.

Call Option. The right, but not the obligation, of an issuer of a security to redeem a security at a specified value and at a specified date or dates prior to its stated maturity date. Most fixed-income calls are a par, but can be at any previously established price. Securities issued with a call provision typically carry a higher yield than similar securities issued without a call feature. There are three primary types of call options (1) European - one-time calls, (2) Bermudan - periodically on a predetermined schedule (quarterly, semi-annual, annual), and (3) American - continuously callable at any time on or after the call date. There is usually a notice period of at least 5 business days prior to a call date.

Callable Bonds/Notes. Securities, which contain an imbedded call option giving the issuer, the right to redeem the securities prior to maturity at a predetermined price and time.

Certificate of Deposit (CD). Bank obligation issued by a financial institution generally offering a fixed rate of return (coupon) for a specified period of time (maturity). Can be as long as 10 years to maturity, but most CDs purchased by public agencies are one year and under.

Collateral. Investment securities or other property that a borrower pledges to secure repayment of a loan, secure deposits of public monies, or provide security for a repurchase agreement.

Collateralization. Process by which a borrower pledges securities, property, or other deposits for securing the repayment of a loan and/or security.

Collateralized Mortgage Obligation (CMO). A security that pools together mortgages and separates them into short, medium, and long-term positions (called tranches). Tranches are set up to pay different rates of interest depending upon their maturity. Interest payments are usually paid monthly. In “plain vanilla” CMOs, principal is not paid on a tranche until all shorter tranches have been paid off. This system provides interest and principal in a more predictable manner. A single pool of mortgages can be carved up into numerous tranches each with its own payment and risk characteristics.

Commercial Paper. Short term unsecured promissory note issued by a company or financial institution. Issued at a discount and matures for par or face value. Usually a maximum maturity of 270 days, and given a short-term debt rating by one or more NRSROs.

Convexity. A measure of a bond's price sensitivity to changing interest rates. A high convexity indicates greater sensitivity of a bond's price to interest rate changes.

Corporate Note. A debt instrument issued by a corporation with a maturity of greater than one year and less than ten years.
Counterparty. The other party in a two party financial transaction. "Counterparty risk" refers to the risk that the other party, to a transaction, will fail in its related obligations. For example, the bank or broker/dealer in a repurchase agreement.

Coupon Rate. Annual rate of interest on a debt security, expressed as a percentage of the bond’s face value.

Current Yield. Annual rate of return on a bond based on its price. Calculated as (coupon rate /price), but does <u>not</u> accurately reflect a bond’s true yield level.

Custody. Safekeeping services offered by a bank, financial institution or trust company, referred to as the “custodian.” Service normally includes the holding and reporting of the customer's securities, the collection and disbursement of income, securities settlement and market values.

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

Delivery Versus Payment (DVP). Settlement procedure in which securities are delivered versus payment of cash, but only after cash has been received. Most security transactions, including those through the Fed Securities Wire system and DTC, are done DVP as a protection for both the buyer and seller of securities.

Depository Trust Company (DTC). A firm through which members can use a computer to arrange for securities to be delivered to other members without physical delivery of certificates. A member of the Federal Reserve System and owned mostly by the New York Stock Exchange, the Depository Trust Company uses computerized debit and credit entries. Most corporate securities, commercial paper, CDs and BAs clear through DTC.

Derivatives. For hedging purposes, common derivatives are options, futures, swaps and swaptions. All Collateralized Mortgage Obligations ("CMOs") are 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).

Derivative Security. Financial instrument created from, or whose value depends upon, one or more underlying assets or indexes of asset values.

Designated Bond. FFCB's regularly issued, liquid, non-callable securities that generally have a 2 or 3 year original maturity. New issues of Designated Bonds are $1 billion or larger. Re-openings of existing Designated Bond issues are generally a minimum of $100 million. Designated Bonds are offered through a syndicate of two to six dealers. Twice each month the Funding Corporation announces its intention to issue a new Designated Bond, reopen an existing issue, or to not issue or reopen a Designated Bond. Issues under the Designated Bond program constitute the same credit standing as other FFCB issues; they simply add organization and liquidity to the intermediate- and long-term Agency market.

Discount Notes. Unsecured general obligations issued by Federal Agencies at a discount. Discount notes mature at par and can range in maturity from overnight to one year. Very large primary (new issue) and secondary markets.

Discount Rate. Rate charged by the system of Federal Reserve Banks on overnight loans to member banks. Changes to this rate are administered by the Federal Reserve and closely mirror changes to the "fed funds rate."

Discount Securities. Non-interest bearing money market instruments that are issued at discount and redeemed at maturity for full face value. Examples include: U.S. Treasury Bills, Federal Agency Discount Notes, Bankers' Acceptances and Commercial Paper.

Discount. The amount by which a bond or other financial instrument sells below its face value. See also "Premium."

Diversification. Dividing investment funds among a variety of security types, maturities, industries and issuers offering potentially independent returns.

Dollar Price. A bond's cost expressed as a percentage of its face value. For example, a bond quoted at a dollar price of 95 ½, would have a principal cost of $955 per $1,000 of face value.

Duff & Phelps. One of several NRSROs that provide credit ratings on corporate and bank debt issues.

Duration. The weighted average maturity of a security's or portfolio's cash flows, where the present values of the cash flows serve as the weights. The greater the duration of a security/portfolio, the greater its percentage price volatility with respect to changes in interest rates. Used as a measure of risk and a key tool for managing a portfolio versus a benchmark and for hedging risk. There are also different kinds of duration used for different purposes (e.g. MacAuley Duration, Modified Duration).

Fannie Mae. See "Federal National Mortgage Association."

Fed Money Wire. A computerized communications system that connects the Federal Reserve System with its member banks, certain U. S. Treasury offices, and the Washington D.C. office of the Commodity Credit Corporation. The Fed Money Wire is the book entry system used to transfer cash balances between banks for themselves and for customer accounts.

Fed Securities Wire. A computerized communications system that facilitates book entry transfer of securities between banks, brokers and customer accounts, used primarily for settlement of U.S. Treasury and Federal Agency securities.

Fed. See "Federal Reserve System."

Federal Agency Security. A debt instrument issued by one of the Federal Agencies. Federal Agencies are considered second in credit quality and liquidity only to U.S. Treasuries.

Federal Agency. Government sponsored/owned entity created by the U.S. Congress, generally for the purpose of acting as a financial intermediary by borrowing in the marketplace and directing proceeds to specific areas of the economy considered to otherwise have restricted access to credit markets. The largest Federal Agencies are GNMA, FNMA, FHLMC, FHLB, FFCB, SLMA, and TVA.

Federal Deposit Insurance Corporation (FDIC). Federal agency that insures deposits at commercial banks, currently to a limit of $250,000 per depositor per bank.

Federal Farm Credit Bank (FFCB). One of the large Federal Agencies. A government sponsored enterprise (GSE) system that is a network of cooperatively-owned lending institutions that provides credit services to farmers, agricultural cooperatives and rural utilities. The FFCBs act as financial intermediaries that borrow money in the capital markets and use the proceeds to make loans and provide other assistance to farmers and farm-affiliated businesses. Consists of the consolidated operations of the Banks for Cooperatives, Federal Intermediate Credit Banks, and Federal Land Banks. Frequent issuer of discount notes, agency notes and callable agency securities. FFCB debt is not an obligation of, nor is it guaranteed by the U.S. government, although it is considered to have minimal credit risk due to its importance to the U.S. financial system and agricultural industry. Also issues notes under its "designated note" program.

Federal Funds (Fed Funds). Funds placed in Federal Reserve Banks by depository institutions in excess of current reserve requirements, and frequently loaned or borrowed on an overnight basis between depository institutions.

Federal Funds Rate (Fed Funds Rate). The interest rate charged by a depository institution lending Federal Funds to another depository institution. The Federal Reserve influences this rate by establishing a "target" Fed Funds rate associated with the Fed's management of monetary policy.

Federal Home Loan Bank System (FHLB). One of the large Federal Agencies. A government sponsored enterprise (GSE) system, consisting of wholesale banks (currently twelve district banks) owned by their member banks, which provides correspondent banking services and credit to various financial institutions, financed by the issuance of securities. The principal purpose of the FHLB is to add liquidity to the mortgage markets. Although FHLB does not directly fund mortgages, it provides a stable supply of credit to thrift institutions that make new mortgage loans. FHLB debt is not an obligation of, nor is it guaranteed by the U.S. government, although it is considered to have minimal credit risk due to its importance to the U.S. financial system and housing market. Frequent issuer of discount notes, agency notes and callable agency securities. Also issues notes under its “global note” and “TAP” programs.

Federal Home Loan Mortgage Corporation (FHLMC or "Freddie Mac"). One of the large Federal Agencies. A government sponsored public corporation (GSE) that provides stability and assistance to the secondary market for home mortgages by purchasing first mortgages and participation interests financed by the sale of debt and guaranteed mortgage backed securities. FHLMC debt is not an obligation of, nor is it guaranteed by the U.S. government, although it is considered to have minimal credit risk due to its importance to the U.S. financial system and housing market. Frequent issuer of discount notes, agency notes, callable agency securities and MBS. Also issues notes under its “reference note” program.

Federal National Mortgage Association (FNMA or "Fannie Mae"). One of the large Federal Agencies. A government sponsored public corporation (GSE) that provides liquidity to the residential mortgage market by purchasing mortgage loans from lenders, financed by the issuance of debt securities and MBS (pools of mortgages packaged together as a security). FNMA debt is not an obligation of, nor is it guaranteed by the U.S. government, although it is considered to have minimal credit risk due to its importance to the U.S. financial system and housing market. Frequent issuer of discount notes, agency notes, callable agency securities and MBS. Also issues notes under its “benchmark note” program.

Federal Reserve Bank. One of the 12 distinct banks of the Federal Reserve System.

Federal Reserve System (the Fed). The independent central bank system of the United States that establishes and conducts the nation's monetary policy. This is accomplished in three major ways: (1) raising or lowering bank reserve requirements, (2) raising or lowering the target Fed Funds Rate and Discount Rate, and (3) in open market operations by buying and selling government securities. The Federal Reserve System is made up of twelve Federal Reserve District Banks, their branches, and many national and state banks throughout the nation. It is headed by the seven-member Board of Governors known as the “Federal Reserve Board” and headed by its Chairman.

Financial Industry Regulatory Authority, Inc (FINRA). A private corporation that acts as a self-regulatory organization (SRO). FINRA is the successor to the National Association of Securities Dealers, Inc. (NASD). Though sometimes mistaken for a government agency, it is a non-governmental organization that performs financial regulation of member brokerage firms and exchange markets. The government also has a regulatory arm for investments, the Securities and Exchange Commission.

Fiscal Agent/Paying Agent. A bank or trust company that acts, under a trust agreement with a corporation or municipality, in the capacity of general treasurer. The agent performs such duties as making coupon payments, paying rents, redeeming bonds, and handling taxes relating to the issuance of bonds.

Fitch Investors Service, Inc. One of several NRSROs that provide credit ratings on corporate and municipal debt issues.

Floating Rate Security (FRN or "floater"). A bond with an interest rate that is adjusted according to changes in an interest rate or index. Differs from variable-rate debt in that the changes to the rate take place immediately when the index changes, rather than on a predetermined schedule. See also "Variable Rate Security."

Freddie Mac. See "Federal Home Loan Mortgage Corporation".

Ginnie Mae. See "Government National Mortgage Association".

Global Notes: Notes designed to qualify for immediate trading in both the domestic U.S. capital market and in foreign markets around the globe. Usually large issues that are sold to investors worldwide and therefore have excellent liquidity. Despite their global sales, global notes sold in the U.S. are typically denominated in U.S. dollars.

Government National Mortgage Association (GNMA or "Ginnie Mae"). One of the large Federal Agencies. Government-owned Federal Agency that acquires, packages, and resells mortgages and mortgage purchase commitments in the form of mortgage-backed securities. Largest issuer of mortgage pass-through securities. GNMA debt is guaranteed by the full faith and credit of the U.S. government (one of the few agencies that is actually full faith and credit of the U.S.).

Government Securities. An obligation of the U.S. government, backed by the full faith and credit of the government. These securities are regarded as the highest quality of investment securities available in the U.S. securities market. See "Treasury Bills, Notes, Bonds, and SLGS."

Government Sponsored Enterprise (GSE). Privately owned entity subject to federal regulation and supervision, created by the U.S. Congress to reduce the cost of capital for certain borrowing sectors of the economy such as students, farmers, and homeowners. GSEs carry the implicit backing of the U.S. Government, but they are not direct obligations of the U.S. Government. For this reason, these securities will offer a yield premium over U.S. Treasuries. Some consider GSEs to be stealth recipients of corporate welfare. Examples of GSEs include: FHLB, FHLMC, FNMA and SLMA.

Government Sponsored Enterprise Security. A security issued by a Government Sponsored Enterprise. Considered Federal Agency Securities.

Index. A compilation of statistical data that tracks changes in the economy or in financial markets.

Interest-Only (IO) STRIP. A security based solely on the interest payments from the bond. After the principal has been repaid, interest payments stop and the value of the security falls to nothing. Therefore, IOs are considered risky investments. Usually associated with mortgage-backed securities.

Internal Controls. An internal control structure ensures that the assets of the entity are protected from loss, theft, or misuse. The internal control structure is designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that 1) the cost of a control should not exceed the benefits likely to be derived and 2) the valuation of costs and benefits requires estimates and judgments by management. Internal controls should address the following points:

1. **Control of collusion** - Collusion is a situation where two or more employees are working in conjunction to defraud their employer.

2. **Separation of transaction authority from accounting and record keeping** - By separating the person who authorizes or performs the transaction from the people who record or otherwise account for the transaction, a separation of duties is achieved.

3. **Custodial safekeeping** - Securities purchased from any bank or dealer including appropriate collateral (as defined by state law) shall be placed with an independent third party for custodial safekeeping.

4. **Avoidance of physical delivery securities** - Book-entry securities are much easier to transfer and account for since actual delivery of a document never takes place. Delivered securities must be properly safeguarded against loss or destruction. The potential for fraud and loss increases with physically delivered securities.

5. **Clear delegation of authority to subordinate staff members** - Subordinate staff members must have a clear understanding of their authority and responsibilities to avoid improper actions. Clear delegation of authority also preserves the internal control structure that is contingent on the various staff positions and their respective responsibilities.

6. **Written confirmation of transactions for investments and wire transfers** - Due to the potential for error and improprieties arising from telephone and electronic transactions, all transactions should be supported by written communications and approved by the appropriate person. Written communications may be via fax if on letterhead and if the safekeeping institution has a list of authorized signatures.

7. **Development of a wire transfer agreement with the lead bank and third-party custodian** - The designated official should ensure that an agreement will be entered into and will address the following points: controls, security provisions, and responsibilities of each party making and receiving wire transfers.

Inverse Floater. A floating rate security structured in such a way that it reacts inversely to the direction of interest rates. Considered risky as their value moves in the opposite direction of normal fixed-income investments and whose interest rate can fall to zero.

Investment Advisor. A company that provides professional advice managing portfolios, investment recommendations and/or research in exchange for a management fee.

Investment Adviser Act of 1940. Federal legislation that sets the standards by which investment companies, such as mutual funds, are regulated in the areas of advertising, promotion, performance reporting requirements, and securities valuations.

Investment Grade. Bonds considered suitable for preservation of invested capital; bonds rated a minimum of Baa3 by Moody's, BBB- by Standard & Poor's, or BBB- by Fitch. Although "BBB" rated bonds are considered investment grade, most public agencies cannot invest in securities rated below "A."

Liquidity. Relative ease of converting an asset into cash without significant loss of value. Also, a relative measure of cash and near-cash items in a portfolio of assets. Also, a term describing the marketability of money market security correlating to the narrowness of the spread between the bid and ask prices.

Local Agency Investment Fund (LAIF): A voluntary investment fund open to state and local government entities and certain non-profit organizations in California in which organization pools their funds for investment. LAIF is managed by the State Treasurer's Office.

Long-Term Core Investment Program. Funds that are not needed within a one year period.

Market Value. The fair market value of a security or commodity. The price at which a willing buyer and seller would pay for a security.

Mark-to-market. Adjusting the value of an asset to its market value, reflecting in the process unrealized gains or losses.

Master Repurchase Agreement. A widely accepted standard agreement form published by the Bond Market Association (BMA) that is used to govern and document Repurchase Agreements and protects the interest of parties in a repo transaction.

Maturity Date. Date on which principal payment of a financial obligation is to be paid.

Medium Term Notes (MTN's). Used frequently to refer to corporate notes of medium maturity (5-years and under). Technically, any debt security issued by a corporate or depository institution with a maturity from 1 to 10 years and issued under an MTN shelf registration. Usually issued in smaller issues with varying coupons and maturities, and underwritten by a variety of broker/dealers (as opposed to large corporate deals issued and underwritten all at once in large size and with a fixed coupon and maturity).

Money Market. The market in which short-term debt instruments (bills, commercial paper, bankers' acceptance, etc.) are issued and traded.

Money Market Mutual Fund (MMF). A type of mutual fund that invests solely in money market instruments, such as: U.S. Treasury bills, commercial paper, bankers' acceptances, and repurchase agreements. Money market mutual funds are registered with the SEC under the Investment Company Act of 1940 and are subject "rule 2a-7" which significantly limits average maturity and credit quality of holdings. MMF's are managed to maintain a stable net asset value (NAV) of $1.00. Many MMFs carry ratings by a NRSRO.

Moody's Investors Service. One of several NRSROs that provide credit ratings on corporate and municipal debt issues.

Mortgage Backed Securities (MBS). Mortgage-backed securities represent an ownership interest in a pool of mortgage loans made by financial institutions, such as savings and loans, commercial banks, or mortgage companies, to finance the borrower's purchase of a home or other real estate. The majority of MBS are issued and/or guaranteed by GNMA, FNMA and FHLMC. There are a variety of MBS structures, some of which can be very risky and complicated. All MBS have reinvestment risk as actual principal and interest payments are dependent on the payment of the underlying mortgages which can be prepaid by mortgage holders to refinance and lower rates or simply because the underlying property was sold.

Mortgage Pass-Through Securities. A pool of residential mortgage loans with the monthly interest and principal distributed to investors on a pro-rata basis. Largest issuer is GNMA.

Municipal Note/Bond. A debt instrument issued by a state or local government unit or public agency. The vast majority of municipals are exempt from state and federal income tax, although some non-qualified issues are taxable.

Mutual Fund. Portfolio of securities professionally managed by a registered investment company that issues shares to investors. Many different types of mutual funds exist (bond, equity, money fund); all except money market funds operate on a variable net asset value (NAV).

Negotiable Certificate of Deposit (Negotiable CD). Large denomination CDs ($100,000 and larger) that are issued in bearer form and can be traded in the secondary market.

Net Asset Value. The market value of one share of an investment company, such as a mutual fund. This figure is calculated by totaling a fund's assets which includes securities, cash, and any accrued earnings, subtracting this from the fund's liabilities and dividing this total by the number of shares outstanding. This is calculated once a day based on the closing price for each security in the fund's portfolio. (See below.)

[(Total assets) - (Liabilities)]/ (Number of shares outstanding)

NRSRO. A "Nationally Recognized Statistical Rating Organization." A designated rating organization that the SEC has deemed a strong national presence in the U.S. NRSROs provide credit ratings on corporate and bank debt issues. Only ratings of a NRSRO may be used for the regulatory purposes of rating. Includes Moody's, S&P, Fitch and Duff & Phelps.

Offered Price. See also "Ask Price."

Open Market Operations. Federal Reserve monetary policy tactic entailing the purchase or sale of government securities in the open market by the Federal Reserve System from and to primary dealers in order to influence the money supply, credit conditions, and interest rates.
Par Value. Face value, stated value or maturity value of a security.

Physical Delivery. Delivery of readily available underlying assets at contract maturity.

Portfolio. Collection of securities and investments held by an investor.

Premium. The amount by which a bond or other financial instrument sells above its face value. See also "Discount."

Primary Dealer. Any of a group of designated government securities dealers designated by to the Federal Reserve Bank of New York. Primary dealers can buy and sell government securities directly with the Fed. Primary dealers also submit daily reports of market activity and security positions held to the Fed and are subject to its informal oversight. Primary dealers are considered the largest players in the U.S. Treasury securities market.

Prime Paper. Commercial paper of high quality. Highest rated paper is A-1+/A-1 by S&P and P-1 by Moody's.

Principal. Face value of a financial instrument on which interest accrues. May be less than par value if some principal has been repaid or retired. For a transaction, principal is par value multiplied by price and includes any premium or discount.

Prudent Investor Standard. Standard that requires that when investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency. More stringent than the "prudent person" standard as it implies a level of knowledge commensurate with the responsibility at hand.

Range Note. A type of structured note that accrues interest daily at a set coupon rate that is tied to an index. Most range notes have two coupon levels; a higher accrual rate for the period the index is within a designated range, the lower accrual rate for the period that the index falls outside the designated range. This lower rate may be zero and may result in zero earnings.

Rate of Return. Amount of income received from an investment, expressed as a percentage of the amount invested.

Realized Gains (Losses). The difference between the sale price of an investment and its book value. Gains/losses are "realized" when the security is actually sold, as compared to "unrealized" gains/losses which are based on current market value. See "Unrealized Gains (Losses)."

Reference Bills: FHLMC's short-term debt program created to supplement its existing discount note program by offering issues from one month through one year, auctioned on a weekly or on an alternating four-week basis (depending upon maturity) offered in sizeable volumes ($1 billion and up) on a cycle of regular, standardized issuance. Globally sponsored and distributed, Reference Bill issues are intended to encourage active trading and market-making and facilitate the development of a term repo market. The program was designed to offer predictable supply, pricing transparency and liquidity, thereby providing alternatives to U.S. Treasury bills. FHLMC's Reference Bills are unsecured general corporate obligations. This program supplements the corporation's existing discount note program. Issues under the Reference program constitute the same credit standing as other FHLMC discount notes; they simply add organization and liquidity to the short-term Agency discount note market.

Reference Notes: FHLMC's intermediate-term debt program with issuances of 2, 3, 5, 10 and 30-year maturities. Initial issuances range from $2 - $6 billion with re-openings ranging $1 - $4 billion. The notes are high-quality bullet structures securities that pay interest semiannually. Issues under the Reference program constitute the same credit standing as other FHLMC notes; they simply add organization and liquidity to the intermediate- and long-term Agency market.

Repurchase Agreement (Repo). A short-term investment vehicle where an investor agrees to buy securities from a counterparty and simultaneously agrees to resell the securities back to the counterparty at an agreed upon time and for an agreed upon price. The difference between the purchase price and the sale price represents interest earned on the agreement. In effect, it represents a collateralized loan to the investor, where the securities are the collateral. Can be DVP, where securities are delivered to the investor's custodial bank, or "tri-party" where the securities are delivered to a third party intermediary. Any type of security can be used as "collateral," but only some types provide the investor with special bankruptcy protection under the law. Repos should be undertaken only when an appropriate BMA approved master repurchase agreement is in place.

Reverse Repurchase Agreement (Reverse Repo). A repo from the point of view of the original seller of securities. Used by dealers to finance their inventory of securities by essentially borrowing at short-term rates. Can also be used to leverage a portfolio and in this sense, can be considered risky if used improperly.

Safekeeping. Service offered for a fee, usually by financial institutions, for the holding of securities and other valuables. Safekeeping is a component of custody services.

Secondary Market. Markets for the purchase and sale of any previously issued financial instrument.

Securities Lending. An arrangement between and investor and a custody bank that allows the custody bank to "loan" the investors investment holdings, reinvest the proceeds in permitted investments, and shares any profits with the investor. Should be governed by a securities lending agreement. Can increase the risk of a portfolio in that the investor takes on the default risk on the reinvestment at the discretion of the custodian.

Sinking Fund. A separate accumulation of cash or investments (including earnings on investments) in a fund in accordance with the terms of a trust agreement or indenture, funded by periodic deposits by the issuer (or other entity responsible for debt service), for the purpose of assuring timely availability of moneys for payment of debt service. Usually used in connection with term bonds.

Spread. The difference between the price of a security and similar maturity U.S. Treasury investments, expressed in percentage terms or basis points. A spread can also be the absolute difference in yield between two securities. The securities can be in different markets or within the same securities market between different credits, sectors, or other relevant factors.

Standard & Poor's. One of several NRSROs that provide credit ratings on corporate and municipal debt issues.

STRIPS (Separate Trading of Registered Interest and Principal of Securities). Acronym applied to U.S. Treasury securities that have had their coupons and principal repayments separated into individual zero-coupon Treasury securities. The same technique and "strips" description can be applied to non-Treasury securities (e.g. FNMA strips).

Structured Notes. Notes that have imbedded into their structure options such as step-up coupons or derivative- based returns.

Supranational Debt. The debt of an international or multi-lateral financial agency used to finance economic and infrastructure development, environmental protection, poverty reduction and renewable energy around the world. Supranational debt is typically rated AAA by most NRSRO's as theses entities are well-capitalized, have significant capital commitments from a diverse capital base, conservative lending and risk management practices and strong supervision.

Swap. Trading one asset for another.

TAP Notes: Federal Agency notes issued under the FHLB TAP program. Launched in 6/99 as a refinement to the FHLB bullet bond auction process. In a break from the FHLB's traditional practice of bringing numerous small issues to market with similar maturities, the TAP Issue Program uses the four most common maturities and reopens them up regularly through a competitive auction. These maturities (2, 3, 5 and 10 year) will remain open for the calendar quarter, after which they will be closed and a new series of TAP issues will be opened to replace them. This reduces the number of separate bullet bonds issued, but generates enhanced awareness and liquidity in the marketplace through increased issue size and secondary market volume.

Tennessee Valley Authority (TVA). One of the large Federal Agencies. A wholly owned corporation of the United States government that was established in 1933 to develop the resources of the Tennessee Valley region in order to strengthen the regional and national economy and the national defense. Power operations are separated from non-power operations. TVA securities represent obligations of TVA, payable solely from TVA's net power proceeds, and are neither obligations of nor guaranteed by the United States. TVA is currently authorized to issue debt up to $30 billion. Under this authorization, TVA may also obtain advances from the U.S. Treasury of up to $150 million. Frequent issuer of discount notes, agency notes and callable agency securities.

Total Return. Investment performance measured over a period of time that includes coupon interest, interest on interest, and both realized and unrealized gains or losses. Total return includes, therefore, any market value appreciation/depreciation on investments held at period end.

Treasuries. Collective term used to describe debt instruments backed by the U.S. Government and issued through the U.S. Department of the Treasury. Includes Treasury bills, Treasury notes, and Treasury bonds. Also a benchmark term used as a basis by which the yields of non-Treasury securities are compared (e.g., "trading at 50 basis points over Treasuries").

Treasury Bills (T-Bills). Short-term direct obligations of the United States Government issued with an original term of one year or less. Treasury bills are sold at a discount from face value and do not pay interest before maturity. The difference between the purchase price of the bill and the maturity value is the interest earned on the bill. Currently, the U.S. Treasury issues 4-week, 13-week and 26-week T-Bills

Treasury Bonds. Long-term interest-bearing debt securities backed by the U.S. Government and issued with maturities of ten years and longer by the U.S. Department of the Treasury. The Treasury stopped issuing Treasury Bonds in August 2001.

Treasury Notes. Intermediate interest-bearing debt securities backed by the U.S. Government and issued with maturities ranging from one to ten years by the U.S. Department of the Treasury. The Treasury currently issues 2-year, 5-year and 10-year Treasury Notes.

Trustee. A bank designated by an issuer of securities as the custodian of funds and official representative of bondholders. Trustees are appointed to insure compliance with the bond documents and to represent bondholders in enforcing their contract with the issuer.

Uniform Net Capital Rule. SEC regulation 15C3-1 that outlines the minimum net capital ratio (ratio of indebtedness to net liquid capital) of member firms and non-member broker/dealers.

Unrealized Gains (Losses). The difference between the market value of an investment and its book value. Gains/losses are “realized” when the security is actually sold, as compared to “unrealized” gains/losses which are based on current market value. See also “Realized Gains (Losses).”

Variable-Rate Security. A bond that bears interest at a rate that varies over time based on a specified schedule of adjustment (e.g., daily, weekly, monthly, semi-annually or annually). See also “Floating Rate Note.”

Weighted Average Maturity (or just “Average Maturity”). The average maturity of all securities and investments of a portfolio, determined by multiplying the par or principal value of each security or investment by its maturity (days or years), summing the products, and dividing the sum by the total principal value of the portfolio. A simple measure of risk of a fixed-income portfolio.

Weighted Average Maturity to Call. The average maturity of all securities and investments of a portfolio, adjusted to substitute the first call date per security for maturity date for those securities with call provisions.

Yield Curve. A graphic depiction of yields on like securities in relation to remaining maturities spread over a time line. The traditional yield curve depicts yields on U.S. Treasuries, although yield curves exist for Federal Agencies and various credit quality corporates as well. Yield curves can be positively sloped (normal) where longer-term investments have higher yields, or “inverted” (uncommon) where longer-term investments have lower yields than shorter ones.

Yield to Call (YTC). Same as “Yield to Maturity,” except the return is measured to the first call date rather than the maturity date. Yield to call can be significantly higher or lower than a security’s yield to maturity.

Yield to Maturity (YTM). Calculated return on an investment, assuming all cash flows from the security are reinvested at the same original yield. Can be higher or lower than the coupon rate depending on market rates and whether the security was purchased at a premium or discount. There are different conventions for calculating YTM for various types of securities.

Yield. There are numerous methods of yield determination. In this glossary, see also "Current Yield,” "Yield Curve," "Yield to Call" and "Yield to Maturity."