

## **Policy 7.1.2 Investment and Cash Management**

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### **POLICY PURPOSE:**

The City establishes investment policies that meet its current investment goals. This policy is intended to establish objectives and criteria for the investment of the City's temporarily idle funds and for the City's Redevelopment Successor Agency and to provide guidelines for the City's cash management system.

This policy is set forth by the City of Sunnyvale (City) for the following purposes:

1. To establish a clear understanding for the City Council, City management, responsible employees, citizens and third parties of the objectives, policies and guidelines for the investment of the City's temporarily idle funds;
2. To offer guidance to investment staff on the investment of City funds; and
3. To establish a basis for evaluating investment results

### **POLICY STATEMENT:**

#### **Objectives**

The City's cash management system shall be designed to accurately monitor and forecast expenditures and revenues, to enable the City to invest funds to the fullest extent possible.

Idle funds of the City shall be invested in accordance with principles of sound treasury management and in accordance with the provisions of California Government Code Section 53600 et seq., the City Charter, the City's Municipal Code and this policy.

The objectives of the City's investment program are, in order of priority:

1. Safety – Safety of principal is the foremost objective of the investment program. Investments of the City shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To attain this objective, diversification is required in order that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio.
2. Liquidity – The City's investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated.
3. Return on Investment – The City's investment portfolio shall be designed with the objective of attaining the safety and liquidity objectives first, and then attaining a market rate of return throughout the budgetary and economic cycles, taking into

## COUNCIL POLICY MANUAL

account the City's investment risk constraints and the cash flow characteristics of the portfolio.

### Standard of Care – Prudent Investor

The governing body of the City and any staff members authorized to make investment decisions on behalf of the City are trustees and therefore fiduciaries subject to the prudent investor standard. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the City, that a prudent person acting in a like capacity and familiar with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the City. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law.

The Director of Finance or his/her designee is authorized to manage the investment portfolio and act within the intent and scope of the investment policy and other written procedures and exercise due diligence, shall be relieved of personal responsibility and liability for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely manner and appropriate action is taken to control adverse developments.

### Ethics and Conflicts of Interest

Officers and employees involved with 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. The Director of Finance or his/her designee and other designated employees are required to file applicable financial disclosures, as required by the Fair Political Practices Commission.

## **OPERATIONAL AND PROCEDURAL MATTERS:**

### Scope

This Investment Policy applies to all funds and investment activities of the City with the following exceptions:

1. The City's Deferred Compensation Plan is excluded because it is managed by a third party administrator and invested by individual plan participants;
2. The City participates in the Public Employees Retirement System, and does not manage any retirement funds internally.

## COUNCIL POLICY MANUAL

3. Proceeds of debt issuance shall be invested in accordance with the general investment philosophy of the City as set forth in this policy; however, such proceeds are invested in accordance with permitted investment provisions of their specific bond indentures.
4. Funds for the Other Post Employment Benefits (OPEB) Trust shall be invested in accordance with the general investment philosophy of the City as set forth in this policy; however, these funds are invested pursuant to California code and the Trust's separate long-term investment policy as approved by Council under the Trust Agreement.

### Authorized Financial Dealers and Institutions

1. The Director of Finance or his/her designee shall maintain a list of institutions qualified and authorized to transact investment business with the City. Eligible institutions include:
  - A. Primary government dealers as designated by the Federal Reserve Bank;
  - B. Regional broker/dealers;
  - C. Nationally or state-chartered banks;
  - D. The Federal Reserve Bank; and
  - E. Direct issuers of securities eligible for purchase by the City.
2. Public deposits shall be made only in qualified public depositories within the State of California as established by State law, or as permitted by Section III.A (4-7). Deposits shall be insured by the Federal Deposit Insurance Corporation, or, to the extent the amount exceeds the insured maximum, shall be collateralized with securities in accordance with state law.
3. A sufficient pool of qualified financial institutions and dealers will be maintained using criteria based on credit worthiness, experience, reference checks, and qualifications under the Securities and Exchange Commission. The City will issue a Request for Qualifications once every three years for these services. All broker/dealers who desire to become qualified must be registered with Financial Industry Regulatory Authority (FINRA) and supply the following as appropriate:
  - A. Audited financial statements
  - B. Completed broker/dealer questionnaire
  - C. Certification of having reviewed the City's Investment Policy.
4. It is the policy of the City to require competitive bidding for investment transactions. Whenever possible, at least three financial dealers or institutions will be contacted to provide price quotations on security purchases and sales.
5. Selection of financial institutions and broker/dealers used by the City shall be at the sole discretion of the City.

Delivery vs. Payment

All investment transactions of the City shall be conducted using standard delivery vs. payment procedures.

Safekeeping of Securities

To protect against potential losses by collapse of individual securities dealers, and to enhance access to securities, interest payments, and maturity proceeds, all securities owned by the City shall be held in safekeeping by a third party bank trust department, acting as agent for the City under the terms of a custody agreement executed by the bank and by the City.

**PERMITTED INVESTMENTS AND GUIDELINES TO ACHIEVE POLICY OBJECTIVES:**

Authorized Investments

All investments shall be made in accordance with Sections 53600 *et seq.* of the Government Code of California and as described within this Investment Policy. Permitted investments under this policy shall include:

1. **Securities issued by the US Treasury**, provided that:
  - A. There shall be no maximum allowable investment in US Treasury securities; and
  - B. As required by Section 53601 of the California Government Code, the City Council hereby grants express authority to the Director of Finance or his/her designee to invest in U.S. Treasury securities with final stated maturities up to seven years.
2. **Securities Issued and fully guaranteed as to payment by a federal agency or issued by a United States Government Sponsored Enterprise**, provided that:
  - A. No more than 30% of the total portfolio may be invested in federal agencies or government sponsored enterprises of any single issuer; and
  - B. As required by Section 53601 of the California Government Code, the City Council hereby grants express authority to the Director of Finance or his/her designee to invest in U. S. Agency securities with final stated maturities up to seven years.
3. **Banker's acceptances**, provided that:
  - A. No more than 30% of the total portfolio may be invested in banker's acceptances;

## COUNCIL POLICY MANUAL

- B. No more than 5% of the total portfolio may be invested per issuer;
  - C. Their maturity does not exceed 180 days; and
  - D. They are issued by institutions with short term debt obligations rated a minimum of P-1 by Moody's or A-1 by Standard and Poors, or the equivalent by a nationally recognized statistical-rating organization (NRSRO).
4. **Federally Insured Bank Deposits** (Non-negotiable certificates of deposit) in state or federally chartered banks, savings and loans, or credit unions in the state of California, provided that:
- A. No more than 20% of the total portfolio may be invested in a combination of federally insured and collateralized time deposits;
  - B. The amount per institution is limited to the maximum covered under federal insurance; and
  - C. Their maturity does not exceed five years.
5. **Collateralized Bank Deposits** (Non-negotiable certificates of deposit) in California banks in excess of insured amounts which are fully collateralized with securities in accordance with California law, provided that:
- A. No more than 20% of the portfolio shall be invested in a combination of federally insured and collateralized time deposits;
  - B. No more than 5% may be invested per issuer; and
  - C. The maturity of such deposits does not exceed 365 days.
6. **Negotiable Certificates of Deposit** (NCDs) issued by a nationally or state-chartered bank, a savings association or a federal association (as defined by Section 5102 of the Financial Code), or by a federally or state-licensed branch of a foreign bank, provided that:
- A. No more than 30% of the total portfolio may be invested in investments made in accordance with this section plus deposits made under section III (7) of this policy;
  - B. No more than 5% of the total portfolio may be invested per issuer;
  - C. The maturity does not exceed 5 years; and
  - D. They are issued by institutions which have long-term obligations which are rated "A" or higher by a nationally recognized statistical rating organization; and/or have short-term debt obligations rated "A" or higher, or the equivalent by a nationally recognized statistical rating organization.
7. **Certificates of Deposit Placement Service** (e.g CDARS or like services) using private sector entity to assist in the placement of deposits above federal insurance amounts in increments less than federal insurance at participating banks, savings and loans, or credit unions nationally through a "selected depository institution" in California, provided that:

## COUNCIL POLICY MANUAL

- A. No more than 30% of the City's total portfolio may be invested in such deposits plus negotiable certificates of deposit purchased pursuant to Section III (6) of this policy;
  - B. The full amount of the principal and the interest that may be accrued during the maximum term of each certificate shall at all times be insured by the FDIC or the NCUA;
  - C. The selected depository institution shall be a nationally or state-chartered bank, savings and loan, or credit union in California and shall serve as the custodian for each certificate of deposit issued by the placement service for the City's account;
  - D. At the same time the City's funds are deposited and the certificates of deposit are issued, the selected depository institution shall receive an amount of deposits from other commercial banks, savings banks, savings and loan associations or credit unions that, in total, are equal to or greater than the full amount of the principal that the City initially deposited with the selected depository institution;
  - E. No credit union may act as a selected depository institution unless:
    - I) The credit union offers federal depository insurance through the NCUA; and
    - II) The credit union is authorized by the NCUA in the deposit placement services, and affirms that moneys held by those credit unions while participating in a deposit placement service will at all times be insured by a federal government entity.
8. **Repurchase agreements** collateralized with securities authorized under Sections III (A1-2) of this policy maintained at a level of at least 102% of the market value of the repurchase agreements, provided that:
- A. No more than 10% of the portfolio shall be invested in repurchase agreements;
  - B. The maximum maturity of repurchase agreements shall be 15 days;
  - C. Securities used as collateral for repurchase agreements shall be delivered to the City's custodian bank, except that securities used as collateral for the one to seven day repurchase agreements with the City's depository bank may be held in safekeeping by an independent third party bank trustee in the name of the City, as evidenced by appropriate receipts of trust; and
  - D. The repurchase agreements are the subject of a master repurchase agreement between the City and the provider of the repurchase agreement. The master repurchase agreement shall be substantially in the form developed by the Securities Industry and Financial Markets Association (SIFMA).

9. **Commercial paper**, provided that:

- A. No more than 15% of the total portfolio may be invested in commercial paper;
- B. No more than 5% of the total portfolio may be invested per issuer.
- C. The maturity does not exceed 270 days from the date of purchase;
- D. The paper is of "prime" quality of the highest ranking or of the highest letter and number rating as provided for by a nationally recognized statistical-rating organization (NRSRO). The entity that issues the commercial paper shall meet all of the following conditions in either paragraph (1) or paragraph (2):
  - I) Is organized and operating in the United States as a general corporation. Has total assets in excess of five hundred million dollars (\$500,000,000). Has debt other than commercial paper, if any, that is rated "A" or higher by a nationally recognized statistical-rating organization (NRSRO).
  - II) Is organized within the United States as a special purpose corporation, trust, or limited liability company. Has program wide credit enhancements including, but not limited to, overcollateralization, letters of credit, or surety bond. Has commercial paper that is rated "A-1" or higher, or the equivalent, by a nationally recognized statistical-rating organization (NRSRO).

10. **State of California Local Agency Investment Fund (LAIF)**, provided that:

- A. No more than 20% of the total portfolio may be invested in LAIF;
- B. It is recognized that LAIF has authority to invest in some instruments that are not permitted for Cities under the California Government Code; and
- C. A thorough investigation of the pool/fund is required prior to investing and on a continual basis. City staff will annually perform due diligence analysis of LAIF based on a standardized questionnaire developed to address investment policy and practices.

11. **Corporate medium-term notes**, provided that:

- A. No more than 30% of the total portfolio may be invested in medium-term notes;
- B. No more than 5% of the total portfolio may be invested per issuer;
- C. Such notes have a maximum maturity of 5 years;
- D. Such notes are 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; and
- E. Such notes are rated "A" or higher by a nationally recognized statistical rating organization.

12. **Mortgage pass-through securities and asset-backed securities**, provided that:
  - A. No more than 20% of the total portfolio may be invested in Mortgage pass-through securities and asset-backed securities;
  - B. Such securities shall have a maximum stated final maturity of 5 years;
  - C. Issued by an issuer having an “A” or higher credit rating for the issuer’s debt as provided by a nationally recognized statistical rating organization; and
  - D. Such securities are rated in the category of “AAA” by a nationally recognized statistical rating organization.
13. **Money market mutual funds**, provided that:
  - A. No more than 10% of the total portfolio may be invested in Money market mutual funds;
  - B. Such funds are registered with the Securities and Exchange Commission and are rated AAA by S&P or Aaa by Moody’s;
  - C. Such funds have retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years’ experience investing in the securities and obligations authorized by California Government Code Section 53601 (a through j) and with assets under management in excess of \$500 million;
  - D. Such funds include in their prospectus the statement that one of the investment fund’s investment objectives is to seek to maintain a net asset value of \$1; and
  - E. Such funds invest only in US Treasury and federal agency securities, and in repurchase agreements backed by US Treasury and federal agency securities.
14. **Municipal Securities**. These include obligations of the state of California, any other state, and any local Agency within the state of California including the City of Sunnyvale to the extent permitted by federal law, provided that:
  - A. The maturity does not exceed 5 years from the date of purchase;
  - B. The rating by a nationally recognized statistical rating organization is in the "A" category or better; and
  - C. For Municipal Obligations in the form of variable rate demand obligations, the obligations shall be supported by a third-party liquidity facility from a financial institution with short-term ratings of at least A-1 by S&P or P-1 by Moody’s. The right of the bondholder to tender the obligation converts these obligations to a short term investment.
15. **Joint Powers Authority (JPA) Pools**, provided that:
  - A. The JPA is organized pursuant to CGC Section 6509.7;



## COUNCIL POLICY MANUAL

- B. The Pool invests only in securities and obligations authorized in CGC Section 53601;
  - C. The Pool is managed by an investment adviser registered with the SEC or exempt from registration; and
  - D. Such adviser has not less than five years of experience investing in securities and obligations authorized in CGC Section 53601, and has assets under management in excess of five hundred million dollars (\$500,000,000).
16. **Supranational Securities.** CGC 53601 defines allowable Supranational Securities as United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by: the International Bank for Reconstruction and Development, the International Finance Corporation, or Inter-American Development Bank, provided that:
- A. No more than 30% of the total portfolio may be invested in Supranational securities;
  - B. The maturity does not exceed 5 years from the date of purchase;
  - C. The instruments are eligible for purchase and resale within the United States; and
  - D. The rating by a nationally recognized statistical rating organization is in the "AA" category or better.

### Prohibited Investment Vehicles and Practices

- 1. State law notwithstanding, any investments not specifically described herein are prohibited, including, but not limited to, mutual funds (other than government money market funds as described in Section III A(12), unregulated and/or unrated investment pools or trusts, collateralized mortgage obligations and futures and options.
- 2. In accordance with Government Code Section 53601.6, investment in inverse floaters, range notes, or mortgage derived interest-only strips is prohibited.
- 3. Investment in any security that could result in a zero interest accrual if held to maturity is prohibited.
- 4. Trading securities for the sole purpose of speculating on the future direction of interest rates is prohibited.
- 5. Purchasing or selling securities on margin is prohibited.
- 6. No direct investments are to be made to support the production or drilling of fossil fuels.

7. Prohibited investments held in the portfolio at the time of adoption of this policy may be held until maturity at the discretion of the Director of Finance.

Risk/Safety

The City recognizes that it is subject to the risks of investing in fixed income securities, especially “market risk” and “call risk” which are risks that the value of the portfolio will fluctuate with changes in the general level of interest rates, and “credit risk,” which is the risk that a security or a portfolio will lose some or all of its value due to a real or perceived change in the ability of the issuer to repay its debt.

1. Mitigating market risk in the portfolio

The City recognizes that, over time, longer-term portfolios achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The City shall mitigate market risk by providing adequate liquidity for short-term cash needs, and by making longer term investments with funds which are not needed for current cashflow purposes. The City further recognizes that certain types of securities, including variable rate securities, securities with principal paydowns prior to maturity, and securities with embedded options (callable securities), will affect the market risk profile of the portfolio differently in different interest rate environments. The City, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

- A. The City shall maintain a percentage of the portfolio in short term securities to provide for cash flows.
- B. The average maturity of the portfolio shall be no greater than 2.5 years.

2. Mitigating credit risk in the portfolio

- A. The diversification requirements included in the Authorized Investments section are designed to mitigate credit risk in the portfolio.
- B. No more than 5% of the total portfolio may be invested in securities of any single issuer, other than the US Government, its agencies and instrumentalities (limited to 30% per issuer), and LAIF. This section does not preclude the investment of up to 10% of the portfolio in short-term repurchase agreements, as defined in Section III(A8) above, money market mutual funds as defined in Section III(A13), or JPA Pools as defined in Section III(A15).
- C. The City may elect to sell a security prior to its maturity and record a capital gain or loss in order to improve the quality, liquidity or yield of the portfolio in response to market conditions or the City’s risk preferences; and
- D. If a security owned by the City is downgraded by either Moody’s or S&P to a level below the minimum quality required by this Investment Policy, it shall be the City’s policy to sell that security as soon as practicable.

## COUNCIL POLICY MANUAL

### Liquidity

1. A schedule of major revenues and expenditures for a rolling 12-month period shall be maintained and coordinated with investments to the extent feasible.
2. Investment maturities may be timed to provide funds for scheduled expenditures not met by anticipated major revenue receipts.
3. To the extent possible, the Twenty Year Resource Allocation Plan shall be used for the cash flow projection purposes, and shall be taken into account in determining long term investment strategy.

### Return Objectives

1. **Overall objective.** The investment portfolio shall be designed with the overall objective, in order of priority, of safety, liquidity, and return on investment.
2. **Specific objective.** The investment performance objective for the portfolio shall be to earn a market average yield for the reporting period comparable to the yield of a Treasury Security with a similar average life.

## **RESPONSIBILITY AND REPORTING:**

### Delegation of Authority

The City Manager is responsible for directing and supervising the Director of Finance and is also responsible to keep the City Council fully advised as to the financial condition of the City.

The Director of Finance is responsible, by Council delegation, for the custody and investment of City funds and the development of procedures to implement this Investment Policy. This delegation requires that the Director of Finance submit a monthly transaction report to the Council accounting for the investment of funds. The Director of Finance is further responsible for the duties and powers imposed on City Treasurers by the laws of the State of California.

The Director of Finance or his/her designee is responsible for monitoring investment market information, recommending investment strategy for portfolio diversity and timing of maturities, as well as ensuring compliance with the City's Investment Policy. The Investment staff shall maintain current knowledge of technical and legal requirements regarding municipal investments through continued education and maintain active membership in the California Municipal Treasurers Association (CMTA).

The City may employ an investment adviser to invest all or a portion of the City's cash. Such Adviser shall be granted discretion to invest and reinvest the portfolio in accordance

## COUNCIL POLICY MANUAL

with this Investment Policy and must be registered under the Investment Advisers Act of 1940. Selection of broker/dealers used by an external investment adviser retained by the City will be at the sole discretion of the investment adviser.

### Reporting, Disclosure and Program Evaluation

The Director of Finance, as Chief Financial Officer and City Treasurer, shall file a quarterly investment report with the City Council and the City Manager within 30 days following the end of the quarter covered by the report. The report shall include the following information:

1. An asset listing showing par value, cost and accurate and complete market value of each security, type of investment, issuer, and interest rate;
2. The Director of Finance shall provide a monthly transaction report to the City Council;
3. A statement of compliance with the Investment Policy; and
4. A statement that the City has adequate funds to meet its cash flow requirements for the next six months.

### Annual Reports

1. The investment policy shall be reviewed and adopted at least annually within 120 days of the end of the fiscal year to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends.
2. A report of portfolio performance for the immediately preceding fiscal year shall be presented as part of the annual investment policy review. This report shall include comparisons of the City's performance compared to the return objectives, and shall include a section on compliance with the investment policy.

### **INTERNAL CONTROL:**

The Director of Finance has established a system of internal controls to ensure compliance with the Investment Policies of the City and the California Government Code. The internal control procedures include segregation of duties in the different phases of an investment transaction, monthly reconciliation of the investment report to the general ledger, and annual policy compliance review by the City's outside auditor. An independent audit is conducted by the City's outside auditors which includes a compliance review of the City's investment activities to the City's Investment Policy, the California Government Code, and Government Accounting Standards Board (GASB) requirements regarding investment disclosures.

The Finance staff has established written investment procedures. These procedures include the process for projecting future cash flows, obtaining and documenting quotes,

## COUNCIL POLICY MANUAL

the review process for purchasing a new investment, how to select a broker when multiple brokers offer the same investment at the same price and other procedures relating to investments. These procedures are reviewed annually.

### **OVERSIGHT**

The Investment Committee consisting of the City Manager, the Assistant City Manager, and the Director of Finance with staff support, will meet at least annually ~~may meet as needed~~ to evaluate the portfolio performance and establish current investment strategies and allocations in accordance with the adopted Policy and its objectives.

(Adopted: RTC 85-388 (7/30/1985); Amended: RTC 86-387 (7/22/1986), 87-421 (8/11/1987), 88-379 (07-26/88), [No RTC] (7/18/1989), 90-342 (7/17/1990), 91-303 (7/23/1991), 92-370 (7/28/1992), 93-363 (7/27/1993), 94-410 (8/9/1994), 95-301 (7/25/1995), 96-300 (7/23/1996), 97-338 (7/29/1997), 98-273 (8/4/1998), 99-383 (8/17/1999), 00-320 (9/12/2000), 01-272 (7/31/2001), 02-296 (7/23/2002), 03-277 (8/12/2003), 04-290 (8/17/2004), 05-242 (8/16/05), (Clerical/clarity update, Policy Update Project 11/2005), 06-262 (8/22/06), 07-286 (8/21/2007), 08-256 (8/26/2008), 08-307 (10/14/2008) 09-213 (8/11/2009), 10-225 (8/31/2010), 11-176 (8/23/2011), 12-211 (9/11/2012), 13-252 (10/22/2013), 14-0804 (10/28/2014), 15-0864 (10/13/2015))

Lead Department: Department of Finance

## GLOSSARY OF INVESTMENT TERMS

**Agencies.** Shorthand market terminology for any obligation issued by a *government-sponsored entity (GSE)*, or a *federally related institution*. Most obligations of GSEs are not guaranteed by the full faith and credit of the US government. Examples are:

**FFCB.** The Federal Farm Credit Bank System provides credit and liquidity in the agricultural industry. FFCB issues discount notes and bonds.

**FHLB.** The Federal Home Loan Bank provides credit and liquidity in the housing market. FHLB issues discount notes and bonds.

**FHLMC.** Like FHLB, the Federal Home Loan Mortgage Corporation provides credit and liquidity in the housing market. FHLMC, also called “FreddieMac” issues discount notes, bonds and mortgage pass-through securities.

**FNMA.** Like FHLB and FreddieMac, the Federal National Mortgage Association was established to provide credit and liquidity in the housing market. FNMA, also known as “FannieMae,” issues discount notes, bonds and mortgage pass-through securities.

**GNMA.** The Government National Mortgage Association, known as “GinnieMae,” issues mortgage pass-through securities, which are guaranteed by the full faith and credit of the US Government.

**PEFCO.** The Private Export Funding Corporation assists exporters. Obligations of PEFCO are not guaranteed by the full faith and credit of the US government.

**TVA.** The Tennessee Valley Authority provides flood control and power and promotes development in portions of the Tennessee, Ohio, and Mississippi River valleys. TVA currently issues discount notes and bonds.

**Asked.** The price at which a seller offers to sell a security.

**Average Life.** In mortgage-related investments, including CMOs, the average time to expected receipt of principal payments, weighted by the amount of principal expected.

**Banker’s Acceptance.** A money market instrument created to facilitate international trade transactions. It is highly liquid and safe because the risk of the trade transaction is transferred to the bank which “accepts” the obligation to pay the investor.

**Benchmark.** A comparison security or portfolio. A performance benchmark is a partial market index, which reflects the mix of securities allowed under a specific investment policy.

**Bid.** The price at which a buyer offers to buy a security.

**Broker.** A broker brings buyers and sellers together for a transaction for which the broker receives a commission. A broker does not sell securities from his own position.

**Callable.** A callable security gives the issuer the option to call it from the investor prior to its maturity. The main cause of a call is a decline in interest rates. If interest rates decline since an issuer issues securities, it will likely call its current securities and reissue them at a lower rate of interest. Callable securities have reinvestment risk as the investor may receive its principal back when interest rates are lower than when the investment was initially made.

**Certificate of Deposit (CD).** A time deposit with a specific maturity evidenced by a certificate. Large denomination CDs may be marketable.

**Collateral.** Securities or cash pledged by a borrower to secure repayment of a loan or repurchase agreement. Also, securities pledged by a financial institution to secure deposits of public monies.

**Collateralized Mortgage Obligations (CMO).** Classes of bonds that redistribute the cash flows of mortgage securities (and whole loans) to create securities that have different levels of prepayment risk, as compared to the underlying mortgage securities.

**Commercial Paper.** The short-term unsecured debt of corporations.

**Cost Yield.** The annual income from an investment divided by the purchase cost. Because it does not give effect to premiums and discounts which may have been included in the purchase cost, it is an incomplete measure of return.

**Coupon.** The rate of return at which interest is paid on a bond.

**Credit Risk.** The risk that principal and/or interest on an investment will not be paid in a timely manner due to changes in the condition of the issuer.

**Current Yield.** The annual income from an investment divided by the current market value. Since the mathematical calculation relies on the current market value rather than the investor's cost, current yield is unrelated to the actual return the investor will earn if the security is held to maturity.

**Dealer.** A dealer acts as a principal in security transactions, selling securities from and buying securities for his own position.

**Debenture.** A bond secured only by the general credit of the issuer.

**Delivery vs. Payment (DVP).** A securities industry procedure whereby payment for a security must be made at the time the security is delivered to the purchaser's agent.

**Derivative.** Any security that has principal and/or interest payments which are subject to uncertainty (but not for reasons of default or credit risk) as to timing and/or amount, or any security which represents a component of another security which has been separated from other components ("Stripped" coupons and principal). A derivative is also defined as a financial instrument the value of which is totally or partially derived from the value of another instrument, interest rate, or index.

**Discount.** The difference between the par value of a bond and the cost of the bond, when the cost is below par. Some short-term securities, such as T-bills and banker's acceptances, are known as **discount securities**. They sell at a discount from par, and return the par value to the investor at maturity without additional interest. Other securities, which have fixed coupons, trade at a discount when the coupon rate is lower than the current market rate for securities of that maturity and/or quality.

**Diversification.** Dividing investment funds among a variety of investments to avoid excessive exposure to any one source of risk.

**Duration.** The weighted average time to maturity of a bond where the weights are the present values of the future cash flows. Duration measures the price sensitivity of a bond to changes in interest rates. (See modified duration).

**Federal Funds Rate.** The rate of interest charged by banks for short-term loans to other banks. The Federal Reserve Bank through open-market operations establishes it.

**Federal Open Market Committee.** A committee of the Federal Reserve Board that establishes monetary policy and executes it through temporary and permanent changes to the supply of bank reserves.

**Haircut.** The margin or difference between the actual market value of a security and the value assessed by the lending side of a transaction (i.e. a repo).

**Leverage.** Borrowing funds in order to invest in securities that have the potential to pay earnings at a rate higher than the cost of borrowing.

**Liquidity.** The speed and ease with which an asset can be converted to cash.

**Make Whole Call.** A type of call provision on a bond that allows the issuer to pay off the remaining debt early. Unlike a call option, with a make whole call provision, the issuer makes a lump sum payment that equals the net present value (NPV) of future coupon payments that will not be paid because of the call. With this type of call, an investor is compensated, or "made whole."

**Margin.** The difference between the market value of a security and the loan a broker makes using that security as collateral.

**Market Risk.** The risk that the value of securities will fluctuate with changes in overall market conditions or interest rates.

**Market Value.** The price at which a security can be traded.

**Marking to Market.** The process of posting current market values for securities in a portfolio.

**Maturity.** The final date upon which the principal of a security becomes due and payable.

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

**Modified Duration.** The percent change in price for a 100 basis point change in yields. Modified duration is the best single measure of a portfolio's or security's exposure to market risk.

**Money Market.** The market in which short-term debt instruments (Tbills, discount notes, commercial paper, and banker's acceptances) are issued and traded.

**Mortgage Pass-Through Securities.** A securitized participation in the interest and principal cash flows from a specified pool of mortgages. Principal and interest payments made on the mortgages are passed through to the holder of the security.

**Mutual Fund.** An entity which pools the funds of investors and invests those funds in a set of securities which is specifically defined in the fund's prospectus. Mutual funds can be invested in various types of domestic and/or international stocks, bonds, and money market instruments, as set forth in the individual fund's prospectus. For most large, institutional investors, the costs associated with investing in mutual funds are higher than the investor can obtain through an individually managed portfolio.

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

**Prepayment Speed.** A measure of how quickly principal is repaid to investors in mortgage securities.

**Prepayment Window.** The time period over which principal repayments will be received on mortgage securities at a specified prepayment speed.

**Primary Dealer.** A financial institution (1) that is a trading counterparty with the Federal Reserve in its execution of market operations to carry out U.S. monetary policy, and (2) that participates for statistical reporting purposes in compiling data on activity in the U.S. Government securities market.



**Prudent Person (Prudent Investor) Rule.** A standard of responsibility which applies to fiduciaries. In California, the rule is stated as “Investments shall be managed with the care, skill, prudence and diligence, under the circumstances then prevailing, that a prudent person, acting in a like capacity and familiarity with such matters, would use in the conduct of an enterprise of like character and with like aims to accomplish similar purposes.”

**Realized Yield.** The change in value of the portfolio due to interest received and interest earned and realized gains and losses. It does not give effect to changes in market value on securities, which have not been sold from the portfolio.

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

**Repurchase Agreement (RP, Repo).** Short-term purchases of securities with a simultaneous agreement to sell the securities back at a higher price. From the seller’s point of view, the same transaction is a reverse repurchase agreement.

**Safekeeping.** A service to bank customers whereby securities are held by the bank in the customer’s name.

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

**Supranational Debt.** Supranational debt is the term for debt (unsecured unsubordinated obligations issued or unconditionally guaranteed) of an international or multi-lateral financial agency. Supranationals are well capitalized and in most cases have strong credit support from contingent capital calls from their member countries. CGC 53601 was amended effective January 1, 2015 to allow local agencies to invest in the senior debt obligations of three supranational issuers which are eligible for purchase and resale within the United States, specifically the International Bank for Reconstruction and Development, International Finance Corporation, and Inter-American Development Bank.

**Total Rate of Return.** A measure of a portfolio’s performance over time. It is the internal rate of return, which equates the beginning value of the portfolio with the ending value; it includes interest earnings, realized and unrealized gains, and losses in the portfolio.

**U.S. Treasury Obligations.** Securities issued by the U.S. Treasury and backed by the full faith and credit of the United States. Treasuries are considered to have no credit risk, and are the benchmark for interest rates on all other securities in the US and overseas. The Treasury issues both discounted securities and fixed coupon notes and bonds.

**Treasury Bills.** All securities issued with initial maturities of one year or less are issued as discounted instruments, and are called Treasury bills. The Treasury currently issues three- and six-month Tbills at regular weekly auctions. It also issues “cash management” bills as needed to smooth out cash flows.

## COUNCIL POLICY MANUAL

**Treasury Notes.** All securities issued with initial maturities of two to ten years are called Treasury notes, and pay interest semi-annually.

**Treasury Bonds.** All securities issued with initial maturities greater than ten years are called Treasury bonds. Like Treasury notes, they pay interest semi-annually.

**Volatility.** The rate at which security prices change with changes in general economic conditions or the general level of interest rates.

**Yield to Maturity.** The annualized internal rate of return on an investment which equates the expected cash flows from the investment to its cost.