

CITY COUNCIL POLICY CITY OF NATIONAL CITY

TITLE: Investments	POLICY #203
ADOPTED: October 23, 1990	AMENDED: June 21, 2022

I. INTRODUCTION

The City of National City's investment program will conform to federal, state, and other legal requirements, including California Government Code Sections 16429.1-16429.4, 53600-53609, and 53630-53686. The following investment policy addresses the methods, procedures, and practices which must be exercised to ensure effective and judicious fiscal and investment management of the City's funds. It is the policy of the City to invest public funds in a manner that will provide a market rate of return, given its requirements for preserving principal and meeting the daily cash flow demands of the City. All investments will comply with this Investment Policy and governing laws.

This Investment Policy replaces any previous Investment Policy or Investment Procedures of the City.

II. SCOPE

This Investment Policy applies to all the City's financial assets and investment activities with the following exception(s):

Proceeds of debt issuance shall be invested in accordance with the City's general investment philosophy as set forth in this policy; however, such proceeds are invested in accordance with permitted investment provisions of their specific bond indentures.

Pooling of Funds: 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.

III. GENERAL OBJECTIVES

The overriding objectives of the investment program are to preserve principal, provide sufficient liquidity, and manage investment risks.

1. *Safety:* Safety of principal is the foremost objective of the investment program. Investments will be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate credit risk and interest rate risk.
2. *Liquidity:* The investment portfolio will remain sufficiently liquid to meet all operating requirements

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3. *Return:* The investment portfolio will be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints for safety and liquidity needs.

IV. PRUDENCE, INDEMNIFICATION, AND ETHICS

- A. *Prudent Investor Standard:* Management of the City's investments is governed by the Prudent Investor Standard as set forth in California Government Code Section 53600.3:

"...all governing bodies of local agencies or persons authorized to make investment decisions on behalf of those local agencies investing public funds pursuant to this chapter 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 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 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."

- B. *Indemnification:* The Administrative Services Director or City Manager designee hereinafter designated as Financial Services Officer and other authorized persons responsible for managing City funds, acting in accordance with written procedures and the Investment Policy and exercising due diligence, will be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported within 30 days and appropriate action is taken to control adverse developments.

- C. *Ethics:* Officers and employees involved in the investment process will 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.

V. DELEGATION OF AUTHORITY

- A. Authority to manage the City's investment program is derived from California Government Code Section 53600 *et seq.* The City Council is responsible for the City's cash management, including the administration of this Investment Policy. Management responsibility for the cash management of City funds is hereby delegated to the Administrative Services Director and/or Financial Services Officer.

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The Administrative Services Director or designee will be responsible for all transactions undertaken and will establish a system of procedures and controls to regulate the activities of subordinate employee.

B. The City may engage the services of one or more external investment managers to assist in the management of the City's investment portfolio in a manner consistent with the City's objectives. Such external managers may be granted discretion to purchase and sell investment securities in accordance with this Investment Policy. Such managers must be registered under the Investment Advisers Act of 1940.

VI. AUTHORIZED FINANCIAL INSTITUTIONS, DEPOSITORIES, AND BROKER/DEALERS

A list will be maintained of financial institutions and depositories authorized to provide investment services. In addition, a list will be maintained of approved security broker/dealers selected by conducting a process of due diligence described in the investment procedures manual. These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).

A. The City's Administrative Services Director or designee will determine which financial institutions are authorized to provide investment services to the City. Institutions eligible to transact investment business with the City include:

1. Primary government dealers as designated by the Federal Reserve Bank;
2. Nationally or state-chartered banks;
3. The Federal Reserve Bank; and
4. Direct issuers of securities eligible for purchase.

B. Selection of financial institutions and broker/dealers authorized to engage in transactions with the City will be at the sole discretion of the City.

C. All financial institutions which desire to become qualified bidders for investment transactions (and which are not dealing only with the investment adviser) must supply the Administrative Services Director or designee with a statement certifying that the institution has reviewed California Government Code Section 53600 *et seq.* and the City's Investment Policy.

D. Selection of broker/dealers used by an external investment adviser retained by the City will be at the sole discretion of the investment adviser.

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E. Public deposits will be made only in qualified public depositories as established by State law. Deposits will be insured by the Federal Deposit Insurance Corporation, or, to the extent the amount exceeds the insured maximum, will be collateralized in accordance with State law.

VII. DELIVERY, SAFEKEEPING AND CUSTODY, AND COMPETITIVE TRANSACTIONS

A. *Delivery-versus-payment*: Settlement of all investment transactions will be completed using standard delivery-vs.-payment procedures.

B. *Third-party safekeeping*: 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 will be held in safekeeping by a third party bank custodian, acting as agent for the City under the terms of a custody agreement executed by the bank and the City.

C. *Competitive transactions*: All investment transactions will be conducted on a competitive basis which can be executed through a bidding process involving at least three separate brokers/financial institutions or through the use of a nationally recognized trading platform.

VIII. AUTHORIZED AND SUITABLE INVESTMENTS

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

1. **Municipal Bonds**. These include bonds of the City, the State of California, any other municipality, within the state of California. The bonds will be registered in the name of the City or held under a custodial agreement at a bank.

- a. Are rated in the category of "A" or better by at least two nationally recognized statistical rating organizations; and
- b. No more than 5% per issuer.
- c. No more than 30% of the total portfolio may be invested in municipal bonds.

2. **US Treasury** and other government obligations for which the full faith and credit of the United States are pledged for the payment of principal and interest. There are no limits on the dollar amount or percentage that the City may invest in US Treasuries.

3. **Federal Agency or United States government-sponsored enterprise obligations, participations, or other instruments**, including those issued by or fully guaranteed as to

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principal and interest by federal agencies or United States government-sponsored enterprises. There are no limits on the dollar amount or percentage that the City may invest in government-sponsored enterprises.

4. **Banker's acceptances**, provided that:

- a. They are issued by institutions with short term debt obligations rated "A1" or higher, or the equivalent, by at least two nationally recognized statistical-rating organizations (NRSRO); and have long-term debt obligations which are rated "A" or higher by at least two nationally recognized statistical rating organizations;
- b. The maturity does not exceed 180 days; and
- c. No more than 40% of the total portfolio may be invested in banker's acceptances and no more than 5% per issuer.

5. **Federally insured time deposits** (Non-negotiable certificates of deposit) in state or federally chartered banks, savings and loans, or credit unions, provided that:

- a. The amount per institution is limited to the maximum covered under federal insurance; and
- b. The maturity of such deposits does not exceed 5 years.

6. **Certificate of Deposit Placement Service (CDARS)**

- a. No more than 30% of the total portfolio may be invested in a combination of certificates of deposit including CDARS
- b. The maturity of CDARS deposits does not exceed 5 years.

7. **Negotiable certificates of deposit (NCDs)**, provided that:

- a. They are issued by institutions which have long-term obligations which are rated "A" or higher by at least two nationally recognized statistical rating organizations; and/or have short term debt obligations rated "A1" or higher, or the equivalent, by at least two nationally recognized statistical rating organizations;
- b. The maturity does not exceed 5 years; and
- c. No more than 30% of the total portfolio may be invested in NCDs and no more than 5% per issuer.

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

- a. The maturity does not exceed 270 days from the date of purchase;
- b. The issuer is a corporation organized and operating in the United States with assets in excess of \$500 million;
- c. They are issued by institutions whose short term obligations are rated "A-1" or higher, or the equivalent, by at least two nationally recognized statistical rating organizations; and whose long-term obligations are rated "A" or higher by at least two nationally recognized statistical rating organizations; and
- d. No more than 25% of the portfolio is invested in commercial paper and no more than 5% per issuer.

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

- a. The City may invest up to the maximum permitted amount in LAIF; and
- b. LAIF's investments in instruments prohibited by or not specified in the City's policy do not exclude it from the City's list of allowable investments, provided that the fund's reports allow the Administrative Services Director or Financial Services Officer or designee to adequately judge the risk inherent in LAIF's portfolio.

10. **Local government investment pools.**

- a. San Diego County Investment Pool

11. **Corporate medium term notes (MTNs)**, provided that:

- a. Such notes have a maximum maturity of 5 years;
- b. 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;
- c. Are rated "A" category or better by at least two nationally recognized statistical rating organizations; and
- d. Holdings of medium-term notes may not exceed 30% of the portfolio and no more than 5% per issuer.

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12. Mortgage pass-through securities, asset-backed securities, and collateralized mortgage obligations,^[AS1] provided that such securities:

- ,
- a. Have a maximum stated final maturity of 5 years.
 - b. Be rated in a rating category of “AA” or its equivalent or better by a nationally recognized statistical rating organization.
 - c. Purchase of securities authorized by this subdivision may not exceed 20% of the portfolio.

13. Money market mutual funds that are registered with the Securities and Exchange Commission under the Investment Company Act of 1940:

- a. Provided that such funds meet either of the following criteria:
 1. Attained the highest ranking or the highest letter and numerical rating provided by not less than two nationally recognized statistical rating organizations; or,
 2. 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.
- b. Purchase of securities authorized by this subdivision may not exceed 20% of the portfolio.

14. Supranationals, provided that:

- a. Issues are US 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.
- b. The securities are rated in a category of “AA” or higher by a NRSRO.
- c. No more than 30% of the total portfolio may be invested in these securities.
- d. No more than 10% of the portfolio may be invested in any single issuer.

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- e. The maximum maturity does not exceed five (5) years.

IX. PORTFOLIO RISK MANAGEMENT

A. The following are prohibited investment vehicles and practices:

1. State law notwithstanding, any investments not specifically described herein are prohibited, including, but not limited to futures and options.
2. In accordance with California 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. Under a provision sunsetting on January 1, 2026, securities backed by the U.S. Government that could result in a zero- or negative-interest accrual if held to maturity are permitted.^[AS2]
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. The use of reverse repurchase agreements, securities lending or any other form of borrowing or leverage is prohibited.
7. The purchase of foreign currency denominated securities is prohibited.

B. Mitigating credit risk in the portfolio

Credit risk 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. The City will mitigate credit risk by adopting the following strategies:

1. The diversification requirements included in Section IX are designed to mitigate credit risk in the portfolio;
2. No more than 5% of the total portfolio may be invested in securities of any single issuer, except as noted in Section VIII of this Investment Policy;
3. 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

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4. If securities owned by the City are downgraded by either Moody's or S&P to a level below the quality required by this Investment Policy, it will be the City's policy to review the credit situation and make a determination as to whether to sell or retain such securities in the portfolio.
 - a. If a security is downgraded, the Administrative Services Director or designee will use discretion in determining whether to sell or hold the security based on its current maturity, the economic outlook for the issuer, and other relevant factors.
 - b. If a decision is made to retain a downgraded security in the portfolio, its presence in the portfolio will be monitored and reported monthly to the City Council.

C. Mitigating market risk in the portfolio

Market risk is the risk that the portfolio value will fluctuate due to changes in the general level of interest rates. The City recognizes that, over time, longer-term portfolios have the potential to achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The City will mitigate market risk by providing adequate liquidity for short-term cash needs, and by making longer-term investments only with funds that are not needed for current cash flow purposes. The City further recognizes that certain types of securities, including variable rate securities, securities with principal pay-downs prior to maturity, and securities with embedded options, 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:

1. The City will maintain a minimum of three months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements;
2. The maximum percent of callable securities (does not include "make whole call" securities as defined in the Glossary) in the portfolio will be 20%;
3. The maximum stated final maturity of individual securities in the portfolio will be five years, except as otherwise stated in this policy; and
4. The duration of the portfolio will at all times be approximately equal to the duration (typically plus or minus 20%) of a Market Benchmark Index selected by the City based on the City's investment objectives, constraints and risk tolerances. The City's current Benchmark will be documented in the investment procedures manual.

X. INVESTMENT OBJECTIVES (PERFORMANCE STANDARDS AND EVALUATION)

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A. Overall objective: The investment portfolio will be designed with the overall objective of obtaining a total rate of return throughout economic cycles, commensurate with investment risk constraints and cash flow needs.

B. Specific objective: The investment performance objective for the portfolio will be to earn a total rate of return over a market cycle which is approximately equal to the return on the Market Benchmark Index as described in the City's investment procedures manual.

XI. PROCEDURES AND INTERNAL CONTROLS

A. Procedures: The Director of Administrative Services or designee will establish written investment policy procedures in a separate investment procedures manual to assist investment staff with day-to-day operations of the investment program consistent with this policy. Such procedures will include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Director of Administrative Services or designee.

B. Internal Controls: The Director of Administrative Services or designee is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft, or misuse. The internal control structure will be designed to provide reasonable assurance that these objectives are met. Internal controls will be in the City's investment procedures manual.

XII. REPORTING AND REVIEW

A. Monthly reports: The Director of Finance and/or Financial Services Officer must submit a monthly report to the legislative body accounting for transactions made during the reporting period.

B. Quarterly reports: Quarterly investment reports will be submitted by the Administrative Services Director or designee to the City Council, at an agenda meeting. Consistent with the requirements contained in California Government Code Section 53646, information in the quarterly investment reports shall include, but not be limited to, the following:

1. Type of investment
2. Name of issuer and/or financial institution
3. Date of purchase
4. Date of maturity
5. Current market value for all securities
6. Rate of interest
7. Purchase price of investment
8. Other data as required by the City

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C. Annual Policy review: The Investment Policy will be reviewed at least annually and, as necessary, adopted, 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.

Related Policy References

California Government Code Sections: 16429.1 – 16429.4, and 53600 – 53609 and 53630-53686
Investment Company Act of 1940
Investment Advisers Act of 1940
Securities and Exchange Commission Rule #15C3-1
Appendix I attached: “Authorized Personnel”
Appendix II attached: “Glossary of Investment Terms”

Prior Policy Amendments

October 23, 1990 – Established Policy
May 9, 1995 (Resolution No. 95-62) Updated Policy and Inclusion in the Policy Manual and Amend policy adopted October 23, 1990
August 6, 1996 (Resolution No. 96-130)
August 26, 1997 (Resolution No. 97-110)
October 6, 1998 (Resolution No. 98-136)
September 7, 1999 (Resolution No. 99-130)
October 2, 2001 (Resolution No. 2001-151)
October 1, 2002 (Resolution No. 2002-149)
October 7, 2003 (Resolution No. 2003-139)
June 7, 2005 (Resolution No. 2005-118)
October 4, 2005 (Resolution No. 2005-215)
August 21, 2007 (Resolution No. 2007-202)
February 19, 2008 (Resolution No. 2008-37)
February 19, 2008 (Resolution No. 2008-38) CDC
January 10, 2012 (Resolution No. 2012-09)
December 10, 2013 (Resolution No. 2013-189)
December 16, 2014 (Resolution No. 2014-172)
December 15, 2015 (Resolution No. 2015-186)
December 6, 2016 (Resolution No. 2016-189)
October 17, 2017 (Resolution No. 2017-203)
November 20, 2018 (Resolution No. 2018-189)
August 18, 2020 (Resolution No. 2020-151)

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Appendix I

Authorized Personnel

The following positions are authorized to transact investment business and wire funds for investment purposes on behalf of the City of National City:

City Manager
Assistant City Manager
Financial Services Officer
Director of Administrative Services or designee

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Appendix II 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:

FDIC. The Federal Deposit Insurance Corporation provides insurance backed by the full faith and credit of the US government to certain bank deposits and debt obligations.

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 “Freddie Mac” issues discount notes, bonds and mortgage pass-through securities.

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

GNMA. The Government National Mortgage Association, known as “Ginnie Mae,” 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.

Asset-Backed Securities. Securities supported by pools of installment loans or leases or by pools of revolving lines of credit.

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

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rate of interest. Callable securities have reinvestment risk as the investor may receive its principal back when 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

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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.

Local Agency Investment Fund (LAIF). A voluntary investment fund managed by the California State Treasurer's Office open to government entities and certain non-profit organizations in California.

Local Government Investment Pool. Investment pools including the Local Agency Investment Fund (LAIF), county pools, joint powers authorities (JPAs). These funds are not subject to the same SEC rules applicable to money market mutual funds.

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 either on a continuous or an intermittent basis. MTNs are highly flexible debt instruments that can be structured to respond to market opportunities or to investor preferences.

Modified duration. The percent change in price for a 100 basis point change in yields. 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 (T-bills, 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.

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Municipal Securities. Securities issued by state and local agencies to finance capital and operating expenses.

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.

Nationally Recognized Statistical Rating Organization (NRSRO). A credit rating agency the United States Securities and Exchange Commission uses for regulatory purposes. Credit rating agencies provide assessments of an investment's risk. The issuers of investments, especially debt securities, pay credit rating agencies to provide them with ratings. The three most prominent NRSROs are Fitch, S&P, and Moody's.

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 US monetary policy, and (2) that participates for statistical reporting purposes in compiling data on activity in the US Government securities market.

Prudent person (man) 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 familiar 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.

Short Term. Less than one (1) years' time.

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

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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. A Supranational is a multi-national organization whereby member states transcend national boundaries or interests to share in the decision making to promote economic development in the member countries.

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.

US Treasury obligations. Securities issued by the US 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 T-bills at regular weekly auctions. It also issues “cash management” bills as needed to smooth out cash flows.

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.

Value. Principal plus accrued interest.

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.