

SAN BERNARDINO MUNICIPAL WATER DEPARTMENT

POLICIES & PROCEDURES MANUAL

POLICY 10.120 - INVESTMENT POLICY

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Approved by the Board 4/10/18 Resolution No. 926

1. POLICY:

It is the policy of the City of San Bernardino Municipal Water Department to invest public funds in a manner which provide the highest investment return with the maximum security, while meeting all cash flow demands. Investments will be made in conformity to the California Government Code, Sections 53601 through 53659 and approved by the Board of Water Commissioners of the City of San Bernardino.

2. SCOPE

This investment policy applies to the proceeds received from the settlement of *State of California Department of Toxic Substance Control v. United States Department of the Army, United States District Court Case No. 96-5205-MRP* consolidated with *City of San Bernardino Municipal Water Department v. United States Department of the Army, United States District Court Case No. 96-8867-MRP*. This Policy is in lieu of any other City policy. In the event of any conflict between this policy and any other policy, this policy shall control.

3. PRUDENCE

Investments shall be made with judgement and care - under circumstances then prevailing - which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

1.1. The standard of prudence to be used shall be the "prudent investor" standard and shall be applied in the context of managing an overall portfolio. Investment

officers acting in accordance with this Investment Policy and the Investment Management Procedures and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments.

- 1.2. It is the Municipal Water Department's full intent, at the time of purchase, to hold all investments until maturity to ensure the return of all invested principal dollars.

4. OBJECTIVES

Pursuant to Government Code Section 53600.5 which states "When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, the primary objective of a trustee shall be to safeguard the principal of the funds under its control. The secondary objective shall be to meet the liquidity needs of the depositor. The third objective shall be to achieve a return on the funds under its control."

1.3. Safety

Safety of principal is the foremost objective of the City of San Bernardino Municipal Water Department. Each investment transaction shall seek to ensure that capital losses are avoided, whether from securities default, broker-dealer default or erosion of market values. To attain this objective, the City of San Bernardino Municipal Water Department shall seek to preserve principal by mitigating credit risk and market risk.

1.4. Liquidity

The City of San Bernardino Municipal Water Department's investment portfolio will remain sufficiently liquid to enable the Water Department to meet all cash flow requirements which might be reasonably anticipated.

1.5. Yield

The Water Department's investment portfolio shall be designated with the objective of attaining a market rate

of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The cores of investments are limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall not be sold prior to maturity with the following exceptions:

- A security with declining credit may be sold early to minimize loss of principal.
- A security swap would improve the quality, yield or target duration in the portfolio.
- Liquidity needs of the portfolio require that the security be sold.

5. DELEGATION OF AUTHORITY

Authority to manage the City of San Bernardino Municipal Water Department's investment program is hereby granted to the City Treasurer. Responsibility for the operation of the investment program is delegated by the City Treasurer to the Municipal Water Department's Director of Administration and Finance, who shall act in accordance with established written procedures and internal controls for the operation of the investment program consistent with this Investment Policy.

1.6. Investment Procedures

Procedures should include reference to safekeeping, wire transfer agreements, banking service contracts, and collateral/depository agreements. Such procedures shall 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.

6. ETHICS AND CONFLICTS OF INTEREST

Employees involved in the investment process shall refrain from personal business activity that conflicts with proper execution of the investment program, or impairs their ability to make impartial investment decisions. Employees shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that

could be related to the performance of the investment portfolio. Employees shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the City of San Bernardino Municipal Water Department.

7. SELECTION OF FINANCIAL SERVICES PROVIDERS

1.7. Selection of Trustees and Investment Advisors

The Municipal Water Department may utilize the services of Trustees and Investment Advisors. As it deems necessary, the Municipal Water Department will select Trustees and Investment Advisors through a competitive process. An annual review of any selected financial service providers will be conducted by the Director of Finance.

1.8. Selection of Broker/Dealers

Should broker/dealer services be needed, a list will be maintained of broker/dealers authorized to provide investment services. To the extent practicable, the Department shall endeavor to complete investment transactions using a competitive bid process whenever possible. These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1.

All broker/dealers who desire to become qualified bidders for investment transactions must supply the following:

- (1) Audited financial statements
- (2) Proof of Financial Industry Regulatory Authority (FINRA) certification
- (3) Proof of State registration
- (4) Certification of having read the City of San Bernardino Municipal Water Department's Investment Policy, Investment Management Procedures and depository contracts, and the California Government Code, Section 53600 *et seq.*

An annual review of the financial condition and registration of all broker/dealers qualified to be on the list will be conducted by the Director of Administration and Finance.

If the Department has an investment advisor, the investment advisor may use its own list of authorized broker/dealers to conduct transactions on behalf of the Department.

8. AUTHORIZED AND SUITABLE INVESTMENTS

The City of San Bernardino Municipal Water Department is authorized by Government Code Section 53601 to invest in the following securities, as of the date of this policy. Percentage holding limits listed in this section apply at the time the security is purchased.

- (1) United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.
 - Maximum allowable portfolio percentage: 100%.
- (2) Federal agency or United States government-sponsored enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises, including callables.
- (3) **There is no percentage limitation of the portfolio which can be invested in this category. No more than 25% of the portfolio may be invested in any single agency/government-sponsored enterprise issuer.**

Bills of exchange or time drafts drawn on and accepted by a commercial bank, otherwise known as bankers acceptances.

- Purchases of banker's acceptances may not exceed 180 days to maturity nor exceed 40% of the Municipal Water Department's money, which may be invested pursuant to this section. However, no more than 5% of the Municipal Water Department's money may be invested in the bankers acceptances of any one commercial bank pursuant to this section. Bankers Acceptances must be issued by institutions which have short-term debt obligations rated "A-1" or its equivalent or better by at least one NRSRO; or long-term debt obligations which

are rated in a rating category of "A" or its equivalent or better by at least one NRSRO.

- (4) Commercial paper of "prime" quality of the highest ranking or of the highest letter and numerical rating as provided for by at least one NRSRO and issued by corporations which have long-term obligations rated in a rating category of "A" or its equivalent or better by at least one NRSRO. The issuer must be a corporation organized and operating in the United States with assets in excess of \$500 million.
 - Purchases of eligible commercial paper may not exceed 25% of the Water Department's money. Eligible commercial paper shall have a maximum maturity of 270 days. In addition, the Water Department may purchase no more than 10% of the outstanding commercial paper of any single issuer. No more than 5% of the portfolio may be invested in any single issuer.
- (5) Negotiable certificates of deposit issued by a nationally or state-chartered bank, a savings association or federal association, a state or federal credit union, or by a federally- or state-licensed branch of a foreign bank.
 - Purchases of negotiable certificates of deposit may not exceed 30% of the Municipal Water Department's money which may be invested pursuant to this section. No more than 5% of the portfolio may be invested in any single issuer.
- (6) Time deposits, non-negotiable and collateralized in accordance with the California Government Code, may be purchased through banks or savings and loan associations.
 - No more than 25% of the Municipal Water Department's money may be invested in time deposits.
 - Medium-term notes, defined as all corporate and depository institution debt securities 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. Securities eligible for investment shall be rated in a rating category of "AA" or its equivalent or better by at least one NRSRO. Purchases of medium-term notes may not exceed 30% of the Municipal Water Department's money that may be invested pursuant to this section. No more than 5% of the

market value of the portfolio may be invested in notes issued by one corporation. Commercial paper holdings should also be included when calculating the 5% limitation.

- (7) Any mortgage pass-through security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable pass-through certificate, or consumer receivable-backed bond having an "A" or higher rating for the issuer's debt by at least one NRSRO and rated in a rating category of "AA" or equivalent or better by at least one NRSRO.
 - Purchase of securities authorized by this section may not exceed 20% of the Municipal Water Department's money. No more than 5% of the portfolio may be invested in any single Asset-Backed or Commercial Mortgage security issuer. There is no issuer limitation on any Mortgage security where the issuer is the US Treasury or a Federal Agency/GSE.
- (8) Various daily cash funds including short-term money market accounts administered for or by trustees, paying agents and custodian banks contracted by the City of San Bernardino Municipal Water Department may be purchased as allowed under State of California Government Code.
- (9) Obligations of the State of California or any local agency within the state, including bonds payable solely out of revenues from a revenue producing property owned, controlled or operated by the state or any local agency, or by a department, board, agency or authority of the state or any local agency. The securities must be rated in a rating category of "A" or its equivalent or better by at least one nationally recognized statistical rating organization ("NRSRO"). No more than 5% of the portfolio may be invested in any single issuer. No more than 30% of the portfolio may be in Municipal Securities described in this section 8.(10) and 8.(11) combined.
- (10) Registered treasury notes or bonds of any of the other 49 states in addition to California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state, or by a department, board, agency, or authority of any of these states. The securities must be rated in a rating category of "A" or its equivalent or better by at least one nationally recognized statistical rating organization

("NRSRO"). No more than 5% of the portfolio may be invested in any single issuer. No more than 30% of the portfolio may be in Municipal Securities described in section 8.(10) and this section 8.(11) combined.

- (III) Supranationals which are United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development (IBRD), International Finance Corporation (IFC), or Inter-American Development Bank (IADB), with a maximum remaining maturity of five years or less, and eligible for purchase and sale within the United States. Investments under this subdivision shall be rated at least "AA" or its equivalent by a NRSRO.
- Purchases of supranationals may not exceed 30% of the Municipal Water Department's money which may be invested pursuant to this section. No more than 10% of the portfolio may be invested in any single issuer.
- (12) Mutual Funds and Money Market Mutual Funds that are registered with the Securities and Exchange Commission under the Company Act of 1940, provided that:
- a. Mutual Funds that invest in the securities and obligations as authorized under California Government Code, Section 53601 (a) to (k) and (m) to (q) inclusive and that meet either of the following criteria:
 1. Attained the highest ranking or the highest letter and numerical rating provided by not less than two (2) NRSROs; 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 and with assets under management in excess of \$500 million.
 3. No more than 10% of the total portfolio may be invested in shares of any one mutual fund.
 - b. Money Market Mutual Funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940 and issued by diversified

management companies and meet either of the following criteria:

1. Have attained the highest ranking or the highest letter and numerical rating provided by not less than two (2) NRSROs; 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 managing money market mutual funds with assets under management in excess of \$500 million.
3. No more than 20% of the total portfolio may be invested in Money Market Mutual Funds.

c. No more than 20% of the total portfolio may be invested in these securities.

In addition to the above, the City of San Bernardino Municipal Water Department is hereby authorized to invest in:

(A) Any security guaranteed by, or supported by a pledge of any of the above listed securities (see (1) through (9) above).

(B) A collateralized "Guaranteed Investment Contract"

- A "Guaranteed Investment Contract" is defined as a contract in which an insurance company or an affiliate thereof guarantees to return the principal and interest to the Municipal Water Department on a series of specified dates and at specified rates of interest.

The State of California managed investment pool ("LAIF") or other Local Government Investment Pools, may be used up to the maximum permitted by California State law.

In the event of any changes to the California Government Code addressing permissible and allowable investments, the terms and provisions of the Government Code shall prevail.

If securities owned by the Department are downgraded by an NRSRO to a level below the quality required by this investment policy, it will be the Department's policy to review the credit situation and make a determination as to whether to sell or retain such securities in the portfolio.

• If a security is downgraded, the Director of Administration and Finance 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.

• 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 Water Board and the City Treasurer.

9. MAXIMUM MATURITIES

To the extent possible, it is prudent that the Municipal Water Department match its investments with anticipated cash flow requirements. Because the investments support a 50 year or greater obligation, it is the intention of the Municipal Water Department to hold investments with maturities in excess of 5 years, and is hereby specifically authorized to do so.

10. DIVERSIFICATION

Unless the investment is a Guaranteed Investment Contract, the investments shall be diversified by:

- Limiting investments to avoid overconcentration in securities from a specific issuer or business sector (excluding U.S. Treasury securities),
- Limiting investment in securities that have higher credit risks,
- Investing in securities with varying maturities, and
- Continuously investing a portion of the portfolio in readily available funds such as local government investment pools, money market funds or overnight repurchase agreements to ensure that appropriate liquidity is maintained in order to meet cash flow requirements.

11. SAFEKEEPING AND CUSTODY

All security transactions entered into by the Municipal Water Department shall be conducted on a delivery-versus-payment (DVP) basis. Securities will be held by a third party custodian designated by the Director of Administration and Finance and evidenced by safekeeping receipts.

12. INTERNAL CONTROLS

The Director of Administration and Finance shall establish an annual process of independent review by an external auditor.

This review will provide internal control by assuring compliance with policies and procedures.

13. PERFORMANCE EVALUATION

The investment portfolio shall be designed to attain a market-average rate of return throughout budgetary and economic cycles, taking into account the Department's risk constraints, the cash flow characteristics of the portfolio, and state and local laws, ordinances or resolutions that restrict investments.

The Director of Administration and Finance shall monitor and evaluate the portfolio's performance relative to the chosen market benchmark(s), which will be included in the Director of Administration and Finance's periodic report. The Director of Administration and Finance shall select an appropriate, readily available index to use as a market benchmark.

14. REPORTING

The Director of Administration and Finance shall prepare an investment report at least monthly, including a management summary that provides an analysis of the status of the current investment portfolio and transactions made over the last month. This management summary will be prepared in a manner which will allow the Municipal Water Department to ascertain whether investment activities during the reporting period have conformed to the Investment Policy. The report should be provided to the Water Board and the City Treasurer. The report will include the following:

- Issuer or broker/dealer (financial institution)
- A listing of individual securities held at the end of the reporting period by authorized investment category.
- Average life and final maturity of all investments listed.
- Coupon, discount or earnings rate.
- Par value, Amortized Book Value, Market Value, and source of fair market value.
- Percentage of the portfolio represented by each investment category.
- A description of the compliance with the Investment Policy.
- A description of the funds, investments and programs (including lending programs) managed by contracted parties (i.e. LAIF; investment pools, outside money managers and securities lending agents)

- Information demonstrating that the Water Department's expenditure requirements can be met in the following year.
- Other information regarding the Water Department's portfolio as appropriate.

15. INVESTMENT POLICY ADOPTION

The City of San Bernardino Municipal Water Department's Investment Policy shall be adopted by resolution of the Board of Water Commissioners and the City Council. The Policy shall be reviewed annually by the Water Board and the City Council, and as otherwise necessary. Any modifications made thereto must be approved by both the Water Board and the City Council.

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.

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 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.

CERTIFICATE OF DEPOSIT ACCOUNT REGISTRY SYSTEM (CDARS). A private placement service that allows local agencies to purchase more than \$250,000 in CDs from a single financial institution (must be a participating institution of CDARS) while still maintaining FDIC insurance coverage. CDARS is currently the only entity providing this service. CDARS facilitates the trading of deposits between the California institution and other participating institutions in amounts that are less than \$250,000 each, so that FDIC coverage is maintained.

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.

- 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 open to government entities and certain non-profit organizations in California that is managed by the State Treasurer's Office.
- LOCAL GOVERNMENT INVESTMENT POOL.** Investment pools that range from the State Treasurer's Office Local Agency Investment Fund (LAIF) to county pools, to 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 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 (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.

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 that the Securities and Exchange Commission in the United States 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.

NEGOTIABLE CD. A short-term debt instrument that pays interest and is issued by a bank, savings or federal association, state or federal credit union, or state-licensed branch of a foreign bank. Negotiable CDs are traded in a secondary market and are payable upon order to the bearer or initial depositor (investor).

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 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. 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. 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.

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 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.

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.

Policy Review

Established:	<u>8/24/2004</u>
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Minor Changes (HR) GM Approved:	<u>7/2021</u>