City of South Lake Tahoe
Investment Policy
Fiscal Year 2022-2023

I. POLICY

It is the policy of the City of South Lake Tahoe (City) to invest public funds in a manner which will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the entity and conforming to all state and local statutes governing the investment of public funds.

II. SCOPE

This investment policy applies to all financial assets of the City which are available for investment by the City's Treasurer. These funds are accounted for in the City's Comprehensive Annual Financial Report and include:

- General Fund
- Special Revenue Funds
- Debt Service Funds
- Capital Project Funds
- Enterprise Funds
- Internal Service Funds
- Fiduciary Funds

III. PRUDENCE

The standard of prudence to be used shall be the "prudent person" standard (as cited in Probate Code Section 16040) and shall be applied in the context of managing the overall portfolio, not to a single item within a diversified portfolio. Investments shall be made with judgment and care (under circumstances then prevailing) which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

IV. OBJECTIVE

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, the City will diversify its investments by investing funds among a variety of securities offering independent returns and financial institutions.

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. **Yield on Investments**: The City's investment portfolio shall be designed with the objective of attaining a benchmark rate of return throughout budgetary and economic cycles,

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

V. DELEGATION OF AUTHORITY

Authority to manage the City's investment program is derived from California Government Code 53607. Management responsibility for the investment program is hereby delegated to the City Treasurer who shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials, and their procedures in the absence of the City Treasurer.

The City Manager shall designate an official to manage investments and designate a second official to perform investment management during absences of the primary designee. The City Manager shall insure that competent investment management is maintained and shall insure that, if both designated investment officials are replaced or are simultaneously absent, any temporary replacement(s) shall be closely supervised, and indoctrinated in the requirements of this Statement of Investment Policy, and given written investment procedures, regulating the authority to invest in maturities beyond six months by means of appropriate controls and restraining requirements. The City Manager shall authorize preparation and filing of documents with all financial institutions with which the City conducts investment activities certifying the names of those persons authorized to effect trades on behalf of the City.

1. Investment Procedures: The City Treasurer shall establish written investment policy procedures for the operation of the investment program consistent with this policy. The procedures should include reference to: safekeeping, SIFMA master repurchase agreements, wire transfer agreements, banking service contracts and collateral/depository agreements. Such procedures shall include explicit delegation of authority of 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 City Treasurer.

VI. ETHICS AND CONFLICT OF INTEREST

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which would impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the City Manager any material financial interests in financial institutions that conduct business within their jurisdiction, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the City. All the City's employees who are listed on the City's Conflict of Interest Policy are required by the Fair Political Practices Commission to complete and file a Form 700 annually. All persons, broker/dealers, financial institutions and advisors providing investment services or bond issuance shall disclose to the Treasurer all fee sharing, fee-splitting, and commission arrangements with other entities or persons prior to the City agreeing to buy an investment or issue bonds.

VII. AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS

To promote the optimum yield on the investment of City funds, investment procedures shall be designed to encourage competitive bidding on transactions from approved financial institutions or broker/dealers.

1. On an annual basis, the Treasurer shall recommend a list of at least three broker/dealers who are authorized to provide investment services. The list shall be approved by the City Council. All broker/dealers who wish to be considered for the list must meet the following minimum requirements;

   1.1 Must certify that they have read and agree to comply with the investment policies of the City.
   1.2 Must be a "primary" or regional dealer that qualifies under the Securities and Exchange Commission Rule 15C3-1 (Uniform Net Capital Rule).
   1.3 Must be experienced in institutional trading practices and familiar with the California Government Code as related to investments for local governmental agencies.
   1.4 Must have been in business for at least three years.
   1.5 Must provide current audited financial statements.
   1.6 Must provide proof of Financial Industry Regulatory Authority certification.

2. All financial institutions in which the City's public funds are deposited will supply the Treasurer with the following;

   2.1 Current audited financial statements.
   2.2 Depository contracts.
   2.3 Proof that the institution is State or Federally chartered.

<u>VIII. AUTHORIZED AND SUITABLE INVESTMENTS</u>

The City is empowered by statute to invest in the following types of securities: (see Section XII for a description of each investment type)

1. Certificates of Deposit (or Time Deposits) placed with commercial banks and or savings and loan institutions.
2. Bankers' Acceptances.
3. Securities of the U.S. Government or its agencies.
4. Commercial Paper.
5. Medium-Term Corporate Notes.
6. Local Agency Investment Fund (State Pool) Demand Deposits, (LAIF).
7. Negotiable Certificates of Deposit.
8. Passbook Savings Account Demand Deposits.
9. Government Security Mutual Funds.
10. Bonds, Notes or California State and Local Agencies.
11. Bond proceeds may be invested as authorized by California Government Code 53601(m) but may also be invested in authorized investments as outlined in bond covenants and agreements.
12. Notes, Bonds and other securities of all fifty United States.
13. Supranationals

<u>Prohibited Investments</u>: The following investments are either prohibited by law or

authorized by law and prohibited by the City Treasurer. Under Provisions of California Code 53601.6 the City shall not invest any funds covered by this Investment Policy in inverse floaters, range notes, interest-only strips derived from mortgage pools or any investment that may result in a zero-interest accrual if held to maturity. Also, the City shall not invest in Reverse Repurchased Agreements and Mortgage Pass Through Securities.

IX. INVESTMENT POOLS/MUTUAL FUNDS

A thorough investigation of the pool/funds is required prior to investing, and on a quarterly basis. There shall be a questionnaire developed which will answer the following general questions:

- A description of eligible investment securities, and a written statement of investment policy and objectives.
- A description of interest calculations and how it is distributed, and how gains and losses are treated.
- A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced, and the program audited.
- A description of who may invest in the program, how often, what size deposit and withdrawal are allowed.
- A schedule for receiving statements and portfolio listings.
- Are reserves, retained earnings, etc. utilized by the pool/fund?
- A fee schedule, and when and how is it assessed.
- Is the pool/fund eligible for bond proceeds and/or will it accept such proceeds?

At this time there are no City investments in pools or mutual funds.

X. COLLATERIZATION

Collateralization will be required on two types of investments: certificates of deposit and sweep checking accounts. In order to anticipate market changes and provide a level of security for all funds, the collateralization level will be 110% of market value of principal and accrued interest.

The City chooses to limit collateral to the following: certificates of deposit and sweep checking accounting held by an independent third party with whom the entity has a current custodial agreement. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to the entity and retained. The right of collateral substitution is granted.

Collateral for other investments must be 110% of principal for government securities. and 150% of principal for first mortgages.

XI. SAFEKEEPING AND CUSTODY

All security transactions entered into by the City shall be conducted on a delivery-versus payment (DVP) basis. Securities will be held by a third-party custodian designated by the

Treasurer and evidenced by safekeeping receipts.

XII. DIVERSIFICATION

The City will diversify its investments by security type and institution in order to reduce portfolio risk while maintaining market average rates.

Security Type and Institution - U.S. Treasury securities and authorized pools, and any portfolio or institutional limits shall comply with California Government Code. Investments are further limited by specific language relating to each investment type as stated below.

Maximum Maturities - To the extent possible, the City Treasurer will attempt to match investments with anticipated cash flow requirements. The City's portfolio will be directly invested in securities with a maturity of no more than five years from the date of purchase.

The City Treasurer may invest in the following types of Investment Instruments:

1. Certificate of Deposit: Certificates of deposit or "time deposits" of up to $250,000 are federally insured. Beyond that amount, these CDs must be collateralized with the collateral held separately from the issuing institution. The value of the investment must have collateral of at least 110 percent if government securities, or collateral of at least 150 percent if mortgage-backed securities. Statute does not limit CDs, however, this Investment Policy shall limit such investments to a maximum of 25 percent of the portfolio (GC 53601(i)). In addition, time deposits shall be placed in institutions meeting all capital requirements and which maintain a rating equivalent to FDIC rating of "One" or "Two" or a Sheshunoff performance rating of A or better.

2. Bankers' Acceptances: The maximum investment with any one institution will not exceed $1.0 million. The maximum maturity will be 180 days. The maximum proportion of City funds invested in Bankers' Acceptance shall not exceed 20% of the total City portfolio. Maximum 5% invested per issuer. (Note: California Government Code allows a maximum of 40%).

3. Securities of the U.S. Government or its Agencies: Maximum maturity is five years and maximum investment is 50% of total City Portfolio.

4. Commercial Paper: Commercial paper will be used solely as a short-term investment not to exceed 270 days. Commercial paper will be 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. $2,000,000 combined any issuer, maximum 25% of City portfolio.

5. Medium-Term Corporate Notes: The City may invest in medium-term corporate notes with a maximum of five years maturity 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.

Notes shall be rated in a rating category of "A" or its equivalent or better by a nationally recognized rating service. The maximum proportion of City funds invested in Medium Term Corporate Notes shall not exceed 30% of the total City Portfolio.

6. Local Agency Investment Fund (State Pool): The investment with LAIF may not, by state regulation, exceed $75 million. LAIF transactions, by LAIF guidelines, are not to exceed 15 per month.

7. Negotiable Certificates of Deposit: The maximum maturity is five years. The maximum investment is 30% of the total City Portfolio. Maximum 5% or $1,000,000 invested per issuer. Negotiable Certificates of Deposits (NCD) shall be evaluated in terms of the credit worthiness of the issuer, as these deposits are uninsured and uncollateralized notes.

8. Passbook Savings Account Demand Deposits: This account shall be maintained solely for the following purposes:

a. Investment of amounts over $100,000.00 received too late in the day to invest in other instruments; or,

b. Investment of amounts under $100,000.00 for periods of up to ten working days in order to fine-tune cash flow and minimize LAIF transactions in a given month.

9. Government Security Mutual Funds: Shares of beneficial interest (mutual funds) issued by diversified management companies investing in securities/obligations authorized by California Government Code Section 53600, et. seq., and complying with Section 53601, are permitted investments. Section 53601(l) further defines requirements. A maximum of 20 percent of the portfolio may be so invested.

10. Bonds, Notes or other evidences of indebtedness issue by the California State and Local Agencies: Bonds issued by the local agency, including bonds payable solely out of the revenues from revenue -producing property owned, controlled, or operated by California state or local agency, or by a department, board, agency, or authority of the local agency as authorized by California Government Code 53601 (a). Notes eligible for investment shall be rated in a category of "A" or its equivalent by two Nationally Recognized Rating Organizations.

Bonds, notes, warrants, or other evidences of indebtedness of any local agency within this state, include bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority of the local agency. A maximum of 20% of the portfolio may be so invested.

11. Bond Proceeds: Section 53601 (m) allows greater flexibility with respect to the types of investments that may be made with bond proceeds. Specifically, the law permits money from bond proceeds, obligations under a lease, installment sales, or other agreements of a local agency to be invested in any security that meets the statutory provisions governing the issuance of the bond or other agreements made by the issuing agency. In doing so, this section of the code

recognizes that outstanding contracts between issuers and bond holders may not comply with the investment statutes and gives local agencies greater discretion in how to invest bond proceeds.

12. U.S. Treasury Notes and Bonds: Registered Treasury notes or bonds of all 50 United States 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 the state as authorized by California Government Code 53601 (c) and (d). Maximum maturity is five years and maximum investment is 50% of total City Portfolio.

13. Supranationals: United States 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, 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 in a rating category of "AA" or its equivalent or better by an NRSRO and shall not exceed 30 percent of the agency's moneys that may be invested pursuant to this section.

XIII. MAXIMUM MATURITIES

To the extent possible, the City will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow and authorized by the City Council, the City will not directly invest in securities maturing more than five years from the date of purchase.

CD maturities will normally not exceed five years. U.S. Government or Agency securities will not exceed five years. At least 50% of idle funds can be placed in investments which can be liquidated for at least face value in the event of an emergency. The City uses LAIF for its idle funds to insure this requirement is met.

XIV. INTERNAL CONTROL

The Treasurer 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.

The Finance department shall establish a system of internal controls, which shall be documented in writing. The controls shall be designed to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of the City. Controls deemed most important include; control of collusion, separation of duties, separating transition authority from accounting and record keeping, custodial safekeeping, clear delegation of authority, specific limitations regarding securities losses and remedial action, written confirmation of telephone transactions, minimizing the number of authorized investment officials, documentation of transactions and strategies, and ethical standards.

XV. PERFORMANCE STANDARDS

The investment portfolio will be designed to attain at least a market-average rate of return during budgetary and economic cycles. Whenever possible, and consistent with risk limitations as defined herein and prudent investment principles, the Treasurer shall seek to augment returns above the market average rate of return as shown on the average CMT (Constant Maturity Treasury) whose maturity most closely matches the average maturity of the portfolio. In addition, the City portfolio will be compared with LAIF and the goal is to maintain a higher positive annual yield than LAIF's annual yield.

1. Investment Strategy: The City's investment strategy is to buy and hold investments until maturity. However, the Treasurer may sell a security due to adverse changes in credit risk or due to unexpected cash flow needs.

2. Market Yield (Benchmark): The basis used by the Treasurer to determine whether market yields are being achieved shall be the rates of return from the following combination of indices: Local Agency Investment Fund (LAIF) and 3-month, 6-month, and 1-year Treasury Bills.

3. Review: The investment policy shall be reviewed at least annually by the City Manager and Finance Director and approved by the City Council to ensure its consistency with the overall objectives of safety (including diversification), liquidity and return, as well as its relevance to current law and financial/economic trends.

The City's philosophy prohibits speculation; i.e., the purchase of securities with the intent to profit from favorable changes in market prices or market conditions. Leveraging or borrowing money for the purpose of investing is specifically prohibited.

XVI. REPORTING

The City Treasurer shall provide investment information to City Council.

Periodic Reports – If any, the City Treasurer will provide a monthly transaction report of all investments including any pooled investment fund portfolio to the City Council, City Manager, Chief Financial Officer and City Clerk. Also, within thirty days of the end of each quarter a full report of the City's operational cash investment portfolio report will be provided with additional information such as market pricing. This report shall include the type of investment, issuer, date of maturity, par and dollar amount invested in all securities, investments and moneys held by the local agency, and shall additionally include a description of any of the local agency's funds, investments, or programs, that are under the management of contracted parties, including lending programs. With respect to all securities held by the local agency, and under management of any outside party that is not also a local agency or the State of California Local Agency Investment Fund (LAIF), the report shall also include a current market value as of the date of the report and shall include the source of this same valuation.

Annual Report – This investment policy will be presented annually following the close of the fiscal year, to the City Council for approval.

Financial Statements per GASB #31 – City Treasurer will provide the portfolio's market value gains/losses to Finance to be incorporated in the fiscal year-end balance sheet.

Financial Statements per GASB #40 – Effective June 30, 2005, additional disclosure is required. City Treasurer will provide detailed maturity and rating information to Finance to be incorporated in the Annual Comprehensive Financial Report (ACFR).

XVII. INVESTMENT POLICY ADOPTION

The City's investment policy shall be adopted by resolution of the City's legislative authority. Per Government code, the policy shall be reviewed annually by the City Council and any modifications made thereto must be approved by the City Council.

XVIII. GUIDELINES

Guidelines are established to direct and control activities in such a manner that previously established goals are achieved.

1. Investment Transactions: Every investment transaction must be authorized, documented and reviewed by the local agency Treasurer.

2. Pooled Cash: Whenever practical, local agency cash should be consolidated into one bank account and invested on a pooled concept basis. Interest earnings may be allocated to fund cash and investment balances.

3. Competitive Bids: Purchase and sale of securities should be made on the basis of competitive offers and bids when practical.

4. Cash Forecast: The cash flow for the local agency should be analyzed with the receipt of revenues and maturity of investments scheduled so that adequate cash will be available to meet disbursement requirements.

5. Investment Limitations: Security purchases and holdings shall be maintained within statutory limits imposed by the Investment Policy and California Government code. Any investments not listed are not subject to % limitations.

Bankers' Acceptance	40%	Code Section 53601 (f)
Commercial Paper	25%	Code Section 53601 (g)
Medium-Term Corporate Notes	30%	Code Section 53601 (j)
Negotiable Cert. Of Deposit	30%	Code Section 53601 (h)

6. Liquidity: The marketability (salability) of a security should be considered at the time of purchase as the security may have to be sold at a later date to meet unanticipated cash demand.

7. Long-Term Maturities: As a general rule, long-term maturities should not represent a significant percentage of the total portfolio, as the principal risk involved can outweigh the potential for higher earnings.

8. Authorized Broker/Dealers: Execute investment transactions with previously approved broker/dealers who have certified compliance with the City's investment policy.

9. Diversification: The portfolio should consist of a mix of various types of securities, issuers and maturities.

10. Annual Review: The investment portfolio will be reviewed yearly by the Treasurer, City Manager and Finance department representative.

11. Evaluation of Certificates of Deposit: The following items will govern the valuation:

    a. Time Certificates of Deposit (TCD) are FDIC insured.

    b. Negotiable Certificates of Deposit (NCD) shall be evaluated in terms of the credit worthiness of the issuer, as these deposits are uninsured and uncollateralized notes.

Attachment A:

The City's specific permitted investment guidelines are summarized below. It should be noted that the City's permitted investments are more restrictive than the State guidelines.

PERMITTED INSTRUMENTS	CITY GUIDELINES
Certificates of Deposits	5 years / 25% max / $250,000 max per issuer
Bankers Acceptances	180 days / 40% max / 5% per issuer/20% max per City Investment policy
Securities of the U.S. Government or its Agencies	5 years / 50% max
Commercial Paper	270 days / 25% max / 5% per issuer combined
Medium-Term Corporate Notes	5 years / 30% max / $2,000,000 combined any Issuer / max of 30% of portfolio
Local Agency Investment Fund (State Pool)	LAIF $75,000,000 / no limit
Negotiable Certificates of Deposit	5 years / 30% max / lesser of 5% or $1,000,000 per issuer
Passbook Savings Account	10 days / investments under $100,000
Government Security Mutual Funds	20% max / 5% per issuer
Bonds, Notes issued by: California State and Local Agencies	5 years / 20% max / 5% per issuer
Bond Proceeds	See section XII - number 11
U.S. Treasuries Notes and Bonds	5 years / 50% of portfolio
Supranationals	5 years / 30% max / AA rated
Reverse Repurchase Agreements	Not allowed
Mortgage Pass Through Securities	Not allowed
Repurchase Agreements	Not allowed

Percentages of investment allocation and investment maximum limits apply at the time of purchase. The designated portfolio manager may at his/her discretion temporarily exceed these guidelines when repositioning the portfolio. Should the manager recommend an extended departure from the diversification's guideline (more than 90 days) City council approval will be required.

The Investment Policy sets forth minimum credit ratings for each type of permitted security. These credit limits apply at the time of the initial purchase of the said security and a subsequent change in rating status does not necessarily force the sale or disposition of the investment. In the event that the security is later downgraded below minimum required levels, the Treasurer and City staff will assess the risk exposure, make a decision on the course of action, and advise the City council.

GLOSSARY

AGENCIES: Federal agency securities.

ANNUAL COMPREHENSIVE FINANCIAL REPORT (ACFR): The official annual report for the City of South Lake Tahoe. It includes five combined statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

ASKED: The price at which securities are offered.

BANKERS ACCEPTANCES (BA): A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

BENCHMARK: A comparative base for measuring the performance or risk tolerance of the investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio's investments.

BID: The price offered for securities. (When you are selling securities, you ask for a bid.) See offer.

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

CERTIFICATES OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a Certificate. Large-denomination CD's are typically negotiable.

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

COUPON: (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. (b) A certificate attached to a bond evidencing interest due on a payment date.

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

DEBENTURE: A bond secured only by the general credit of the issuer.

DELIVERY VERSUS PAYMENT (DVP): There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipts is delivery of securities with an exchange of a signed receipt for the securities.

DERIVATIVES: (1) Financial instruments whose return profile is linked to, or derived from, the movement of one or more underlying index or security, and may include a leveraging factor, or (2) financial contracts based upon national amounts whose value is derived from an underlying index or security (interest rates, foreign exchange rates, equities or commodities.)

DISCOUNT: The difference between the cost price of a security and its value at maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

DISCOUNT SECURITIES: Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value (e.g., U.S. Treasury bills).

DIVERSIFICATION: Dividing investment funds among a variety of securities and issuers offering independent returns.

FEDERAL CREDIT AGENCIES: Agencies of the Federal government set up to supply credit to various classes of institutions and individuals, e.g., S&L's, small business firms, students, farmers, farm cooperatives and exporters.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits, currently up to $250,000 per deposit. FEDERAL FUNDS RATE: The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

FEDERAL HOME LOAN BANKS (FHLB): Government sponsored wholesale banks (currently 12 regional banks), which lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit unions and insurance companies. The mission of the FHLB's is to liquefy the housing related assets of its members who must purchase stock in their district bank.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA): FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing & Urban Development, H.U.D. It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

FEDERAL FUNDS: Non-interest bearing deposits held by member banks at the Federal Reserve, also used to denote immediately available funds in the clearing sense. Fed Funds also used to refer to these funds.

FEDERAL OPEN MARKET COMMITTEE (FOMC): Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

FEDERAL RESERVE SYSTEM: The central bank of the United States created by Congress and consisting of a seven-member Board of Governors in Washington, D.C., 12 Regional Banks and about 5,700 commercial banks that are members of the system.

GOVERNMENTAL NATIONAL MORTGAGE ASSOCIATION (GNMA or Ginnie Mae):

Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. Security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA or FMHA mortgages. The term pass-throughs is often used to describe Ginnie Maes.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

LAIF (Local Agency Investment Fund): A special fund in the State Treasury which local agencies may use to deposit funds for investment. There is no minimum investment period and the minimum transaction is $5,000, in multiples of $1,000 above that, with a maximum balance of $75,000,000 for any agency. The City is restricted to a maximum of fifteen transactions per month. It offers high liquidity because deposits can be converted to cash in twenty-four hours and no interest is lost. All interest is distributed to those agencies participating on a proportionate share basis determined by the amounts deposited and the length of time they are deposited. Interest is paid quarterly. The State retains an amount for reasonable costs of making the investments, not to exceed one-quarter of one percent of the earnings. The interest rates are competitive with other securities because of pooling the State's surplus cash with the surplus cash deposited. This creates a multi-billion-dollar money pool and allows diversified investments. In a high interest rate market, the City does better than LAIF, but in times of low interest rates, LAIF yields are higher. The City continually invests in the Local Agency Investment Fund.

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

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase-reverse agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer- lender to liquidate the underlying securities in the event of default by the seller-borrower.

MATURITY: The date upon which the principal or stated value of an investment becomes due and payable.

MONEY MARKET FUNDS: Open-ended mutual fund that invests in highly liquid and safe securities (bills, commercial paper, bankers' acceptances, CD's, etc.) and pays money market rates of interest. The fund's net asset value remains a constant $1 a share.

OPEN MARKET OPERATIONS: Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank, as directed by the FOMC, in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserves most important and most flexible monetary policy tool.

PORTFOLIO: Collection of securities held by an investor.

PRIMARY DEALER: A group of government securities dealers that submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and

Exchange Commission (SEC) registered securities broker-dealers, banks, and a few unregulated firms.

PRUDENT PERSON RULE: An investment standard. In some states the law requires that a fiduciary, such as a trustee, may invest money only in a list of securities selected by the state (the so-called legal list). In other states, the trustee may invest in a security if it is one which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

QUALIFIED PUBLIC DEPOSITORIES: A financial institution which does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability and which has been approved by the Public Deposit Protection Commission to hold public deposits.

RATE OF RETURN: The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond or the current income return.

REPURCHASE AGREEMENTS (RP OR REPO): A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security Abuyer@ in effect lends the Aseller@ money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money that is, increasing bank reserves.

SAFEKEEPING: A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

SECONDARY MARKET: A market made for the purchase and sale of outstanding issues following the initial distribution.

SECURITIES & EXCHANGE COMMISSION: Agency created by Congress to protect investors in securities transactions by administering securities legislation.

SEC RULE 15C3-l: See uniform net capital rule.

STRUCTURED NOTES: Notes issued by Government Sponsored Enterprises (FHLB, FNMA, SLMA, etc.) and Corporations, which have imbedded options (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns) into their debt structure. Their market performance is impacted by the fluctuation of interest rates, the volatility of the imbedded options and shifts in the shape of the yield curve.

SUPRANATIONALS: United States 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, 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 in a rating category of "AA" or its equivalent or better by an NRARO and shall not exceed 30 percent of the agency's moneys that may be invested pursuant to this section.

TREASURY BILLS: A non-interest-bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months, or one year.

TREASURY BOND: Long-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of more than 10 years.

TREASURY NOTES: Medium-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from 2 to 10 years.

UNIFORM NET CAPITAL RULE: Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called net capital rule and net capital ratio. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

YIELD: The rate of annual income return on an investment, expressed as a percentage. (a) INCOME YIELD is obtained by dividing the current dollar income by the current market price for the security. (b) NET YIELD or YIELD TO MATURITY is the current income yield minus any premium above par or plus any discount from par in purchase price with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.