



<b>Policy:</b>	INVESTMENT POLICY	
<b>Approval Date:</b>	<b>Revision Date:</b> 03/08/2022	<b>Approved by:</b> Board of Directors

**PROCEDURE**

Purpose:

To describe the process the District uses in making investment decisions.

Additional Authority:

California Government Code Sections 53600 through 53686 and the Coachella Valley Water District Resolution as adopted by its Board of Directors.

Scope:

The policy includes; definition of duties, objectives, investment strategy and permissible investment securities.

Responsible Party:

Director of Finance, Department of Finance

**POLICY**

**I. Governing Authority**

The investment program of the Coachella Valley Water District shall be operated in conformance with federal, state, and other legal requirements, including applicable portions of California Government Code Sections 53600 through 53686 and the Coachella Valley Water District Resolution as adopted by its Board of Directors

**II. Scope**

This policy applies to the investment of all District funds, excluding CalPERS, OPEB Trusts (if any), the investment of employees' deferred compensation funds invested pursuant to Government Code Section 53609, and bond proceeds invested pursuant to their bond documents. Except for cash in certain restricted and special funds, Coachella Valley Water District will consolidate cash balances for all funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping of assets, and administration. Investment income will be allocated to the various funds based on their respective cash balances and in accordance with generally accepted accounting principles.

### III. General Objectives

The primary objectives, in priority order, of investment activities shall be **safety, liquidity, and yield**:

#### A. Safety

Safety of principal is the foremost objective of the District's investment program. Investments shall be undertaken in a manner that seeks to avoid capital losses from financial institution default, broker-dealer default or the erosion of market value. The objective is to mitigate credit risk and interest rate risk.

##### 1. Credit Risk

Coachella Valley Water District will minimize credit risk, which is the risk of loss due to issuer default by doing the following:

- a) Limiting investments to the types of securities listed in Section VII of this Investment Policy.
- b) Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisers with which Coachella Valley Water District will do business in accordance with Section V of this policy.
- c) Diversifying the investment portfolio so that the impact of potential losses from any one type of security or from any one individual issuer will be minimized

##### 2. Interest Rate Risk

Coachella Valley Water District will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates by structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity

#### B. Liquidity

Liquidity is the second most important objective of the District's investment program. The investment portfolio shall remain sufficiently liquid to meet all operating and capital requirements that may be reasonably anticipated. This is

accomplished by structuring the portfolio so that securities mature concurrently with cash needs to meet anticipated demands.

C. Yield

Coachella Valley Water District's cash management portfolio shall be designed with the objective of attaining a market rate of return at all times, The market rate of return will be compared against the District's benchmark which is defined as the ICE BofAML 1 to 3 year AAA-A Rated US Corporate and Government Index (ICE BofAML Ticker: B110)

IV. **Standard of Care**

The District's investment program is a fiduciary responsibility, and shall be conducted using the following standards of care:

A. Prudence

The standard of prudence to be used by District investment officials shall be the "prudent investor standard" as required by California Government Code Section 53600.3. The "prudent investor standard" states that when investing, reinvesting, purchasing, acquiring, exchanging, selling or managing public funds, a trustee shall act with care, skills, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person 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 District.

B. Ethics and Conflicts of Interest

Officers and employees involved in the investment process shall refrain from personal business activities that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees and investment officials 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 and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the District.

C. Delegation of Authority

California Government Code Section 53607 provides the authority for the legislative body to delegate the full responsibility to the treasurer of the local agency. Investments will be directed under the authority of the Director of

Finance of the Coachella Valley Water District. Other authorized staff includes the General Manager, Assistant General Manager, and Controller. These other staff may direct investments in the absence of the Finance Director or at other times as deemed appropriate.

Whenever possible, investment transactions to be entered into during the absence of the Finance Director should be discussed and approved in advance of the Finance Director's absence. This approval should include the staff member who is going to initiate the investment transactions and the staff member who is going to approve them, and the associated disbursement of funds to complete the purchase.

The Board may delegate day-to-day investment decision making and execution authority to an investment advisor. The advisor shall follow the policy and such other written instructions as are provided.

**V. Authorized Financial Institutions, Depositories and Broker/Dealers**

**A. For District Directed Investments**

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 creditworthiness (e.g., a minimum capital requirement of \$10,000,000 and at least 5 years of operation). These may include Primary Dealers, as designated by the Federal Reserve, or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).

All financial institutions and broker/dealers who desire to become qualified for investment transactions must supply the following as appropriate:

1. Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines
2. Proof of Financial Industry Regulatory Authority (FINRA) certification (not applicable to Certificate of Deposit counterparties)
3. Proof of state registration

4. Completed broker/dealer questionnaire (not applicable to Certificate of Deposit issues)
5. Certification of having read and understood and agreeing to comply with the District's investment policy

All Time Certificates of Deposit will be purchased directly from the institution receiving the deposit. An annual review of the financial condition and registration of all qualified financial institutions and broker/dealers will be conducted by the Finance Director or Controller. This list will be reported annually to the Board of Directors at the same time that the Board reviews and approves the District's investment policy

**B. For Investments Executed by an Investment Advisor**

Upon approval of the Board, an investment advisor engaged by the District may use its list of approved issuers and broker/dealers for transactions on behalf of the District. For investments not purchased directly from the issuer, the Advisor will ensure that it has confirmed each broker/dealer's:

1. Securities Exchange Commission (SEC) registration as a broker-dealer
2. Membership in Financial Industry Regulatory Authority (FINRA)
3. FINRA State registration or licensure

**VI. Safekeeping and Custody**

**A. Safekeeping**

Securities will be held by an independent third-party custodian selected by the entity as evidenced by safekeeping receipts in Coachella Valley Water District's name. The safekeeping institution shall annually provide a copy of their most recent report on internal controls (Statement of Auditing Standards No. 70).

**B. Internal Controls**

The Finance Department is responsible for ensuring compliance with the Policy as well as establishing systems of internal control to prevent losses due to fraud, employee error, misrepresentations by third parties, and imprudent actions by

staff, etc. The internal control structure shall be designed to provide reasonable assurance that these objectives are met.

Compliance with these internal control procedures will be assured through the District's annual independent audit and reported to the District's General Manager and Board of Directors.

These internal controls include the following:

1. The employee who initiates the investment transaction cannot approve the disbursement of funds.
2. The record keeping of investment transactions should be performed by staff not involved in the investment process.
3. All marketable securities purchased shall be held by a third-party custodian on a Delivery vs. Payment basis. The term "third-party custodian" refers to an institution other than the parties that the District purchases investments from. The arrangement will be formalized by written agreement. The use of a third-party ensures that no funds are released until the securities are delivered. Additionally, by having a third party serve as the custodian, the District will be notified if the security purchased is not delivered on time. "Failed" trades such as this occasionally occur. The District shall take from the third-party custodian institution a receipt for securities so deposited.
4. Pursuant to Government Code Section 53608, the District may deposit for safekeeping with a federal or state association, a trust company or a state or national bank located within California or with the Federal Reserve Bank of San Francisco or any branch thereof within California, or with any Federal Reserve bank or with any state or national bank located in any city designated as a reserve city by the Board of Governors of the Federal Reserve System.

The Finance Department shall establish and update, as needed, written investment procedures for the operation of the investment program consistent with this Policy. Procedures will include steps to be taken in preparation for investing, authorized financial institutions, authorized investments, selecting investment maturities and cash flow forecasting, investment safekeeping, wire

transfer procedures, investing in the Riverside County Treasurer's Pooled Investment Fund (TPIF), minimum dollar amounts to be kept in TPIF or other Local Government Investment Pool Shares (LGIPs) for liquidity purposes, banking service contracts, and other business functions associated with maintaining the investment program.

## VII. **Suitable and Authorized Investments**

### A. Investment Types

In accordance with Government Code Section 53601, the following investments will be authorized by this Policy:

1. U.S. 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.
2. Federal agency or United States government-sponsored enterprise obligations or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises.
3. Registered state warrants or treasury notes or bonds of this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency, or authority of the state. Obligations eligible for investment under this subdivision must be rated in a rating category of "A" or its equivalent or better by a Nationally Recognized Statistical Rating Organization (NRSRO).
4. 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 the other 49 states, in addition to California. Obligations eligible for investment under this subdivision must be rated in a rating category of "A" or its equivalent or better by a NRSRO.
5. Bonds, notes, warrants, or other evidences of indebtedness of a 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. Obligations eligible for investment under this subdivision must be rated in a rating category of "A" or its equivalent or better by a NRSRO.

6. Certificates of deposit and other evidences of deposit issued by a federally or state- chartered bank or savings and loan. These require full collateralization and a contract with the depository for the deposit of public funds, pursuant to Government Code Section 53649. No more than 30% of the District's investment portfolio may be invested in the certificates of deposit of any one commercial bank, at any one time. Certificates of Deposit will be purchased directly from the institution receiving the deposit.
7. Negotiable certificates of deposit issued by a nationally or state- chartered bank, a savings association or a federal association (as defined by Section 5102 of the Financial Code), a state or federal credit union, or by a federally- or state-licensed branch of a foreign bank. Purchases above amounts insured by the FDIC are limited to securities rated in a rating category of "A" (long-term) or "A-1" (short-term) or their equivalents or better by a NRSRO. No more than 30% of the District's investment portfolio may be invested in negotiable certificates of deposit.
8. Bankers' acceptances that are drawn on and accepted by a commercial bank. Eligible bankers' acceptances shall have the highest ranking or the highest letter and number rating as provided for by a nationally recognized statistical-rating organization and a maximum maturity of 180 days. No more than 40% of the District's investment portfolio may be invested in bankers' acceptances.
9. Commercial paper 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. The entity that issues the commercial paper shall meet all of the following conditions in either paragraph a, or paragraph b:
  - a) The entity meets the following criteria:



- 1) Is organized and operating in the United States as a general corporation.
  - 2) Has total assets in excess of five hundred million dollars (\$500,000,000).
- b) Has debt other than commercial paper, if any, that is rated in a rating category of "A" its equivalent, or better by a NRSRO. The entity meets the following criteria:
- 1) Is organized within the United States as a special purpose corporation, trust, or limited liability company.
  - 2) Has program wide credit enhancements including, but not limited to, over collateralization, letters of credit, or surety bond.
  - 3) Has commercial paper that is rated "A-1" or higher by a NRSRO.

No more than 25% of the District's investment portfolio may be invested in commercial paper. Eligible commercial paper shall have a maximum maturity of 270 days. Investments may not represent more than 10% of the outstanding commercial paper of any single corporate issue.

10. Medium-term corporate notes, defined as all corporate and depository institution debt securities with a maximum remaining maturity of 5 years or less, 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. Medium-term corporate notes shall be rated in a rating category of "A" or its equivalent or better by a NRSRO. No more than 30% of the District's investment portfolio may be invested in medium-term notes.
11. Riverside County Treasurer's Pooled Investment Fund (TPIF).
12. Funds may be invested in the District's own bonds.

13. Money Market Funds. Shares of beneficial interest issued by diversified management companies that are money market funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1, et seq.). To be eligible for investment pursuant to this subdivision these companies shall either: attain the highest ranking letter or numerical rating provided by not less than two of the three largest nationally recognized statistical-rating organization, or have an investment advisor registered or exempt from registration with the Securities and Exchange Commission with not less than 5 years' experience managing money market mutual funds and with assets under management in excess of \$500,000,000. The purchase price of shares shall not exceed 20% of the investment portfolio of the District.
14. Local Government Investment Pools (LGIPs). Shares of beneficial interest issued by a joint powers authority organized pursuant to Section 6509.7 that invests in the securities and obligations authorized in Government Code. The District will limit investments to LGIPs that seek to maintain a stable net asset value and have a rating of AAA or the equivalent by an NRSRO.
15. Supranational 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 in a rating category of "AA", its equivalent, or better by at least one NRSRO. Purchases of supranational shall not exceed 30% of the investment portfolio of the District.
16. Asset-Backed Securities (ABS) including mortgage pass-through securities, collateralized mortgage obligations, mortgage-backed or other pay-through bonds, equipment lease-backed certificates, consumer receivable pass-through certificates, or consumer receivable-backed bonds from issuers not defined in sections "a" and "b" of the Authorized Investments section of this policy with a maximum maturity not to exceed five years' maturity. Securities eligible for investment under this subdivision shall be rated in a rating category of "AA" or its equivalent or

better by at least one NRSRO. Purchase of securities authorized by this subdivision may not exceed 20% of the District's total portfolio.

Credit criteria and maximum percentages apply at the time a security is purchased. If an investment's credit rating falls below the minimum rating required at the time of purchase, the District's investment advisor will take appropriate action regarding the disposition of the investment and will notify the Director of Finance and General Manager.

**B. Collateralization**

Collateralization of District investments will be directed pursuant to Government Code Section 53652. Full collateralization will be required on all demand deposit accounts, including checking accounts and non-negotiable certificates of deposit (including FDIC insurance). It will be the District's policy to regularly verify that all active deposits (checking accounts) and inactive deposits (certificates of deposit) are properly collateralized.

**VIII. Suitable and Authorized Investments**

**A. Diversification**

1. The District's investment program shall be diversified by:
  - a) Limiting investments to avoid overconcentration in securities from a specific issuer or business sector (excluding U.S. Treasury and Federal Agency securities)
  - b) Limiting investment in securities that have higher credit risks
  - c) Investing in securities with varying maturities
  - d) Investing a portion of the portfolio in readily available funds such as Riverside County Treasurer's Pooled Investment Fund (TPIF), LGIPs or AAA rated money market funds to ensure that appropriate liquidity is maintained in order to meet ongoing obligations
2. The following diversification limitations shall be imposed on the portfolio:

- a) Non-government investments, other than TPIF, LGIPs, or eligible money market funds, will be restricted to no more than 5% of the District's portfolio in any one institution at any one time regardless of security type.
- b) Maturity: The maximum maturity of any single investment in the portfolio shall be limited to 5 years unless the Board determines that there is a specific purpose to make an investment with a maturity longer than 5 years and provides approval no less than three months prior to the investment. Investment maturities shall take into consideration the anticipated cash flow needs of the District.
- c) Liquidity risk: A portion of the portfolio will be continuously invested in readily available funds such as TPIF, LGIPs, or money market funds to ensure that appropriate liquidity is maintained to meet the District's ongoing obligations.
- d) Whenever practical, investments with a minimum par value of \$1 million will be made, in order to efficiently and effectively manage the District's portfolio.

To the extent possible, Coachella Valley Water District shall attempt to match its investments with anticipated cash flow requirements.

**B. Competitive Bids**

At least three competitive bids/offers shall be obtained and recorded on all investment transactions conducted for securities in the secondary market. The bids/offers shall be retained with other related investment documentation.

**IX. Reporting**

The Director of Finance shall prepare a monthly investment report within 30 days following the end of the month. This report will include a management summary that provides an analysis of the status of the current investment portfolio and the individual transactions executed over the last month. This management summary will be prepared in a manner which will allow the District to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report will be

provided in the General Manager's monthly report. The report will include the following:

- A. List of all investments held at end of month, including the name of the institution, type of investment, issuer, effective interest rate, maturity date, cost, par value, and current market value for each investment, and for the portfolio as a whole.
- B. Investment transactions
- C. The weighted average yield to maturity of the portfolio as of the end of the month.
- D. Certification from the Director of Finance that the portfolio is in compliance with the Policy and that sufficient liquidity is available to meet the District's expenditure requirements within the next six months.

#### X. **Policy Considerations**

The investment policy shall be reviewed and adopted by the District Board of Directors annually. The General Manager may approve necessary revisions that may arise during the year, which will be later reported to the Board of Directors.

#### XI. **Suitable and Authorized Investments**

The table below summarizes the suitable and authorized investments. The table is meant for summary purposes only. All investments are to be evaluated for inclusion into the investment portfolio using all elements contained in the investment policy. In the event of a discrepancy the Director of Finance will review the policy and make the determination of a security's eligibility and document the conclusion.

<b>SUMMARY OF AUTHORIZED INVESTMENTS</b>				
<b>Type of Security</b>	<b>% Limit Per Issuer</b>	<b>% Limit Per Type of Security</b>	<b>Minimum Quality</b>	<b>Maximum Maturity</b>
U.S. Treasuries	n/a	100%	n/a	5 years
Federal Agencies	n/a	100%	n/a	5 years
Municipal Bonds	5%	100%	A	5 years

Non-Negotiable Certificates of Deposits	5%	30%	Must be collateralized pursuant to Government Code Section 53649	5 years
Negotiable Certificates of Deposits	5%	30%	A1/P1 <sup>1</sup>	5 years
Bankers' Acceptances	5%	40%	A1/P1 <sup>2</sup>	180 days
Commercial Paper	5%	25%	A1/P1 <sup>2</sup> If available, long-term debt rating "A" or better	270 days
Corporate Medium Term Notes	5%	30%	A	5 years
Riverside County Treasurer's Pooled Investment Fund (TPIF)	n/a	n/a	n/a	n/a
Money Market Mutual Funds (Shares of beneficial interest in money market funds)	n/a	20%	AAA <sup>3</sup>	n/a
Local Government Investment Pools (LGIPs)	n/a	n/a	AAA <sup>2</sup>	n/a
Supranational Securities	Issuers are limited to IADB, IBRD and IFC	30%	AA <sup>2</sup>	5 Years
Asset Backed Securities (ABS), Collateralized Mortgage Obligations (CMOs) and Mortgage-Backed Securities (MBS)	5%	20% combined CMOs, MBS' and ABS'	AA <sup>2</sup>	5 years

<sup>1</sup>Requires a credit rating from one NRSROs for amounts greater than the FDIC insured limit<sup>2</sup>Requires a credit rating from one NRSRO<sup>3</sup>Requires a credit rating from two NRSROs

## XII. 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.

**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.

**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.

**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.

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