



# **City of Atascadero**

## **Investment Policy**

**Dated October 22, 2024**

## TABLE OF CONTENTS

	<u>Page</u>
I. OVERVIEW.....	1
Introduction	
Scope	
General Objectives	
Standards of Care	
II. INVESTMENT AUTHORITY AND RESPONSIBILITIES.....	4
Authorized Investment Officers	
Investment Procedures	
Internal Control	
State Oversight	
Conflicts of Interest	
III. ELIGIBLE FINANCIAL INSTITUTIONS.....	6
Selection of Eligible Financial Institutions	
Safekeeping and Custody	
IV. AUTHORIZED INVESTMENTS.....	8
Investment Types	
Due Diligence Requirement	
Prohibited Investments	
Legislative Changes	
V. INVESTMENT PARAMETERS.....	13
Diversification	
Maximum Maturities	
VI. CASH MANAGEMENT.....	14
VII. EVALUATION OF INVESTMENT PERFORMANCE.....	15
Benchmark Comparison	
VIII. INVESTMENT REPORTING.....	16
IX. INVESTMENT POLICY REVIEW AND ADOPTION.....	17
X. APPENDIX	
Glossary.....	Glossary-1

# **I. OVERVIEW**

## **INTRODUCTION**

The purpose of this document is to provide guidelines for the prudent investment of funds not required for the immediate needs of the City, and outline policies for maximizing the efficiency of the City's cash management system. The ultimate goal is to enhance the economic status of the City while protecting its pooled cash.

## **SCOPE**

Included in the scope of the City's investment policy are the following major guidelines and practices, which are to be used in achieving the City's primary investment objectives:

- Investment Authority and Responsibilities
- Eligible Financial Institutions
- Authorized Investments
- Investment Parameters
- Cash Management
- Evaluation of Investment Performance
- Investment Reporting
- Investment Policy Review and Adoption

It is intended that this policy cover all funds and investment activities under the direct authority of the City. These funds are accounted for in the Annual Financial Report and include the general fund, special revenue funds, debt service funds, capital project funds, enterprise funds, internal service funds and agency funds, including any Successor Agency funds in the City's pooled cash funds.

Subject to the prior written consent and approval of the City Treasurer and City Manager, financial assets held and invested by trustees or fiscal agents are excluded from this policy. However, such assets are nevertheless subject to the regulations established by the State of California pertaining to investments by local agencies as well as the related bond indentures.

## **I. OVERVIEW (continued)**

### **GENERAL OBJECTIVES**

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

1. *Safety*

Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate credit risk and interest rate risk.

a. Credit Risk

The City will minimize credit risk, the risk of loss due to the failure of the security issuer or backer, by:

- Limiting investments to the safest types of securities.
- Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisers with which the City will do business.
- Diversifying the investment portfolio so that potential losses on individual securities will be minimized.

b. Interest Rate Risk

The City will minimize the risk that the market value of securities in the portfolio will fall due to changes in general 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.
- Investing operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools.

2. *Liquidity*

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands (static liquidity). Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity). A portion of the portfolio will also be placed in money market mutual funds or local government investment pools, which offer same-day liquidity for short-term funds.

## I. OVERVIEW (continued)

### GENERAL OBJECTIVES (continued)

#### 3. *Yield*

The investment portfolio shall be designed 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 core of investments is limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. For purposes of comparing alternative investments all yields should be converted to a "money market" equivalent yield. Securities shall not be sold prior to maturity with the following exceptions:

- a. A security with declining credit may be sold early to minimize loss of principal.
- b. A security swap would improve the quality, yield, or target duration in the portfolio.
- c. Liquidity needs of the portfolio require that the security be sold.
- d. A capital gain would be realized that better positions the overall portfolio in achieving investment policy goals.

### STANDARDS OF CARE

The City operates its pooled idle cash investments under the "Prudent Person Rule" which obligates a fiduciary to ensure that investments shall be made:

*"...using the judgment and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital". (Uniform Prudent Investor Act)*

Investment officers acting in accordance with written procedures and this investment policy 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 the liquidity and the sale of securities are carried out in accordance with the terms of this policy.

## **II. INVESTMENT AUTHORITY AND RESPONSIBILITIES**

### **AUTHORIZED INVESTMENT OFFICERS**

California Government Code Section 53601 states that the legislative body of a local agency (i.e., the City Council) is authorized to invest surplus moneys as specified in that code section. In accordance with California Government Code Section 53607, this authority may be delegated to the City Treasurer for a one-year period by the City Council. Subject to review, the City Council may renew the delegation of authority under this code section each year. Idle cash management and investment transactions are the responsibility of the City Treasurer or designee. The City Council has authorized the following officials to undertake investment transactions on behalf of the City:

City Treasurer  
City Manager  
Director of Administrative Services  
Deputy Director of Administrative Services

It is the policy of the City for the Director of Administrative Services to manage the investment activity of the funds of the City. The City Manager and the City Treasurer shall supervise the activities of the Director of Administrative Services.

The Finance Committee may meet to discuss the status of current investments, strategies for future investment, and other investment matters deemed relevant, and shall report to the City Council as necessary. The City Attorney shall, as required by Government Code section 36518, review the bonding requirement for the City Treasurer upon entering the duties of the Treasurer's office.

### **INVESTMENT PROCEDURES**

The authorized investment officers as stated above, in accordance with the City of Atascadero Investment Policy, are responsible for administering an investment program which:

- Adheres to the Statement of Investment Policy
- Prioritizes safety and liquidity
- Determines risk and optimizes return
- Provides for a system of due diligence in making investment decisions.

### **INTERNAL CONTROL**

The Director of Administrative Services is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived and (2) the valuation of costs and benefits requires estimates and judgments by management.

## **II. INVESTMENT AUTHORITY AND RESPONSIBILITIES (continued)**

### **INTERNAL CONTROL (continued)**

Accordingly, the Director of Administrative Services shall establish a process for an annual independent review by an external auditor to assure compliance with policies and procedures. The internal controls shall address the following points:

- Control of collusion
- Separation of transaction authority from accounting and record keeping
- Custodial safekeeping
- Avoidance of physical delivery securities
- Clear delegation of authority to subordinate staff members
- Written or electronic signature confirmation of transactions for investments and wire transfers
- Development of a wire transfer agreement with the lead bank and third party custodian

### **STATE OVERSIGHT**

The City shall comply with the regulations established by the State of California pertaining to investments.

### **CONFLICTS OF INTEREST**

The City adopts the following policy concerning conflicts of interest:

1. 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 could impair their ability to make impartial investment decisions.
2. Officers and employees involved in the investment process shall disclose to the City Clerk any material financial interest in financial institutions that conduct business with the City of Atascadero and they shall further disclose any large personal financial/investment positions that could be related to the performance of the City's portfolio.
3. Officers shall refrain from undertaking personal investment transactions with the same individual with which business is conducted on behalf of the City.
4. In making investment decisions, the Investment Officers shall be guided by the recommendations of the Finance Committee and avoid the undue influence of individual City officers and officials.
5. Investments are prohibited in certificates of deposit of state or federal credit unions if any city officer, city manager or city fiscal officer serves on the credit union board or in any key committee positions.

### **III. ELIGIBLE FINANCIAL INSTITUTIONS (continued)**

#### **SELECTION OF ELIGIBLE FINANCIAL INSTITUTIONS**

Broker/dealers and safekeeping/custodial agents who desire to become qualified for investment transactions must provide the following documents (as appropriate) for annual review by the Director of Administrative Services:

- Audited financial statements
- Proof of the Financial Industry Regulatory Authority FINRA , certification
- Proof of state registration
- Completed broker/dealer questionnaire
- Certification of having read and understood and agreeing to comply with the City's investment policy.

In selecting financial institutions for deposit or investment of funds, the authorized Investment Officers shall consider the credit-worthiness of the institution.

- Deposits The City will only deposit funds with an institution that has a rating of at least "A" as assigned by an established rating service based on quarterly financial information provided by the Federal Reserve Board and the Federal Home Loan Bank Board (i.e., The Financial Directory). Ratings will be monitored on a quarterly basis and any downgrade in rating below "A" will be reported to the Finance Committee together with a recommendation for possible action.
- Brokers/Dealer Investments must be purchased directly from the issuer, from an institution licensed by the state as a broker-dealer, from a member of a federally regulated securities exchange, or from a brokerage firm designated as a primary government dealer by the Federal Reserve Bank. Broker/dealers shall be selected by creditworthiness (e.g., a minimum capital requirement of \$10,000,000 and at least five years of operation).
- Safekeeping and Custodial Institutions Safekeeping and custodial institutions shall be selected on the basis of credit worthiness with a minimum of capitalization of \$100,000,000 and at least 5 years of operation. Safekeeping and custodial institutions must be fiduciaries of the City and independent of any broker/dealers. All safekeeping and custodial arrangements shall require written agreements. All safekeeping and custodial agreements shall be reviewed by the City Treasurer and Director of Administrative Services and approved by the City Attorney prior to conducting any investment activities.

From time to time, the investment officer may choose to invest in instruments offered by minority and community financial institutions. In such situations, a waiver to the above criteria may be granted. Deposits covered by insurance can be exempted from the Safekeeping and Custodial Institutions clause related to credit worthiness. All terms and

#### **SELECTION OF ELIGIBLE FINANCIAL INSTITUTIONS (continued)**



### **III. ELIGIBLE FINANCIAL INSTITUTIONS (continued)**

relationships will be fully disclosed prior to purchase and will be reported to the appropriate entity on a consistent basis and should be consistent with state or local law.

These types of investment purchases should be approved by City Council in advance. The authorized Investment Officers will maintain a file of the broker/dealers and authorized safekeeping/custodial institutions with which it is currently doing business which will include the firm name, contact person, telephone number, and current audited financial statements.

#### **SAFEKEEPING AND CUSTODY**

All trades where applicable will be executed by delivery vs. payment (DVP) to ensure that securities are deposited in an eligible financial institution prior to the release of funds. A third-party custodian as evidenced by safekeeping receipts will hold securities.

## **IV. AUTHORIZED INVESTMENTS**

### **INVESTMENT TYPES**

The California Government Code Sections 16429.1 and 53601 govern investment of City funds. Investments may not have a term or maturity at the time of investment of longer than that authorized by Section 53601 or five years unless the City Council has granted prior express authority.

As previously stated, the City operates its investments under the prudent person rule (Civil Code Section 2261, et. seq.), except where more specifically restricted. This affords the City a broad spectrum of investments, so long as the investment is deemed prudent and is allowable under current legislation of the State of California (Government Code Section 53600, et. seq.) and applicable City trust agreements, if any.

It should be noted that while the Government Code specifies the maximum percentage of the portfolio that may be held in each type of investment at any one time, fluctuations in the portfolio balance will prevent strict adherence to such restrictions. Therefore, percentage limitations shall apply to investments at the time of purchase.

Consistent with the GFOA Policy Statement on State and Local Laws Concerning Investment Practices, the following investments will be permitted by this policy and are those defined by state and local law where applicable:

**1. State Treasurer's Local Agency Investment Fund (LAIF)**

Government Code Section 16429.1: The City may invest in the Local Agency Investment Fund. LAIF is a diversified investment pool administered by the California State Treasurer. Monies invested with LAIF are pooled with State monies in order to earn the maximum rate of return consistent with safe and prudent treasury management.

LAIF information including LAIF policies and restrictions shall be available in the City's Administrative Services Department. A thorough investigation of the pool is required on a continual basis. (See Due Diligence Requirement on page 11.)

**2. U.S. Government Issues**

Government Code Sections 53601 (b) and (f): The City's portfolio may be invested in U.S. government obligations, U.S. government agency obligations, and U.S. government instrumentality obligations, which have a liquid market with a readily determinable market value.

**3. California and California Local Agency Municipal Obligations**

Government Code Sections 53601 (c) and (e): The City may invest in 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. In addition, these securities shall be rated in a rating category of "A" or its equivalent or higher by a nationally

## **IV. AUTHORIZED INVESTMENTS (continued)**

### **INVESTMENT TYPES (continued)**

- 3. California and California Local Agency Municipal Obligations (cont.)**  
recognized statistical rating organization (NRSRO). Purchase of California and California local agency municipal obligations, together with other state municipal obligations, may not exceed thirty percent (30%) of the City's investment portfolio.
- 4. Other State Municipal Obligations**  
Government Code Section 53601 (d): The City may invest in registered treasury notes or bonds of any of the other 49 United 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 United States, in addition to California. In addition, these securities shall be rated in a rating category of "A" or its equivalent or higher by a NRSRO. Purchase of other state municipal obligations, together with California and California local agency municipal obligations, may not exceed thirty percent (30%) of the City's investment portfolio
- 5. Bankers Acceptances**  
Government Code Section 53601 (g): Up to forty percent (40%) of the City's portfolio may be invested in Bankers Acceptances which are defined as bills of exchange or time drafts, drawn on and accepted by a commercial bank, which are eligible for purchase by the Federal Reserve System, although no more than thirty percent (30%) of the portfolio may be invested in Bankers Acceptances with any one commercial bank. Additionally, the maturity periods cannot exceed 180 days.
- 6. Commercial Paper**  
Government Code Section 53601 (h): A maximum of twenty five percent (25%) of the City's portfolio may be invested in highest tier (e.g. A-1, P-1, F-1 or D-1 or higher) commercial paper as rated by an NRSRO. Issuing corporations must be organized and operating in the United States, have in excess of \$500 million total assets, and have at least an "A" rating (by an NRSRO) on debt other than commercial paper. The maturity period cannot exceed 270 days. Purchases of eligible commercial paper from a single issuer may not exceed ten percent (10%) of total investment assets.

## **IV. AUTHORIZED INVESTMENTS (continued)**

### **INVESTMENT TYPES (continued)**

#### **7. Certificates of Deposit**

A maximum of thirty percent (30%) of the City's portfolio may be invested in certificates of deposit. The minimum requirements for Certificate of Deposit investments shall be:

- Investments and accrued interest shall never exceed the FDIC insurance limit in any one institution.
- Qualified institutions must have a minimum equity ratio of 6% and a minimum capitalization of \$10,000,000.

Purchases of negotiable certificates of deposit, issued by a nationally or state-chartered bank or a state or federal association, or by a state licensed branch of a foreign bank, may not exceed 30 percent of the agency's surplus money, which may be invested pursuant to this section, per Government Code Section 53601(i). Negotiable certificates of deposit may be purchased in the secondary market at a discount but never at a premium, since the premium would not be FDIC insured.

California law requires that public funds be collateralized by maintaining with the agent of the depository government securities having a market value of at least one hundred ten percent (110%) of the value of the public fund accounts. The collateralization requirement may be waived to the extent that funds are federally insured. For deposits equivalent to the maximum insured amount, security may also be waived for interest accrued on the deposit provided the interest is computed by the depository on the average daily balance of the deposits, paid monthly and computed on a 360-day basis.

#### **8. Money Market Mutual Funds**

Government Code Section 53601 (l): 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-l et seq.) shall not exceed twenty percent (20%) of the agency's surplus money that may be invested pursuant to this section. The fund shall be managed by a registered or exempt investment advisor with not less than 5 years' experience managing money market mutual funds with assets under management in excess of five hundred million dollars (\$500,000,000). The fund shall have attained the highest ranking or the highest letter and numerical rating provided by not less than two NRSROs. No more than ten percent (10%) of the agency's surplus funds may be invested in shares of beneficial interest of any one money market mutual fund.

## **IV. AUTHORIZED INVESTMENTS (continued)**

### **INVESTMENT TYPES (continued)**

#### **9. Supranational Agency Securities**

Government Code Section 53601 (g): Up to thirty percent (30%) of the City's portfolio may be invested in 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 paragraph shall be rated in a rating category of "AA" or its equivalent or better by an NRSRO. No more than 10% of the City's portfolio shall be invested in obligations of any one bank.

### **DUE DILIGENCE REQUIREMENT**

As stated, a thorough investigation of an investment pool or mutual fund is required prior to investing and on a continual basis. At a minimum, the following information shall be reviewed periodically for each pool and/or mutual fund:

1. A description of eligible investment securities, and a written statement of investment policy and objectives.
2. A description of interest calculations, how interest is distributed, and how gains and losses are treated.
3. A description of how these securities are safeguarded (including the settlement process), and how often these securities are priced and the program audited.
4. A description of who may invest in the program, how often, and the size of deposits and withdrawals.
5. A schedule for receiving statements and portfolio listings.
6. Whether reserves, retained earnings, etc. are utilized by the pool/fund.
7. A fee schedule and when and how fees are assessed.
8. Whether the pool/fund is eligible for bond proceeds and/or will it accept such proceeds.

### **PROHIBITED INVESTMENTS**

The City of Atascadero shall not invest in any investment instrument/pool/fund unless specifically allowed under the "Investment Types" section of this policy.

The City of Atascadero shall comply with Government Code Section 53601.6 that states in pertinent part, " A local agency shall not invest any funds pursuant to this article in inverse floaters, range notes, or mortgage-derived interest-only strips."

## **IV. AUTHORIZED INVESTMENTS (continued)**

### **LEGISLATIVE CHANGES**

Any State of California legislative action that further restricts allowable maturities, investment types or percentage allocations will be incorporated into the City of Atascadero Investment Policy and supersede any and all previous applicable language. If the City is holding an investment that is subsequently prohibited by a legislative change, the City may hold that investment, if it is deemed prudent by the Finance Committee, until the maturity date to avoid an unnecessary loss.

### **REVIEW OF INVESTMENT PORTFOLIO**

The securities held by the City must be in compliance with Authorized Investments at the time of purchase. The City Treasurer shall establish procedures to report to the City Council and Finance Committee, in the event of any major and critical incidences of noncompliance identified through the review of the portfolio.

## **V. INVESTMENT PARAMETERS**

### **DIVERSIFICATION**

The investments shall be diversified by:

- Limiting investments to avoid over concentration in securities from a specific issuer or business sector (excluding Local Agency Investment Fund and 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 (LAIF), or money market funds to ensure that appropriate liquidity is maintained in order to meet ongoing obligations.

### **MAXIMUM MATURITIES**

In order to minimize the impact of market risk, it is intended that all investments will be held to maturity.

To the extent possible, the City shall attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the City will not directly invest in securities maturing more than five (5) years from the date of purchase or in accordance with state and local statutes and ordinances. The Finance Committee may meet to review weighted average maturity limitations (which often range from 90 days to 2 years), consistent with investment objectives and economic conditions.

Investments may be sold prior to maturity for cash flow, appreciation purposes or in order to limit losses; however, no investment shall be made based solely on earnings anticipated from capital gains.

Because of inherent difficulties in accurately forecasting cash flow requirements, a portion of the portfolio should be continuously invested in readily available funds.

## **VI. CASH MANAGEMENT**

In order to obtain a reasonable return on public funds, the following cash management practice will be followed:

1. Maintain maximum investment of all City funds not required to meet immediate cash flow needs.
2. Except for cash in certain restricted and special funds, the City will consolidate cash balances from all funds to maximize investment earnings. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.
3. Maximize the City's cash flow through immediate deposit of all receipts, use of direct deposit when available, and appropriate timing of payment to vendors.
4. Daily cash flow management shall be the responsibility of the Director of Administrative Services in conjunction with the City Treasurer.



## **VII. EVALUATION OF INVESTMENT PERFORMANCE**

The investment portfolio will be designed to obtain a market average rate of return during budgetary and economic cycles, taking into account the City's investment risk constraints and cash flow needs.

### **BENCHMARK COMPARISON**

The investment portfolio shall be structured to optimize the return given the risk constraints and cash flow needs.

Investment activity summary reports shall be generated on a monthly basis for presentation to the City Council.

In evaluating the performance of the City's portfolio in complying with this policy, it is expected that yields on City investments will regularly meet or exceed the average return on a two-year U.S. Treasury Note. However, the Finance Committee for evaluation purposes considers a variance of .5% positive or negative from the benchmark reasonable.

## **VIII. INVESTMENT REPORTING**

### **REPORTS TO CITY COUNCIL**

The City Treasurer shall prepare and submit a quarterly investment report to the City Council. This report will include the following elements relative to the investments held at quarter-end.

1. Face value.
2. Security description.
3. Coupon rate.
4. Maturity date.
5. Investment rating.
6. Investment type.
7. Purchase date.
8. Cost of security.
9. Yield-to-Maturity
10. Estimated market value.
11. Amortized premium/discount.
12. Unrealized Gain <Loss>.
13. Listing of investment by maturity.
14. Gains or Losses on the sale of securities not held to maturity.
15. Bank failures.
16. Investment ratings downgraded by Moody's or Standard and Poor's.
17. Statement relating the report to the Statement of Investment Policy.
18. Statement that there are sufficient funds to meet the next six months' obligations.

## **IX. INVESTMENT POLICY REVIEW AND ADOPTION**

The Statement of Investment Policy shall be submitted as needed to the City Council for adoption. The policy shall be reviewed periodically to ensure its consistency with the overall objectives of the City and its relevance to current law and financial and economic trends. Any modifications made thereto must be approved by the City Council.

## **APPENDIX: Glossary**

The following is a glossary\* of key investing terms.

**Accrued Interest** - The accumulated interest due on a bond as of the last interest payment made by the issuer.

**Agency** - A debt security issued by a federal or federally sponsored agency. Federal agencies are backed by the full faith and credit of the U.S. Government. Federally sponsored agencies (FSAs) are backed by each particular agency with a market perception that there is an implicit government guarantee. An example of federal agency is the Government National Mortgage Association (GNMA). An example of a FSA is the Federal National Mortgage Association (FNMA).

**Amortization** - The systematic reduction of the amount owed on a debt issue through periodic payments of principal.

**Average Life** - The average length of time that an issue of serial bonds and/or term bonds with a mandatory sinking fund feature is expected to be outstanding.

**Basis Point** - A unit of measurement used in the valuation of fixed-income securities equal to 1/100 of 1 percent of yield, e.g., "1/4" of 1 percent is equal to 25 basis points.

**Bid** - The indicated price at which a buyer is willing to purchase a security or commodity.

**Book Value** - The value at which a security is carried on the inventory lists or other financial records of an investor. The book value may differ significantly from the security's current value in the market.

**Callable Bond** - A bond issue in which all or part of its outstanding principal amount may be redeemed before maturity by the issuer under specified conditions.

**Call Price** - The price at which an issuer may redeem a bond prior to maturity. The price is usually at a slight premium to the bond's original issue price to compensate the holder for loss of income and ownership.

**Call Risk** - The risk to a bondholder that a bond may be redeemed prior to maturity.

**Cash Sale/Purchase** - A transaction that calls for delivery and payment of securities on the same day that the transaction is initiated.

\*This glossary has been adapted from an article, entitled "Investment terms for everyday use," that appeared in the April 5, 1996, issue of *Public Investor*, GFOA's subscription investment newsletter.

## **APPENDIX: Glossary (continued)**

**Collateralization** - Process by which a borrower pledges securities, property, or other deposits for the purpose of securing the repayment of a loan and/or security.

**Commercial Paper** - An unsecured short-term promissory note issued by corporations, with maturities ranging from 2 to 365 days.

**Convexity** - A measure of a bond's price sensitivity to changing interest rates. A high convexity indicates greater sensitivity of a bond's price to interest rate changes.

**Coupon Rate** - The annual rate of interest received by an investor from the issuer of certain types of fixed-income securities. Also known as the "interest rate".

**Credit Quality** - The measurement of the financial strength of a bond issuer. This measurement helps an investor to understand an issuer's ability to make timely interest payments and repay the loan principal upon maturity. Generally, the higher the credit quality of a bond issuer, the lower the interest rate paid by the issuer because the risk of default is lower. Credit quality ratings are provided by nationally recognized rating agencies.

**Credit Risk** - The risk to an investor that an issuer will default in the payment of interest and/or principal on a security.

**Current Yield (Current Return)** - A yield calculation determined by dividing the annual interest received on a security by the current market price of that security.

**Delivery Versus Payment (DVP)** - A type of securities transaction in which the purchaser pays for the securities when they are delivered either to the purchaser or his/her custodian.

**Derivative Security** - Financial instrument created from, or whose value depends upon, one or more underlying assets or indexes of asset values.

**Discount** - The amount by which the par value of a security exceeds the price paid for the security.

**Diversification** - A process of investing assets among a range of security types by sector, maturity, and quality rating.

**Duration** - A measure of the timing of the cash flows, such as the interest payments and the principal repayment, to be received from a given fixed-income security. This calculation is based on three variables: term to maturity, coupon rate, and yield to maturity. The duration of a security is a useful indicator of its price volatility for given changes in interest rates.

## **APPENDIX: Glossary (continued)**

**Fair Value** - The amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

**Federal Funds (Fed Funds)** - Funds placed in Federal Reserve banks by depository institutions in excess of current reserve requirements. These depository institutions may lend fed funds to each other overnight or on a longer basis. They may also transfer funds among each other on a same-day basis through the Federal Reserve banking system. Fed funds are considered to be immediately available funds.

**Federal Funds Rate** - Interest rate charged by one institution lending federal funds to the other.

**Government Securities** - An obligation of the U.S. government, backed by the full faith and credit of the government. These securities are regarded as the highest quality of investment securities available in the U.S. securities market. See "Treasury Bills, Notes, and Bonds."

**Interest Rate** - See "Coupon Rate".

**Interest Rate Risk** - The risk associated with declines or rises in interest rates that cause an investment in a fixed-income security to increase or decrease in value.

**Internal Controls** - An internal control structure designed to ensure that the assets of the entity are protected from loss, theft, or misuse. The internal control structure is designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that 1) the cost of a control should not exceed the benefits likely to be derived and 2) the valuation of costs and benefits requires estimates and judgments by management. Internal controls should address the following points:

1. Control of collusion - Collusion is a situation where two or more employees are working in conjunction to defraud their employers.
2. Separation of transaction authority from accounting and record keeping - By separating the person who authorizes or performs the transaction from the people who record or otherwise account for the transaction, a separation of duties is achieved.
3. Custodial safekeeping - Securities purchased from any bank or dealer including appropriate collateral (as defined by state law) shall be placed with an independent third party for custodial safekeeping.
4. Avoidance of physical delivery securities - Book-entry securities are much easier to transfer and account for since actual delivery of a document never takes place. Delivered securities must be properly safeguarded against loss or destruction. The potential for fraud and loss increases with physically delivered securities.

## **APPENDIX: Glossary (continued)**

### **Internal Controls (continued)**

5. Clear delegation of authority to subordinate staff members - Subordinate staff members must have a clear understanding of their authority and responsibilities to avoid improper actions. Clear delegation of authority also preserves the internal control structure that is contingent on the various staff positions and their respective responsibilities.
6. Written confirmation of transactions for investments and wire transfers - Due to the potential for error and improprieties arising from telephone and electronic transactions, all transactions should be supported by written communications and approved by the appropriate person. Written communications may be via fax if on letterhead and if the safekeeping institution has a list of authorized signatures.
7. Development of a wire transfer agreement with the lead bank and third-party custodian - The designated official should ensure that an agreement will be entered into and will address the following points: controls, security provisions, and responsibilities of each party making and receiving wire transfers.

**Inverted Yield Curve** - A chart formation that illustrates long-term securities having lower yields than short-term securities. This configuration usually occurs during periods of high inflation coupled with low levels of confidence in the economy and a restrictive monetary policy.

**Investment Company Act of 1940** - Federal legislation which sets the standards by which investment companies, such as mutual funds, are regulated in the areas of advertising, promotion, performance reporting requirements, and securities valuations.

**Investment Policy** - A concise and clear statement of the objectives and parameters formulated by an investor or investment manager for a portfolio of investment securities.

**Investment-grade Obligations** - An investment instrument suitable for purchase by institutional investors under the prudent person rule. Investment-grade is restricted to those obligations rated BBB or higher by a rating agency.

**Liquidity** - An asset that can be converted easily and quickly into cash.

**Local Agency Investment Fund (LAIF)** - The Local Agency Investment Fund (LAIF) is a voluntary program created by statute; began in 1977 as an investment alternative for California's local governments and special districts and it continues today. The enabling legislation for the LAIF is Section 16429.1 et seq. of the California Government Code.

This program offers local agencies the opportunity to participate in a major portfolio, which invests hundreds of millions of dollars, using the investment expertise of the State Treasurer's Office investment staff at no additional cost to the taxpayer.

**Mark-to-market** - The process whereby the book value or collateral value of a security is adjusted to reflect its current market value.

## **APPENDIX: Glossary (continued)**

**Market Risk** - The risk that the value of a security will rise or decline as a result of changes in market conditions.

**Market Value** - Current market price of a security.

**Maturity** - The date on which payment of a financial obligation is due. The final stated maturity is the date on which the issuer must retire a bond and pay the face value to the bondholder. See "Weighted Average Maturity."

**Money Market Mutual Fund** - Mutual funds that invest solely in money market instruments (short-term debt instruments, such as Treasury bills, commercial paper, bankers' acceptances, repos and federal funds).

**Mutual Fund** - An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments. Mutual funds are regulated by the Investment Company Act of 1940 and must abide by the following Securities and Exchange Commission (SEC) disclosure guidelines:

1. Report standardized performance calculations.
2. Disseminate timely and accurate information regarding the fund's holdings, performance, management and general investment policy.
3. Have the fund's investment policies and activities supervised by a board of trustees, which are independent of the adviser, administrator or other vendor of the fund.
4. Maintain the daily liquidity of the fund's shares.
5. Value their portfolios on a daily basis.
6. Have all individuals who sell SEC-registered products licensed with a self-regulating organization (SRO) such as National Association of Securities Dealers (NASD).
7. Have an investment policy governed by a prospectus that is updated and filed by the SEC annually.

**Mutual Fund Statistical Services** - Companies that track and rate mutual funds.

**National Association of Securities Dealers (NASD)** - A self-regulatory organization (SRO) of brokers and dealers in the over-the-counter securities business. Its regulatory mandate includes authority over firms that distribute mutual fund shares as well as other securities.

**Net Asset Value** - The market value of one share of an investment company, such as a mutual fund. This figure is calculated by totaling a fund's assets which includes securities, cash, and any accrued earnings, subtracting this from the fund's liabilities and dividing this total by the number of shares outstanding. This is calculated once a day based on the closing price for each security in the fund's portfolio. (See below.)

$$\frac{[(\text{Total assets}) - (\text{Liabilities})]}{(\text{Number of shares outstanding})}$$

**No Load Fund** - A mutual fund that does not levy a sales charge on the purchase of its shares.



## **APPENDIX: Glossary (continued)**

**Nominal Yield** - The stated rate of interest that a bond pays its current owner, based on par value of the security. It is also known as the “coupon,” “coupon rate,” or “interest rate.”

**NRSRO** - Nationally recognized statistical rating organization

**Offer** - An indicated price at which market participants are willing to sell a security or commodity. Also referred to as the “Ask price.”

**Par** - Face value or principal value of a bond, typically \$1,000 per bond.

**Positive Yield Curve** - A chart formation that illustrates short-term securities having lower yields than long-term securities.

**Premium** - The amount by which the price paid for a security exceeds the security’s par value.

**Prime Rate** - A preferred interest rate charged by commercial banks to their most creditworthy customers. Many interest rates are keyed to this rate.

**Principal** - The face value or par value of a debt instrument. Also may refer to the amount of capital invested in a given security.

**Prospectus** - A legal document that must be provided to any prospective purchaser of a new securities offering registered with the SEC. This can include information on the issuer, the issuer’s business, the proposed use of proceeds, the experience of the issuer’s management, and certain certified financial statements.

**Prudent Person Rule** - An investment standard outlining the fiduciary responsibilities of public funds investors relating to investment practices.

**Regular Way Delivery** - Securities settlement that calls for delivery and payment on the third business day following the trade date (T+3); payment on a T+1 basis is currently under consideration. Mutual funds are settled on a same day basis; government securities are settled on the next business day.

**Reinvestment Risk** - The risk that a fixed-income investor will be unable to reinvest income proceeds from a security holding at the same rate of return currently generated by that holding.

**Repurchase Agreement (Repo or RP)** - An agreement of one party to sell securities at a specified price to a second party and a simultaneous agreement of the first party to repurchase the securities at a specified price or at a specified later date.

## **APPENDIX: Glossary (continued)**

**Reverse Repurchase Agreement (Reverse Repo)** - An agreement of one party to purchase securities at a specified price from a second party and a simultaneous agreement by the first party to resell the securities at a specified price to the second party on demand or at a specified date.

**Rule 2a-7 of the Investment Company Act** - Applies to all money market mutual funds and mandates such funds to maintain certain standards, including a 13-month maturity limit and a 90-day average maturity on investments, to help maintain a constant net asset value of one dollar (\$1.00).

**Safekeeping** - Holding of assets (e.g., securities) by a financial institution.

**Serial Bond** - A bond issue, usually of a municipality, with various maturity dates scheduled at regular intervals until the entire issue is retired.

**Sinking Fund** - Money accumulated on a regular basis in a separate custodial account that is used to redeem debt securities or preferred stock issues.

**Supranational Agency** – Global entity whose membership transcends national boundaries and whose constituent countries share in decision making, such as the International Bank of Reconstruction and Development (IBRD) or the World Bank, whose purpose is to promote economic development.

**Swap** - Trading one asset for another.

**Term Bond** - Bonds comprising a large part or all of a particular issue that come due in a single maturity. The issuer usually agrees to make periodic payments into a sinking fund for mandatory redemption of term bonds before maturity.

**Total Return** - The sum of all investment income plus changes in the capital value of the portfolio. For mutual funds, return on an investment is composed of share price appreciation plus any realized dividends or capital gains. This is calculated by taking the following components during a certain period.

$$(\text{Price appreciation}) + (\text{Dividends paid}) + (\text{Capital gains}) = \text{Total Return}$$

**Treasury Bills** - Short-term U.S. government non-interest bearing debt securities with maturities of no longer than one year and issued in minimum denominations of \$10,000. Auctions of three- and six-month bills are weekly, while auctions of one-year bills are monthly. The yields on these bills are monitored closely in the money markets for signs of interest rate trends.

**Treasury Notes** - Intermediate U.S. government debt securities with maturities of one to ten years and issued in denominations ranging from \$1,000 to \$1,000,000 or more.

## **APPENDIX: Glossary (continued)**

**Treasury Bonds** - Long-term U.S. government debt securities with maturities of ten years or longer and issued in minimum denominations of \$1,000. Currently, the longest outstanding maturity for such securities is 30 years.

**Uniform Net Capital Rule** - SEC Rule 15C3-1 outlining capital requirements for broker/dealers.

**Volatility** - A degree of fluctuation in the price and valuation of securities.

**“Volatility Risk” Rating** - A rating system to clearly indicate the level of volatility and other non-credit risks associated with securities and certain bond funds. The rating for bond funds range from those that have extremely low sensitivity to changing market conditions and offer the greatest stability of the returns (“aaa” by S&P; “V-1” by Fitch) to those that are highly sensitive with currently identifiable market volatility risk (“ccc-“ by S&P, “V-10” by Fitch).

**Weighted Average Maturity (WAM)** - The average maturity of all the securities that comprise a portfolio. According to SEC rule 2a-7, the WAM for SEC registered money market mutual funds may not exceed 90 days and no one security may have a maturity that exceeds 397 days.

**When Issued (WI)** - A conditional transaction in which an authorized new security has not been issued. All “when issued” transactions are settled when the actual security is issued.

**Yield** - The current rate of return on an investment security generally expressed as a percentage of the security’s current price.

**Yield-to-call (YTC)** - The rate of return an investor earns from a bond assuming the bond is redeemed (called) prior to its nominal maturity date.

**Yield-to-maturity** - The rate of return yielded by a debt security held to maturity when both interest payments and the investor’s potential capital gain or loss are included in the calculation of return.

**Zero-coupon Securities** - Security that is issued at a discount and makes no periodic interest payments. The rate of return consists of a gradual accretion of the principal of the security and is payable at par upon maturity.