MOULTON NIGUEL WATER DISTRICT
STATEMENT OF INVESTMENT POLICY

Effective: July 1, 2019

I. BACKGROUND

A. Prudent management of the District includes the adoption of appropriate goals, objectives, policies and guidelines for the investment of available funds.

B. The District's cash management system is designed to monitor and forecast accurately expenditures and revenues, thus enabling the District to invest funds to the fullest extent possible.

C. This policy serves to organize and formalize the District's investment-related activities, while complying with all applicable statutes governing the investment of public funds.

D. This policy supersedes any previous Investment Policies of the Moulton Niguel Water District.

II. PURPOSE

A. This statement is set forth by the District for the following purposes:

1. To establish a clear understanding for the Board, District management, responsible employees and third parties of the objectives, policies, and guidelines for the investment of District funds.

2. To offer guidance to any investment adviser on the investment of District funds.

3. To establish a basis for evaluating investment results.

B. The general purpose of this Investment Policy is to outline a philosophy and attitude, which will guide the investment of District funds toward the desired investment goals. It is intended to be sufficiently specific to be meaningful, yet adequately flexible to be practical.

III. INVESTMENT AUTHORITY

A. In accordance with Section 53600 et seq. of the Government Code of the state of California, the authority to invest public funds is expressly delegated to the Board of Directors for subsequent delegation to the Treasurer. Investments are limited to those instruments specified by this Investment Policy.

B. The Moulton Niguel Water District may engage the services of one or more external investment advisers who are registered under the Investment Advisers Act of 1940 to assist in the management of the District's investment portfolio in a manner consistent with the District's objectives. External investment advisers may be granted discretion to purchase and sell investment securities in accordance with this investment policy.

C. This policy covers all funds and investment activities under the direct authority of the District, as set forth in the State Government Code, Sections 53600 et seq., with the following exceptions:

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

2. Any other funds specifically exempted by the District.

IV. PRUDENCE

A. Pursuant to California Government Code, Section 53600.3, all persons authorized to make investment decisions on behalf of the Agency are trustees and therefore fiduciaries subject to the Prudent Investor Standard:

"…all governing bodies of local agencies or persons authorized to make investment decisions on behalf of those local agencies investing public funds pursuant to this chapter are trustees and therefore fiduciaries subject to the prudent investor standard. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the Agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the Agency. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law."

B. The Treasurer or designated investment advisor and other authorized persons responsible for managing District funds 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 that the Treasurer or other authorized persons acted in good faith. Deviations from expectations of a security's credit or market risk should be reported to the governing body in a timely fashion and appropriate action should be taken to control adverse developments.

V. STATEMENT OF OBJECTIVES

A. The District's investment program is based first upon the principals of safety and liquidity. The expected return on investments is considered only after the first two criteria are met.

B. In order of priority, three fundamental criteria shall be followed:

1. SAFETY. Safety of principal is the foremost objective of the investment program. Investments will be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To attain this objective, the District will diversify its investments by investing funds among a variety of securities with independent returns.

2. LIQUIDITY. The investment portfolio will remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated.

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

C. Funds are divided into three categories:

1. Funds needed for current operating expenses and capital requirements, known as the "Liquid Fund,"

2. Funds needed over the next one to five years known as the “Limited Maturity Fund”, and

3. Funds not currently needed, known as the “Operating Reserve Fund.”

D. The District shall inform the investment adviser from time to time of amounts to be allocated to each of the three categories.

E. The investment goals of the Liquid Fund shall be:

1. To preserve principal,

2. To provide liquidity for operating and maintenance expenses, debt service payments, and capital requirements, and

3. To earn a total rate of return commensurate with the first two goals.

F. The investment goals of the Limited Maturity Fund shall be:

1. To preserve principal,

2. To provide liquidity for operating and maintenance expenses, debt service payments, and capital requirements within the next one to five

years, and

3. To earn a total rate of return commensurate with the first two goals.

G. The investment goal of the Operating Reserve Fund shall be:

1. To preserve principal and

2. To provide growth over the long term by earning the rate of return available from the longer-term investments permitted under the California Government Code.

VI. INVESTMENT PERFORMANCE OBJECTIVES AND GUIDELINES

A. Liquid Fund

1. The investment performance objectives for the Liquid Fund shall be to earn a return over a market cycle, which equals or exceeds the return on 90-day Treasury Bills.

2. The average maturity of the Liquid Fund shall not exceed 90 days, and the maximum final stated maturity of individual securities in the Liquid Fund may not exceed one year.

3. The District’s Treasurer shall communicate periodically with the investment adviser in order to keep the adviser informed as to the District's specific short-term liquidity requirements.

4. The Liquid Fund shall maintain a minimum fund balance sufficient to provide adequate cash reserves to pay current operating expenses.

B. Limited Maturity Fund

1. The investment performance objective of the Limited Maturity Fund is to earn a return that equals or exceeds the return of the ICE Bank of America Merrill Lynch 0-3 Year Treasury Index.

C. Operating Reserve Fund

1. The investment performance objective for the Operating Reserve Fund shall be to earn a rate of return over a market cycle, which exceeds the return on the ICE Bank of America Merrill Lynch 1-10 Year US Treasury and Agency Index, or an equivalent index determined by the District.

2. The maximum stated final maturity of individual investments in the Operating Reserve Fund is ten years.

VII. INVESTMENT POLICIES

A. Investment of District funds is governed by California Government Code Section 53601 et seq., a copy of which is attached to this policy as Exhibit B. A Summary of Permitted Investments, prepared by District's current investment adviser is attached as Exhibit A.

B. The District manages its investments under the prudent investor standard.

C. The District's Treasurer is designated by the Board of Directors as the officer responsible for the investment of District funds; provided, the Board may designate such responsibility to investment advisers pursuant to Section VII.D. below. The investment function shall be overseen by the Finance and Information Technology Committee of the Board of Directors.

D. Because the Operating Reserve Fund has the specific purpose of providing for long-term growth, and because cash flow requirements of the District are met through other investments, the Board of Directors hereby grants authority for the purchase of securities with maturities in excess of five years in the Operating Reserve Fund only.

E. The maximum stated final maturity of individual investments in the Operating Reserve Fund is be ten years.

F. No more than 40% of the Operating Reserve Fund may be invested in securities with maturities in excess of five years.

G. Investment securities and cash shall be held in a bank custody account in the name of the District

H. All investments shall be made as "delivery vs. payment" transactions.

VIII. Authorized Financial Institutions, Broker/Dealers, Depositories

A. The District shall work with financial institutions that are reputable and trustworthy, knowledgeable and experienced in Public Agency investing and able to meet all of their financial obligations. These institutions may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15c3-1 (uniform net capital rule).

B. In accordance with Section 53601.5, institutions eligible to transact investment business with the District include:

1. Primary government dealers as designated by the Federal Reserve Bank and non-primary government dealers.

2. Nationally or state-chartered banks.

3. The Federal Reserve Bank.

4. Direct issuers of securities eligible for purchase.

C. Selection of financial institutions and broker/dealers authorized to engage in transactions will be at the sole discretion of the District, except where the District utilizes an external investment adviser in which case the District may rely on the adviser for selection.

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

E. Selection of broker/dealers used by an external investment adviser retained by the District will be at the sole discretion of the adviser. Where possible, transactions with broker/dealers shall be selected on a competitive basis and their bid or offering prices shall be recorded. If there is no other readily available competitive offering, best efforts will be made to document quotations for comparable or alternative securities. When purchasing original issue instrumentality securities, no competitive offerings will be required as all dealers in the selling group offer those securities at the same original issue price.

IX. RISK MANAGEMENT AND DIVERSIFICATION

A. Mitigating Credit Risk in the Portfolio

Credit risk is the risk that a security or a portfolio will lose some or all of its value due to a real or perceived change in the ability of the issuer to repay its debt. The District will mitigate credit risk by adopting the following strategies:

a) The diversification requirements included in the "Authorized Investments" section of this policy are designed to mitigate credit risk in the portfolio.
b) No more than 5% of the total portfolio may be invested in securities of any single issuer, except where the issuer is the US Government, its Agencies and Government-Sponsored Enterprises (GSEs), an authorized Supranational issuer or where the security is a Money Market Mutual Fund, Local Agency Investment Fund (LAIF) or other Local Government Investment Pool.
c) The District may elect to sell a security prior to its maturity and record a capital gain or loss in order to manage the quality, liquidity or yield of the portfolio in response to market conditions or District's risk preferences.
d) If securities owned by the District are downgraded by a nationally recognized statistical rating organization (NRSRO) to a level below the quality required by this investment policy, it will be the District's policy to review the credit situation and make a determination as to whether to sell or retain such securities in the portfolio.
   (i) If a security is downgraded, the Treasurer will use discretion in determining whether to sell or hold the security based on its current maturity, the economic outlook for the issuer, and other relevant factors.
   (ii) If a decision is made to retain a downgraded security in the portfolio, its presence in the portfolio will be monitored and reported monthly to the Board of Directors.

B. Mitigating Market Risk in the Portfolio

Market risk is the risk that the portfolio value will fluctuate due to changes in the general level of interest rates. The District recognizes that, over time, longer-term portfolios have the potential to achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The

District will mitigate market risk by providing adequate liquidity for short-term cash needs, and by making longer-term investments only with funds that are not needed for current cash flow purposes.

The District further recognizes that certain types of securities, including variable rate securities, securities with principal paydowns prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments. The District, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

a) The District will maintain a minimum of six months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements.
b) The maximum percent of callable securities (does not include “make whole call” securities as defined in the Glossary) in the portfolio will be 20%.
c) The maximum stated final maturity of individual securities in the portfolio will be five (5) years, except as otherwise stated in this policy.
d) The duration of the portfolio will generally be approximately equal to the duration (typically, plus or minus 20%) of a Market Benchmark, an index selected by the District based on the District’s investment objectives, constraints and risk tolerances.

X. AUTHORIZED INVESTMENTS

A. The District’s investments are governed by California Government Code, Sections 53600 et seq. Within the investments permitted by the Code, the District seeks to further restrict eligible investments to the guidelines listed below. In the event a discrepancy is found between this policy and the Code, the more restrictive parameters will take precedence. Percentage holding limits listed in this section apply at the time the security is purchased.

B. Any investment currently held at the time the policy is adopted which does not meet the new policy guidelines can be held until maturity, and shall be exempt from the current policy (with the exception of credit quality). At the time of the investment’s maturity or liquidation, such funds shall be reinvested only as provided in the current policy.

C. An appropriate risk level shall be maintained by purchasing securities that are of high quality, liquid, and marketable. The portfolio shall be diversified by security type and institution to avoid incurring unreasonable and avoidable risks regarding specific security types or individual issuers.

D. The authorized investments are as listed below:

1. MUNICIPAL SECURITIES include obligations of the District, the State of California, any of the other 49 states, and any local District within the State of California, provided that:

a) The securities are rated in a rating category of "A" or higher by at least one nationally recognized statistical rating organization ("NRSRO").

b) No more than 5% of the portfolio may be invested in any single issuer.

c) No more than 30% of the portfolio may be in Municipal Securities.

d) The maximum stated maturity does not exceed five (5) years, with the exception of securities that have a "put" feature of five years or less.

2. U.S. TREASURIES and other government obligations for which the full faith and credit of the United States are pledged for the payment of principal and interest. There are no limits on the dollar amount or percentage of the portfolio that the District may invest in U.S. Treasuries, provided that:

a) The maximum maturity is five (5) years, with the exception of securities held in the Operating Reserve, which can have a stated maturity of 10 years.

3. FEDERAL AGENCIES or United States Government-Sponsored Enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises. There are no limits on the dollar amount or percentage of the portfolio that the District may invest in Federal District or GSEs, provided that:

a) No more than 25% of the portfolio may be invested in any single District/GSE issuer.

b) The maximum maturity does not exceed five (5) years, with the exception of securities held in the Operating Reserve, which may have a stated maturity of 10 years.

4. BANKER'S ACCEPTANCES, provided that:

a) They are issued by institutions which have short-term debt obligations rated in a rating category of "A-1" or higher by at least one NRSRO; or long-term debt obligations which are rated in a rating category of "A" or higher by at least one NRSRO.

b) No more than 40% of the portfolio may be invested in Banker's Acceptances.

c) No more than 5% of the portfolio may be invested in any single issuer.

d) The maximum maturity does not exceed 180 days.

5. COMMERCIAL PAPER, provided that:

a) The issuer is a corporation organized and operating in the United States with assets in excess of $500 million.

b) The securities are rated in a rating category of "A-1"or higher by at least one NRSRO.

c) The securities are issued by corporations which have long-term obligations rated in a rating category of "A" or higher by at least one NRSRO.

d) The District may purchase no more than 10% of the outstanding commercial paper of any single issuer.

e) No more than 25% of the portfolio may be invested in Commercial Paper.

f) No more than 5% of the portfolio may be invested in any single issuer.

g) The maximum maturity does not exceed 270 days.

6. NEGOTIABLE CERTIFICATES OF DEPOSIT (NCDS), issued by a nationally or state-chartered bank, a savings association or a federal association, a state or federal credit union, or by a federally licensed or state-licensed branch of a foreign bank, provided that:

a) The amount of the NCD insured up to the FDIC limit does not require any credit ratings.

b) Any amount above the FDIC insured limit must be issued by institutions which have short-term debt obligations rated in a rating category of "A-1" or higher by at least one NRSRO; or long-term obligations rated in a rating category of "A" or higher by at least one NRSRO.

c) No more than 30% of the total portfolio may be invested in NCDs

d) No more than 5% of the portfolio may be invested in any single issuer.

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

7. FEDERALLY INSURED TIME DEPOSITS (Non-Negotiable Certificates of Deposit) in state or federally chartered banks, savings and loans, or credit unions, provided that:

a) The amount per institution is limited to the maximum covered under federal insurance.

b) No more than 20% of the portfolio will be invested in a combination of federally insured and collateralized time deposits.

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

8. COLLATERALIZED TIME DEPOSITS (Non-Negotiable Certificates of Deposit) in state or federally chartered banks, savings and loans, or credit unions in excess of insured amounts which are fully collateralized with securities in accordance with California law, provided that:

a) No more than 20% of the portfolio will be invested in a combination of federally insured and collateralized time deposits.

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

9. COLLATERALIZED BANK DEPOSITS. District deposits with financial institutions will be collateralized with pledged securities per California Government Code, Section 53651.

10. REPURCHASE AGREEMENTS collateralized with securities authorized under California Government Code, maintained at a level of at least 102% of the market value of the Repurchase Agreement. There are no limits on the dollar amount or percentage that the District may invest, provided that:

a) Securities used as collateral for Repurchase Agreements will be delivered to an acceptable third party custodian.

b) Repurchase Agreements are subject to a Master Repurchase Agreement between the District and the provider of the repurchase agreement. The Master Repurchase Agreement will be substantially in the form developed by the Securities Industry and Financial Markets Association (SIFMA).

c) The maximum maturity does not exceed one (1) year.

11. STATE OF CALIFORNIA LOCAL DISTRICT INVESTMENT FUND (LAIF), provided that:

a) The District may invest up to the maximum amount permitted by LAIF.

b) LAIF's investments in instruments prohibited by or not specified in the District's policy do not exclude the investment in LAIF itself from the District's list of allowable investments, provided LAIF's reports allow the Treasurer and the outside investment adviser to adequately judge the risk inherent in LAIF's portfolio.

12. LOCAL GOVERNMENT INVESTMENT POOLS

a) The District may invest up to the maximum amount permitted by the following respective Local Government Investment Pools:

(1) CALTRUST

(2) California Asset Management Program (CAMP)

b) Local Government Investment Pool investments in instruments prohibited by or not specified in the District's policy do not exclude the investment in LGIPs itself from the District's list of allowable investments, provided the specific LGIP's reports allow the Treasurer and the outside investment adviser to adequately judge the risk inherent in LGIP's portfolio.

13. CORPORATE MEDIUM TERM NOTES (MTNS), provided that:

a) The issuer is a corporation 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.

b) The securities are rated in a rating category of "A" or higher by at least one NRSRO.

c) No more than 30% of the total portfolio may be invested in MTNs.

d) No more than 5% of the portfolio may be invested in any single issuer.

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

14. Mutual Funds that are registered with the Securities and Exchange Commission under the Investment Company Act of 1940 that invest in the securities and obligations as authorized under California Government Code, Section 53601 (a) to (k) and (m) to (q) inclusive and that meet either of the following criteria:

(1) Attained the highest ranking or the highest letter and numerical rating provided by not less than two (2) NRSROs; or

(2) Have retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience investing in the securities and obligations authorized by California Government Code, Section 53601 and with assets under management in excess of $500 million.

(3) No more than 10% of the total portfolio may be invested in shares of any one mutual fund.

(4) No more than 20% of the total portfolio may be invested in a combination of Mutual Funds and Money Market Mutual Funds.

15. MONEY MARKET MUTUAL FUNDS that are registered with the Securities and Exchange Commission under the Investment Company Act of 1940, provided that:

a) Such Funds meet either of the following criteria:

(1) *Have attained the highest ranking or the highest letter and numerical rating provided by not less than two (2) NRSROs; or*

(2) *Have retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience investing in the securities and obligations authorized by California Government Code, Section 53601 and with assets under management in excess of $500 million.*

(3) *No more than 20% of the total portfolio may be invested in a combination of Mutual Funds and Money Market Mutual Funds.*

16. SUPRANATIONALS, provided that:

a) Issues are US dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank.

b) The securities are rated in a rating category of "AA" or higher by a NRSRO.

c) No more than 30% of the total portfolio may be invested in these securities.

d) No more than 10% of the portfolio may be invested in any single issuer.

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

17. ASSET-BACKED, MORTGAGE-BACKED. MORTGAGE PASS-THROUGH SECURITIES, AND COLLATERALIZED MORTAGE OBLIGATIONS from issuers not defined in sections 2 and 3 of the Authorized Investments section of this policy, provided that:

a) The securities are rated in a rating category of "AA" or its equivalent or better by a NRSRO.

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

c) No more than 5% of the portfolio may be invested in any single Asset-Backed or Commercial Mortgage security issuer.

d) The maximum legal final maturity does not exceed five (5) years.

18. Prohibited Investment Vehicles and Practices

a) State law notwithstanding, any investments not specifically described herein are prohibited, including, but not limited to futures and options.

b) In accordance with Government Code, Section 53601.6, investment in inverse floaters, range notes, or mortgage derived interest-only strips is prohibited.

c) Investment in any security that could result in a zero interest accrual if held to maturity is prohibited.

d) Trading securities for the sole purpose of speculating on the future direction of interest rates is prohibited.

e) Purchasing or selling securities on margin is prohibited.

f) The use of reverse repurchase agreements, securities lending or any other form of borrowing or leverage is prohibited.

g) The purchase of foreign currency denominated securities is prohibited.

XI. Collateralization

A. CERTIFICATES OF DEPOSIT (CDs). The District shall require any commercial bank or savings and loan association to deposit eligible securities with an Agency of a depository approved by the State Banking Department to secure any uninsured portion of a Non-Negotiable Certificate of Deposit. The value of eligible securities as defined pursuant to California Government Code, Section 53651, pledged against a Certificate of Deposit shall be equal to 150% of the face value of the CD if the securities are classified as mortgages and 110% of the face value of the CD for all other classes of security.

B. COLLATERALIZATION OF BANK DEPOSITS. This is the process by which a bank or financial institution pledges securities, or other deposits for the purpose of securing repayment of deposited funds. The District shall require any bank or financial institution to comply with the collateralization criteria defined in California Government Code, Section 53651.

C. REPURCHASE AGREEMENTS. The District requires that Repurchase Agreements be collateralized only by securities authorized in accordance with California Government Code:

1. The securities which collateralize the repurchase agreement shall be priced at Market Value, including any Accrued Interest plus a margin. The Market Value of the securities that underlie a repurchase agreement shall be valued at 102% or greater of the funds borrowed against those securities.

2. Financial institutions shall mark the value of the collateral to market at least monthly and increase or decrease the collateral to satisfy the ratio requirement described above.

3. The District and its investment adviser shall receive monthly statements of collateral.

XII. Delivery, Safekeeping and Custody

A. DELIVERY-VERSUS-PAYMENT (DVP). All investment transactions shall be conducted on a delivery-versus-payment basis.

B. SAFEKEEPING AND CUSTODY. To protect against potential losses due to failure of individual securities dealers, and to enhance access to securities, interest payments and maturity proceeds, all cash and securities in the District's portfolio shall be held in safekeeping in the District's name by a third party custodian, acting as agent for the District under the terms of a custody agreement executed by the bank and the District. All investment transactions will require a safekeeping receipt or acknowledgment generated from the trade. A monthly report will be received by the District from the custodian listing all securities held in safekeeping with current market data and other information.

C. The only exceptions to the foregoing shall be depository accounts and securities purchases made with: (i) local government investment pools; (ii) time certificates of deposit, and, (iii) money market mutual funds, since the purchased securities are not deliverable.

XIII. Maximum Maturity

A. To the extent possible, investments shall be matched with anticipated cash flow requirements and known future liabilities.

XIV. REPORTING AND REVIEWS

A. Transactions and portfolio holdings

1. The bank custodian and the investment adviser shall each provide monthly statements of holdings and account activity to the District's Treasurer. The bank custodian shall also provide such information to the District's Investment Adviser(s).

2. Confirmations of all transactions and movement of funds shall be forwarded promptly to the District by the investment adviser. The investment adviser shall ensure a duplicate confirmation is provided to the District by the broker.

B. Investment performance

1. The investment adviser shall meet at least quarterly with District management and/or with the Finance & Information Technology Committee of the Board of Directors to review account activity, economic conditions and investment performance.

XV. AMENDMENTS

A. This Investment Policy is subject to amendment from time to time by the Board of Directors. Any changes must be approved by the Board of Directors and communicated in writing to the Treasurer and other responsible employees, appropriate third parties and investment advisers.

B. It shall be the responsibility of the investment adviser to inform the District of changes to the California Government Code, which affect the investment of District funds. Such changes shall be considered promptly by the Board of Directors.

C. The Investment Policy shall be reviewed and approved annually each fiscal year during the budget process.

XVI. GLOSSARY

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.

BID. The price at which a buyer offers to buy a security.

BROKER. A broker brings buyers and sellers together for a transaction for which the broker receives a commission. A broker does not sell securities from his own position.

CALLABLE. A callable security gives the issuer the option to call it from the investor prior to its maturity. The main cause of a call is a decline in interest rates. If interest rates decline since an issuer issues securities, it will likely call its current securities and reissue them at a lower rate of interest. Callable securities have reinvestment

risk as the investor may receive its principal back when interest rates are lower than when the investment was initially made.

CERTIFICATE OF DEPOSIT (CD). A time deposit with a specific maturity evidenced by a certificate. Large denomination CDs may be marketable.

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

COLLATERAL. Securities or cash pledged by a borrower to secure repayment of a loan or repurchase agreement. Also, securities pledged by a financial institution to secure deposits of public monies.

COLLATERALIZED MORTGAGE OBLIGATIONS (CMO). Classes of bonds that redistribute the cash flows of mortgage securities (and whole loans) to create securities that have different levels of prepayment risk, as compared to the underlying mortgage securities.

COMMERICAL 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 MAREKT 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.

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

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

PREMIUM. The difference between the par value of a bond and the cost of the bond, when the cost is above par.

PREPAYMENT SPEED. A measure of how quickly principal is repaid to investors in mortgage securities.

PREPAYMENT WINDOW. The time period over which principal repayments will be received on mortgage securities at a specified prepayment speed.

PRIMARY DEALER. A financial institution (1) that is a trading counterparty with the Federal Reserve in its execution of market operations to carry out U.S. monetary policy, and (2) that participates for statistical reporting purposes in compiling data on activity in the U.S. Government securities market.

PRUDENT PERSON (PRUDENT INVESTOR) RULE. A standard of responsibility which applies to fiduciaries. In California, the rule is stated as “Investments shall be managed with the care, skill, prudence and diligence, under the circumstances then prevailing, that a prudent person, acting in a like capacity and familiar with such matters, would use in the conduct of an enterprise of like character and with like aims to accomplish similar purposes.”

REALIZED YIELD. The change in value of the portfolio due to interest received and interest earned and realized gains and losses. It does not give effect to changes in market value on securities, which have not been sold from the portfolio.

REGIONAL DEALER. A financial intermediary that buys and sells securities for the benefit of its customers without maintaining substantial inventories of securities and that is not a primary dealer.

REPURCHASE AGREEMENT. Short-term purchases of securities with a simultaneous agreement to sell the securities back at a higher price. From the seller’s point of view, the same transaction is a reverse repurchase agreement.

SAFEKEEPING. A service to bank customers whereby securities are held by the bank in the customer’s name.

STRUCTURED NOTE. A complex, fixed income instrument, which pays interest, based on a formula tied to other interest rates, commodities or indices. Examples include inverse floating rate notes which have coupons that increase when other interest rates are falling, and which fall when other interest rates are rising, and "dual index floaters," which pay interest based on the relationship between two other interest rates - for example, the yield on the ten-year Treasury note minus the Libor rate. Issuers of such notes lock in a reduced cost of borrowing by purchasing interest rate swap agreements.

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

TOTAL RATE OF RETURN. A measure of a portfolio's performance over time. It is the internal rate of return, which equates the beginning value of the portfolio with the ending value; it includes interest earnings, realized and unrealized gains, and losses in the portfolio.

U.S. TREASURY OBLIGATIONS. Securities issued by the U.S. Treasury and backed by the full faith and credit of the United States. Treasuries are considered to have no credit risk, and are the benchmark for interest rates on all other securities in the US and overseas. The Treasury issues both discounted securities and fixed coupon notes and bonds.

TREASURY BILLS. All securities issued with initial maturities of one year or less are issued as discounted instruments, and are called Treasury bills. The Treasury currently issues three- and six-month T-bills at regular weekly auctions. It also issues "cash management" bills as needed to smooth out cash flows.

TREASURY NOTES. All securities issued with initial maturities of two to ten years are called Treasury notes, and pay interest semi-annually.

TREASURY BONDS. All securities issued with initial maturities greater than ten years are called Treasury bonds. Like Treasury notes, they pay interest semi-annually.

VOLATILITY. The rate at which security prices change with changes in general economic conditions or the general level of interest rates.

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