POLICY: INVESTMENT POLICY

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I. PURPOSE

To establish guidelines for the prudent investment of public funds in a manner that will protect City funds, meet daily cash flow expenditures, and comply with all federal, state, and local laws and ordinances governing the investment of public funds.

II. BACKGROUND

Effective January 1, 2006, Section 53646(a)(2) of the Government Code was modified to allow local agencies the option of adopting an annual Investment Policy or to adopt an Investment Policy that would remain in effect until changed. In June 2006, the City Council opted to adopt an Investment Policy each year, regardless of whether it changed or not.

III. POLICY

It shall be the policy of the City of Yorba Linda to annually review and adopt an Investment Policy. This Policy applies to all financial assets and funds held by the City of Yorba Linda and the Successor Agency to the Yorba Linda Redevelopment Agency. All Funds reflected in the City's Comprehensive Annual Financial Report are subject to this policy, including any new funds that are created, unless specifically exempted by the City Council. Retirement-related funds in a trust and bank deposits (governed under the California Government Code's "Deposit of Funds" provisions) are excluded from this Policy's requirements.

IV. PROCEDURES

The City Treasurer shall annually review the City's Investment Policy, and incorporate any changes in state law, recommendations from the City's Investment Advisor, recommendations from the various national and state organizations of municipal finance officers, or other changes recommended by City staff. The revised Investment Policy shall be presented to the Finance Committee and the City Council for review and approval.

(A) Responsibilities

No person may engage in investment activities except as provided under the terms of this Policy and the procedures established by the City Treasurer.

1. Responsibilities of the City Council

   The City Council shall annually consider and adopt a written Investment Policy. As provided in this Policy, the Council shall receive monthly City Treasurer Reports and the annual Investment Policy.

2. Responsibilities of the Finance Director / City Treasurer

   The Finance Director is appointed by and serves at the pleasure of the City Manager and is subject to his or her direction and supervision. The Finance Director is charged with responsibility for the conduct of all Finance Department functions.

   The City Treasurer is appointed by the City Council and is charged with responsibility for carrying out all investment actions. The City Council has historically appointed the Finance Director to also serve as City Treasurer, and at least annually delegates its authority to invest and reinvest the City's funds and to sell or exchange purchased securities to the City Treasurer in accordance with Government Code Section 53607. The City Treasurer may delegate the day-to-day investment activities to his/her designee(s) but not the responsibility for the overall investment program. If authorized by the City Council, the City Treasurer may also utilize the services of an external investment advisor to assist with the investment program.

3. Responsibilities of the City Manager

   The City Manager is responsible for keeping the City Council fully advised as to the financial condition of the City.

4. Responsibilities of the Finance Department

   Under the supervision of the Finance Director / City Treasurer, the Finance Department is charged with the responsibility for managing all public funds and securities belonging to or under the control of the City and Successor Agency and for the deposit and investment of those funds in accordance with principles of sound treasury management and applicable laws and ordinances. Appropriate internal controls designed to ensure that assets of the City are protected from loss, theft, or misuse, including but not limited to separation of duties and multiple approvers for transactions, shall be maintained at all times in order to safeguard the City's assets.

5. Responsibilities of the City's Investment Advisor

   Should the City determine that it is appropriate to engage a firm to manage the City's investment portfolio, the Investment Advisor shall invest the City's funds in investments that are in compliance with this policy and provide accurate and timely reports of its investment activities to City staff. The Investment Advisor shall never take possession of the City's funds or assets.

6. Responsibilities of the City's Auditing Firm

The City's auditing firm's responsibilities shall include, but are not limited to, the examination and analysis of fiscal procedures and the examination, checking, and verification of accounts, revenues, and expenditures. A review of the City's investment program is a part of this responsibility.

(B) Prudent Investor Rule

The City of Yorba Linda makes its cash investments under the prudent investor rule (Government Code Section 53600.3), which states, in essence, that in investing and managing property, a trustee shall act with the 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 City, that a prudent person acting in a like capacity and familiar with those matters would use in conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the City. Within the limitations of the Government Code and considering individual investments as part of an overall strategy, investment may be acquired as authorized by law. This affords the City a broad spectrum of investment opportunities as long as an investment is deemed prudent as is allowable under the current laws of the State of California.

The City Treasurer and other individuals assigned to manage the investment portfolio, acting in accordance with state law and the intent and scope of the Investment Policy and other written procedures and exercising due diligence, shall be relieved of personal responsibility and liability for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely manner and appropriate action is taken to control adverse developments.

(C) Ethics and Conflicts of Interest

Officers and employees involved in the investment process shall refrain from personal business activity that conflicts with proper execution of the investment program or impairs their ability to make impartial investment decisions. Additionally, the City Treasurer, other employees designated in the City's conflict of interest code, and the City's Investment Advisor, if one is used, are required to annually file applicable financial disclosures as required by the Fair Political

Practices Commission (FPPC) and are subject to California law relative to conflicts of interest.

(D) Level of Investment

The City strives to maintain the level of investment of all investable cash as near to 100 percent as possible through current and projected cash flow management. The City Treasurer shall maintain a system to monitor and forecast revenues and expenditures so that City funds can be invested to the fullest extent possible while providing sufficient liquidity to meet the City's reasonably anticipated cash flow requirements. Maturities of investments will be selected to provide necessary liquidity, manage interest rate risk, and optimize earnings. Because of inherent difficulties in accurately forecasting cash flow requirements, a portion of the portfolio should be continuously invested in readily available funds.

(E) Investment Criteria

The City seeks safety and liquidity in all of its investments followed by yield. Safety, liquidity, and yield are defined as follows:

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.

2. *Liquidity*. The investment portfolio shall remain sufficiently liquid to meet 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.

3. *Yield*. The investment portfolio shall be designed with the objective of attaining a market rate of return, 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.

(F) Allowable Investments

Sections 53601 & ~~53635~~ 16429.1 of the California Government Code govern allowable investments. The City shall not invest in any investment authorized by the Government Code, but not explicitly listed in this Policy without the prior approval of the City Council. In the event that an apparent discrepancy is found between this Policy and the Government Code, the more restrictive parameters will take precedence. If collateral is required for a particular investment type, it will be provided in compliance with California Government Code requirements. Furthermore, the City will not invest in inverse floaters, range notes, mortgage-derived, interest-only strips, or any security that could result in zero interest accrual if held to maturity. Prior to investing in any pooled investment program (e.g., LAIF, LGIPs, mmfs), the City Treasurer should review the program's documentation (e.g., investment policy, policies for participation, fees) to determine the appropriateness of the pool for City funds. Whenever the City has funds invested in a pooled investment program, the City Treasurer should periodically review the pool's investment holdings.

The City shall diversify the investments within the portfolio to avoid incurring unreasonable risks inherent in over-investing in specific instruments, individual financial institutions, or maturities. To promote diversification, no more than 5% of the portfolio may be invested in the securities of any one issuer, regardless of security type; excluding U.S. Treasuries, federal agencies, supranationals, and pooled investments such as LAIF, money market funds, or local government investment pools.

Credit ratings, where shown, specify the minimum credit rating category required at purchase. For purposes of this Policy, the minimum rating will be determined by the lowest rating by Standard & Poor's, Moody's, or Fitch. In the event that an investment originally purchased within Policy guidelines is downgraded below the Policy requirements, the course of action to be followed by the City Treasurer will then be decided on a case-by-case basis, considering such factors as the reason for the downgrade, prognosis for recovery or further rating downgrades, and the market price of the security.

The weighted average duration of the investment portfolio shall not exceed 3.0 years. For those investment types for which this Policy does not specify a maturity limit, no individual investment shall exceed a maturity of five years from the date of purchase unless the City Council has granted express authority to make that investment either specifically or as a part of an investment program approved by the City Council no less than three months prior to the investment.

The following types of investments are authorized by this Policy:

1. **U.S. Treasury Instruments.** United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest. There is no limitation as to the percentage of the City's portfolio that may be invested in this category.

2. **State of California's Local Agency Investment Fund (LAIF).** A State of California-managed investment pool. The maximum amount invested in this category may not exceed the limit set by LAIF for operating accounts.

3. **Local Government Investment Pools ("LGIP").** Shares of beneficial interest issued by a joint powers authority organized pursuant to Section 6509.7 that invests in the securities and obligations authorized in Government Code. The City will limit investments to LGIPs that seek to maintain a stable net asset value. There is no limitation as to the percentage of the City's portfolio that may be invested in this category.

4. **Municipal Debt.** Registered state warrants or treasury notes or bonds of this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency, or authority of the state.

   Registered treasury notes or bonds of any of the other 49 states in addition to California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the other 49 states, in addition to California.

   Bonds, notes, warrants, or other evidences of indebtedness of a local agency within this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority of the local agency.

   Purchases are limited to securities rated in a rating category of "A" (long-term) or "A-1" (short-term) or their equivalents or better by an NRSRO. A maximum of 30% the City's portfolio may be invested in this category.

5. **Federal Agency Securities.** Federal agency or United States government-sponsored enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises. There is no limitation as to the percentage of the City's portfolio that may be invested in this category.

6. **Negotiable Certificates of Deposit.** Negotiable certificates of deposit 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. Purchases are limited to securities rated in a rating category of “A” (long-term) or “A-1” (short-term) or their equivalents or better by an NRSRO. A maximum of 30% the City’s portfolio may be invested in this category.

8. **Commercial Paper.** Commercial paper of “prime” quality of the highest ranking or of the highest letter and number rating as provided for by a nationally recognized statistical rating organization (NRSRO). The entity that issues the commercial paper shall meet all of the following conditions in either paragraph (1) or (2):

    (1) The entity meets the following criteria: (A) Is organized and operating in the United States as a general corporation; (B) Has total assets in excess of five hundred million dollars ($500,000,000), and (C) Has debt other than commercial paper, if any, that is rated in a rating category of “A” or its equivalent or better by an NRSRO.

    (2) The entity meets the following criteria: (A) Is organized within the United States as a special purpose corporation, trust, or limited liability company, (B) Has program-wide credit enhancements including, but not limited to, overcollateralization, letters of credit, or a surety bond, and (C) Has commercial paper that is rated “A-1” or better, or the equivalent, by an NRSRO.

    Purchases are limited to securities that have a maximum maturity of 270 days. A maximum of 30% the City’s portfolio may be invested in this category.

9. **Medium-Term Notes.** Medium-term notes, defined as all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States. Purchases are limited to securities rated in a rating category of “A” or its equivalent or better by an NRSRO. A maximum of 30% the City’s portfolio may be invested in this category.

10. **Money Market Funds (“MMF”).** Purchases are restricted to Government Money Market Funds. Furthermore, these Money Market Funds must have met either of the following criteria: (A) Attained the

highest ranking or the highest letter and numerical rating provided by not less than two NRSROs, or (B) Retained an investment advisor with not less than five years' experience and registered or exempt from registration with the SEC, with assets under management in excess of five hundred million dollars ($500,000,000). A maximum of 20% of the City's portfolio may be invested in this category.

11. **Supranational Obligations.** United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank, with a maximum remaining maturity of five years or less, and eligible for purchase and sale within the United States. Investments under this subdivision shall be rated in a rating category of "AA" or its equivalent or better by a Nationally Recognized Statistical Rating Organization ("NRSRO"). A maximum of 30% the City's portfolio may be invested in this category.

12. **Asset-Backed Securities.** A mortgage passthrough security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable passthrough certificate, or consumer receivable-backed bond of a maximum of five years' maturity. Securities eligible for investment under this subdivision shall be rated in a rating category of "AA" or its equivalent or better by an NRSRO. A maximum of 20% the City's portfolio may be invested in this category.

(G) Performance Standards

The investment portfolio shall be managed with the objective of obtaining a rate of return throughout budgetary and economic cycles, commensurate with the investment risk constraints and the cash flow needs. The City will employ an active management approach that allows for the sale of securities prior to their scheduled maturity dates for purposes of improving the portfolio's credit quality, liquidity, or return in response to changing market conditions or City circumstances. This Policy recognizes that in a diversified portfolio occasional measured losses are inevitable and must be considered within the context of the overall portfolio's structure and expected investment return, with the proviso that adequate diversification and credit analysis have been implemented.

An appropriate performance benchmark shall be established against which portfolio performance shall be compared on a regular basis. The selected performance benchmark shall be representative of the City's overall investment objectives and liquidity requirements.

(H) Investment Reporting and Portfolio Review

A monthly Treasurer's Report shall be prepared and submitted to the City Council, which shall include a complete description of the portfolio, type of investments, issuers, and other relevant information.

The City Treasurer shall review the portfolio at least on a quarterly basis to verify that the securities in the portfolio are in compliance with this Policy and shall report any issues of material non-compliance in the next monthly Treasurer's Report. Percentage holding limits and diversification requirements listed in this Policy apply at the time a security is purchased. If a percentage holding limit or diversification requirement is exceeded due to a subsequent change in the portfolio, it is not a compliance violation, but no additional securities may be purchased in that category or for that issuer until the holdings are back under the Policy limits. Credit ratings, where shown, specify the minimum credit rating category required at purchase. In the event a security held by the City is subject to a credit rating change that brings it below the minimum credit ratings specified in this Policy, the City Treasurer should notify the City Council of the change in the next monthly Treasurer's Report. The course of action to be followed will then be decided on a case-by-case basis, considering such factors as the reason for the change, prognosis for recovery or further rating downgrades, and the market price of the security. If a security is determined to be out of compliance with this Policy due to a subsequent change in this Policy or the Government Code, it may be held to maturity unless there is a requirement that the security be sold.

(I) Debt Proceeds

Debt proceeds and bond reserve funds are to be invested in accordance with their respective bond indenture. If the indenture is silent as to the permitted investments, the bond proceeds will be invested in the securities permitted by this Policy. Notwithstanding the other provisions of this Policy, the percentage limitations listed elsewhere in this Policy do not apply to bond proceeds and bond proceeds may be invested beyond five years if the maturities of such investments do not exceed the expected use of the funds, the investments are deemed prudent in the opinion of the City Treasurer, and the investments are not prohibited by the applicable bond documents. Tax and Revenue Anticipation Notes or other temporary financing proceeds shall not be invested for a term that exceeds the term of the debt.

(J) Safekeeping

To protect against potential losses by collapse of individual securities dealers, all deliverable securities owned by the City, including collateral on repurchase agreements, shall be held in safekeeping by a third party bank trust department acting as agent for the City under the terms of a custody agreement executed by the bank and by the City. All deliverable securities will be received and delivered using standard delivery-versus-payment procedures.

(K) Qualified Financial Institutions and Broker/Dealers

Investments not purchased directly from the issuer, shall be purchased either from an institution licensed by the state as a broker-dealer or from a member of a federally regulated securities exchange, from a national or state-chartered bank, from a savings association or federal association, or from a brokerage firm designated as a primary government dealer by the Federal Reserve Bank. If the City is utilizing a financial dealer or institution to execute transactions, the City Treasurer shall maintain a list of the firms that have been approved for investment purposes. A copy of this Policy shall be sent annually to all firms with which the City executes investments.

If the City has contracted with an Investment Advisor to provide investment services, the Investment Advisor may use their own list of approved issuers, brokers/dealers, and financial institutions with which to conduct transactions on the City's behalf.

V. DEFINITIONS

AGENCIES: Securities issued by federal agency securities and/or Government-sponsored enterprises (e.g. FNMA, FHLMC, FHLB).

AMORTIZED COST (or Book Value): For investments purchased at a discount, amortized cost constitutes cost plus interest earned to date.

ASKED: The price at which securities are offered for sale; also known as offering price.

ASSET-BACKED SECURITIES (ABS): Securities whose income payments and hence value is derived from and collateralized (or "backed") by a specified pool of underlying assets which are receivables. Pooling the assets into financial instruments allows them to be sold to general investors, a process called securitization, and allows the risk of investing in the underlying assets to be diversified because each security will represent a fraction of the total value of the diverse pool of underlying assets. The pools of underlying assets can comprise common payments credit cards, auto loans, mortgage loans, and other types of assets. Interest and principal is paid to investors from borrowers who are paying down their debt.

BASIS POINT: One hundredth of one percent (i.e. 0.01 percent).

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

BID: The price offered by a buyer of securities. (When you are selling securities, you ask for a bid.) See Offer.

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

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.

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

COMMERCIAL PAPER: An unsecured promissory note with a fixed maturity no longer than 270 days.

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

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report of the City. It includes financial statements in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

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

CREDIT RISK: The risk to an investor that an issuer will default in the payment of interest and/or principal on a security and a loss will result.

CUSTODIAN: A bank or other financial institution that keeps custody of stock certificates and other assets.

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

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

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

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

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

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

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

DURATION: A measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. This calculation is based on three variables: term to maturity, coupon rate, and yield to maturity. Duration is expressed as a number of years. The duration of a security is a useful indicator of its price volatility for given changes in interest rates. Rising interest rates mean falling bond prices, while declining interest rates mean rising bond prices.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits.

FEDERAL FARM CREDIT BANK (FFCB): Government-sponsored institution that consolidates the financing activities of the Federal Land Banks, the Federal Intermediate

Credit Banks and the Banks for Cooperatives. Its securities do not carry direct U.S. Government guarantees.

FEDERAL FUNDS RATE: The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

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

FEDERAL HOME LOAN MORTGAGE CORPORATION (FHLMC or Freddie Mac): Established in 1970 to help maintain the availability of mortgage credit for residential housing. FHLMC finances these operations by marketing guaranteed mortgage certificates and mortgage participation certificates. FHLMC's securities are highly liquid and are widely accepted. FHLMC is currently operated under conservatorship of the U.S. Government.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA or Fannie Mae): FNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a Federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. The corporation's purchases include a variety of adjustable mortgages and second loans, in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA is currently operated under conservatorship of the U.S. Government.

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

FEDERAL RESERVE SYSTEM: The central bank of the U.S. which consists of seven member Board of Governors, 12 regional banks, and about 5,700 commercial banks that are members.

FINANCIAL INDUSTRY REGULATORY AUTHORITY (FINRA): The Financial Industry Regulatory Authority (FINRA) is the largest independent regulator for all securities firms doing business in the United States. All told, FINRA oversees nearly 4,750 brokerage firms, about 167,000 branch offices and approximately 634,000 registered securities representatives.

INTEREST RATE RISK: The risk of gain or loss in market values of securities due to changes in interest-rate levels. For example, rising interest rates will cause the market value of portfolio securities to decline.

INVESTMENT POLICY: A clear and concise statement of the objectives and parameters formulated by an investor or investment manager for a portfolio of investment securities.

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

LOCAL AGENCY INVESTMENT FUND (LAIF): The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment purposes.

LOCAL GOVERNMENT INVESTMENT POOL (LGIP): A type of pooled investment program in which funds from local agency investors/participants are aggregated together for investment purposes.

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

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

MEDIUM-TERM NOTES (MTNs): Unsecured corporate obligations. For purposes of the California Government Code, they have a maximum remaining maturity of five years or less.

MONEY MARKET: The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

MONEY MARKET FUND. A type of mutual fund that invests exclusively in short-term investments.

MORTGAGE-BACKED SECURITIES (MBS): These securities represent an ownership interest in mortgage loans made by financial institutions (savings and loans, commercial banks, or mortgage companies) to finance the borrower's purchase of a home or other real estate. MBS are created when these loans are packaged, or “pooled,” by issuers or servicers for sale to investors. As the underlying mortgage loans are paid off by the homeowners, the investors receive payments of interest and principal.

MUTUAL FUND: A fund operated by an investment company that raises money from shareholders and invests it on their behalf. Profits are distributed to shareholders after the investment company deducts its management fee. Mutual funds are regulated by the SEC.

NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO): A credit rating agency that issue credit ratings that the U.S. Securities and Exchange Commission (SEC) permits other financial firms to use for certain regulatory purposes. The largest three NRSROs are Standard & Poor’s, Moody’s Investors Service and Fitch Ratings.

NEGOTIABLE: Something that can be sold or transferred to another party.

NEGOTIABLE CERTIFICATES OF DEPOSIT: Large denomination certificates of deposit with a fixed maturity date, which can be sold in the money market. They are not collateralized.

OFFER: The price asked by a seller of securities. (When you are buying securities, you ask for an offer.) See Asked and Bid.

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

PAR VALUE: The amount of principal that must be paid at maturity. Also referred to as the face amount of a bond, normally quoted in increments of $1,000 per bond.

PORTFOLIO: Collection of securities held by an investor.

PRIMARY DEALER: A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC)-registered securities broker-dealers, banks, and a few unregulated firms.

PREMIUM: The amount by which a security sells above its par value.

PRINCIPAL: The face or par value of a debt instrument or the amount of capital invested in a given security.

PRUDENT INVESTORS RULE: An investment standard. In California, persons authorized to make investment decisions on behalf of a local agency are considered trustees and therefore fiduciaries subject to the Prudent Investor Rule. A trustee may invest in a security if it is one which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

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

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

SAFEKEEPING: A service banks offer to clients for a fee, where physical securities are held in the bank's vault for protection and book-entry securities are on record with the Federal Reserve Bank or Depository Trust Company in the bank's name for the benefit of the client. As agent for the client, the safekeeping bank settles securities transactions, collects coupon payments, and redeems securities at maturity or, if called, on the call date.

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

SECURITIES: Investment instruments such as notes, bonds, stocks, money market instruments and other instruments of indebtedness of equity.

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

SPREAD: The difference between two figures or percentages. It may be the difference between the bid (price at which a prospective buyer offers to pay) and asked (price at which an owner offers to sell) prices of a quote, or between the amount paid when bought and the amount received when sold.

SUPRANATIONAL: Supranational entities are formed by two or more central governments with the purpose of promoting economic development for the member countries. Supranational institutions finance their activities by issuing debt, such as supranational bonds. Examples of supranational institutions include the European Investment Bank and the World Bank. Similarly to the government bonds, the bonds issued by these institutions are considered direct obligations of the issuing nations and have a high credit rating.

TREASURY SECURITIES. Obligations issued by the federal government, which are backed by the U.S. Government's full faith & credit. Generally considered to have the lowest credit risk of any security. They are issued in a range of maturities:

- TREASURY BILLS. Are short-term, non-interest bearing discount security having initial maturities of one-year or less.
- TREASURY NOTES. Are Intermediate-term coupon-bearing securities having initial maturities from two to ten years.
- TREASURY BONDS. Are long-term coupon-bearing securities having initial maturities of more than ten years.

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

WEIGHTED AVERAGE MATURITY (OR DURATION): The sum of the amount of each investment multiplied by the number of days to maturity (or duration), divided by the total amount of investments.

YIELD: The annual rate of return on an investment expressed as a percentage of the investment. Income yield is obtained by dividing the current dollar income by the current market price for the security.

YIELD CURVE: Yield calculations of various maturities of instruments of the same quality at a given time to show yield relationships.