San Gorgonio Pass Water Agency

DATE: September 24, 2026

TO: Finance and Budget Committee

FROM: Lance Eckhart, General Manager

BY: Jennifer Ustation, Chief Financial Officer

SUBJECT: Update to the Agency Investment Policy

RECOMMENDATION

Staff recommends that the Budget and Finance Committee review the proposed revisions to the Investment Policy and recommend that the Board of Directors adopt the updated policy.

PREVIOUS CONSIDERATION

- Board Meeting – July 12, 2021: The Board adopted Resolution No. 2021-11 Update to Investment Policy and Guidelines
- Board Meeting - May 24, 2021: The Board adopted Resolution No. 2021-07 Update to Investment Policy and Guidelines

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BACKGROUND

The Board last updated the Agency's Investment Policy on **July 12, 2021**. The policy establishes the framework for investing Agency funds, with safety of principal, liquidity, and return on investment as its priorities. Staff have reviewed the policy and prepared an update to provide clearer direction for investment management and Board oversight.

ANALYSIS

The proposed update clarifies the authority delegated to manage investments and updates references to applicable California Government Code provisions. It provides more detailed guidance on authorized investments and financial institutions, investment pools, collateralization, and safekeeping and custody. The revisions also address portfolio review, internal controls, performance standards, and investment reporting. A glossary is included to make the policy easier to apply consistently.

The updated policy is designed for submission to the California Municipal Treasurer's Association (CMTA)'s Investment Policy Certification Program after Board adoption. The program offers independent review and feedback on investment policies to meet the industry's best practices for California's public sector agencies and districts. Submission does not guarantee certification; CMTA makes that determination through its review process. Policies that did not meet the criteria with a score of 85 or above can resubmit for no additional charges if done within 90 days of notification.

FISCAL IMPACT

Adoption of the policy does not, by itself, direct an investment transaction. The currently listed CMTA application fee for a participating member is **$175**.

ACTION

The Finance and Budget Committee will review and recommend approval of the updated Investment Policy to the Board of Directors.

ATTACHMENTS

Updated Investment Policy (Redlined)

RESOLUTION NO. 2026-08

SAN GORGONIO PASS WATER AGENCY
INVESTMENT POLICY AND GUIDELINES
RESCINDING RESOLUTION #2021-11

BE IT RESOLVED by the Board of Directors of the San Gorgonio Pass Water Agency ("Agency") that the following is the policy and guidelines of the Agency for Investment of funds and that adoption of this Resolution 2021-11 does hereby revise and nullify Resolution 2021-07.

Policy
The purpose of this investment policy ("Policy") is to identify prudent policies and procedures that shall govern the investment of the Agency's funds. The ultimate goal of this Policy is to protect the safety of the invested funds, enhance the economic status of the Agency, and to ensure that all investments comply with federal, state, and local laws governing the investment of the funds covered by this Policy.

Scope
This Policy shall cover all funds and investment activities under the direct authority of the Agency and accounted for in the Audited Financial Statements, except for the employee's retirement and deferred compensation funds. In addition, deposits with banks under the California Government Code's "Deposit of Funds" provisions are excluded from this Policy's requirements.

Bond proceeds shall be invested in the securities permitted by the applicable bond documents. If the bond documents are 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.

Objectives
The primary objectives, in priority order, for the Agency's investment activities shall be:

1. **Safety:** Safety of principal is the foremost objective of the investment program. The Agency's investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio.
2. **Liquidity:** The Agency's investment portfolio will remain sufficiently liquid to enable the Agency to meet all operating requirements, which might be reasonably anticipated.
3. **Return on Investment:** The Agency's investment portfolio shall be managed with the objective of attaining a market rate of return throughout budgetary and economic cycles.

The remainder of this Policy describes the policies and procedures to be followed in support of these objectives.

Prudence
All persons authorized to make investment decisions on behalf of the Agency 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. Authorized persons, acting in accordance with written procedures and this 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 appropriate action is taken to control adverse developments.

Delegation of Authority

As permitted under California Government Code 53607 responsibility for the investment program delegates the responsibility to invest or reinvest by the Agency's Board of Directors ("Board") to the Treasurer and the Assistant Treasurer in Resolution Nos. 1994-09 and 2005-10. The Treasure/Assistant Treasurer may delegate the day-to-day investment activities to their designee(s) but not the responsibility for the overall investment program.

As authorized by the Board, the Agency may contract with an SEC registered investment adviser to assist the Treasurer/Assistant Treasurer with the Agency's investment program. The investment adviser's actions shall be in conformance with this Policy and any written direction provided by the Treasurer/Assistant Treasurer. The investment adviser shall never take possession of the Agency's cash or assets.

Ethics and Conflicts of Interest

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Additionally, the Treasurer/Assistant Treasurer, other employees designated by the Agency, and the Investment Advisor, if one is used, are required to prepare an Annual Conflict of Interest Statement (FPPC Form 700). Further, in compliance with California Government Code 5328.2, all Agency officials and employees with investment responsibilities shall complete fiscal and financial training as required by law.

Internal Controls

The Chief Financial Officer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the Agency are protected from loss, theft, or misuse. The procedures should include references to individuals authorized to execute transactions or transfers, safekeeping agreements, repurchase agreements, wire transfer agreements, collateral/depository agreements and banking services contracts, as appropriate. 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 judgement by management. Compliance with this Policy and internal controls shall be reviewed annually by the Agency's independent auditor.

Authorized Financial Dealers and Institutions

The Treasurer (or Chief Financial Officer) will maintain a list of approved financial institutions authorized to provide investment services to the public agency in the State of California. These may include “primary” dealers 3 or regional dealers that qualify under Securities & Exchange Commission Rule 15C3-1 (uniform net capital rule). Best practices include the following: 1) A determination that all approved broker/dealer firms, and individuals covering the public agency, are reputable and trustworthy; 2) the broker/dealer firms should have the ability to meet all their financial obligations in dealing with the Public Agency; 3) the firms, and individuals covering the agency, should be knowledgeable and experienced in Public Agency investing and the investment products involved; 4) no public deposit shall be made except in a qualified public depository as established by the established state laws; 4) all financial institutions and broker/dealers who desire to conduct investment transactions with the public agency may supply the Treasurer (or Chief Financial Officer) with audited financial statements, proof of FINRA certification, trading resolution, proof of State of California registration, a completed broker/dealer questionnaire, certification of having read the Public Agency’s investment policy and depository contracts.

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 Agency is utilizing financial dealers or institutions to execute transactions, the Treasurer/Assistant 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 Agency executes investments.

If the Agency 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 Agency's behalf.

Authorized and Suitable Investments

The California Government Code provides basic investment limits and guidelines for government entities. In the event an apparent discrepancy is found between this Policy and the Government Code, the more restrictive parameters will take precedence. Percentage holding limits listed in this Policy apply at the time the security is purchased. Credit ratings, where shown, specify the minimum credit rating category required at purchased. In the event a security held by the Agency is subject to a credit rating change that brings it below the minimum credit ratings specified in this Policy, the Treasurer/Assistant Treasurer should notify the Board of the change in the next quarterly investment 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 rate drops, and the market price of the security.

A **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 Agency's portfolio that may be invested in this category.

B. 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 Agency's portfolio that may be invested in this category.

C. **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% of the Agency's portfolio may be invested in this category.

D. 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% of the Agency's portfolio may be invested in this category.

E. **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% of the Agency's portfolio may be invested in this category.

F. **Negotiable CDs.** 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% of the Agency's portfolio may be invested in this category.

G. **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. For securities eligible for investment under this subdivision not issued or guaranteed by an agency or issuer identified in paragraph (A) or (B) of this Policy section, the following limitations apply: The security shall be rated in a rating category of “AA” or its equivalent or better by an NRSRO and have a maximum remaining maturity of five years or less. Purchase of securities authorized by this paragraph shall not exceed 20% of the Agency’s investment portfolio.

H. Commercial Paper. Commercial paper of "prime" quality of the highest ranking or of the highest letter and number rating as provided for by an 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 397 days. A maximum of 25% of the Agency's portfolio may be invested in this category.

I. **State of California's Local Agency Investment Fund (LAIF).** Whenever the Agency has funds invested in LAIF, the Treasurer/Assistant Treasurer shall periodically review the program's investments. The maximum amount invested in this category may not exceed the limit set by LAIF for operating accounts.

J. **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 subdivisions (a) to (q) of Government Code Section 53601, inclusive. Each share will represent an equal proportional interest in the underlying pool of securities owned by the joint power’s authority. To be eligible under this section, the joint powers authority issuing the shares will have retained an investment advisor that meets all of the following criteria:

(1) The advisor is exempt from registration with the Securities and Exchange Commission.
(2) The advisor has not less than five years of experience investing in the securities and obligations authorized in subdivisions (a) to (q) California Government Code53601, inclusive.
(3) The advisor has assets under management in excess of five hundred million dollars ($500,000,00).

K. **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 offive hundred million dollars ($500,000,000). Whenever the Agency has any funds invested in an MMF, the Treasurer/Assistant Treasurer shall maintain on file a copy of the MMF's current information statement. A maximum of 20% of the Agency's portfolio may be invested in this category.

Review of Investment Portfolio

The securities held by the Agency must be in compliance with Section 8.0 Authorized and Suitable Investments of California Government Code 53601 at the time of purchase. Because some securities may not comply with Section 8.0 Authorized and Suitable Investments subsequent to the date of purchase, the Agency should at least annually review the portfolio to identify those securities that do not comply.

Ineligible Investments

The Agency shall not invest in any investment authorized by the Government Code, but not explicitly listed in this Policy without the prior approval of the Board. Furthermore, the Agency 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, except as authorized by Government Code Section 53601.6. The Agency may hold any previously permitted but currently prohibited investments until their maturity dates.

Diversification

The Agency 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.

Maximum Maturities

The Treasurer/Assistant Treasurer and/or their designee(s) shall maintain a system to monitor and forecast revenues and expenditures so that Agency funds can be invested to the fullest extent possible while providing sufficient liquidity to meet the Agency'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.

The weighted average maturity 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 Board has granted express authority to make that investment either specifically or as a part of an

investment program approved by the Board no less than three months prior to the investment.

This Policy authorizes investing bond project and reserve funds 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 Treasurer/Assistant Treasurer, and the investments are not prohibited by the applicable bond documents.

Investment Pools/ Mutual Funds

A thorough investigation of the pool/fund is required prior to investing, and on a continual basis. Best efforts will be made to acquire the following information:

1. A description of eligible investment securities, and a written statement of investment policy and objectives.

2. A description of interest calculations and how it is distributed, and how gains and losses are treated.

3. A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced and the program audited.

4. A description of who may invest in the program, how often, what size deposit and withdrawal are allowed. 7

5. A schedule for receiving statements and portfolio listings.

6. Are reserves, retained earnings, etc. utilized by the pool/fund?

7. A fee schedule, and when and how is it assessed.

8. Is the pool/fund eligible for bond proceeds and/or will it accept such proceeds?

Collateralization

All demand deposits and time deposits must be collateralized in accordance with Cal. Govt. Code, section 53630 et seq. To provide an additional margin of safety, collateral for certificates of deposit shall have a market value of at least 110% of the deposit amount, except for any portion covered by federal deposit insurance. Collateral shall be held by an independent third party under a current custodial agreement, with evidence of ownership retained by the Agency.

Safekeeping and Custody To protect against potential losses by collapse of individual securities dealers, all deliverable securities owned by the Agency, including collateral on repurchase agreements, shall be held in safekeeping by a third party bank trust department acting as agent for the Agency under

the terms of a custody agreement executed by the bank and by the Agency. All deliverable securities will be received and delivered using standard delivery-versus-payment procedures.

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 Agency 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 Agency 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 Agency's overall investment objectives and liquidity requirements.

Reporting

The Treasurer/Assistant Treasurer will prepare a quarterly investment report withing 45 days following the end of each quarter per CA GOVT CODE 53646 (b) that shall include a description of the portfolio, type of investments, issuers, maturity dates, par values and current market values of each component of the portfolio, list of transactions, including funds managed for the Agency by third party contract managers. The report will include a certification that: (1) all investment actions executed since the last report have been made in full compliance with this Policy and (2) the report shall include a statement denoting the ability of the Agency to meet its expenditure requirements for the next six months or provide an explanation as to why sufficient money shall or may not be available. The Treasurer/ Assistant Treasurer must provide a monthly report to the legislative body regarding all investment transactions per CA GOVT CODE 53607.

Investment Policy Adoption

The Agency's investment policy shall be adopted by resolution of the Board. This Policy and the Agency's agreement with **PFM** Asset Management shall be reviewed annually by the Treasurer/Assistant Treasurer and any modifications made thereto must be approved by the Board of Directors.

GLOSSARY

The glossary is provided for general information only. It is not to be consider a part of the Policy for determining Policy requirements or terms.

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 (entity). It includes five combined statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

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.