GOLDEN STATE RISK MANAGEMENT AUTHORITY

INVESTMENT POLICY
AND
GUIDELINES

ADOPTED JULY 8, 2015
Re-approved September 19, 2018

CONTENTS

I. INTRODUCTION

Golden State Risk Management Authority ("GSRMA" or the "Authority") is a Joint Powers Authority established pursuant to California Government Code Section 6500 et. seq. GSRMA was originally formed on July 1, 1979 under the name Glenn County Joint Powers Authority (GCJPA). In response to continued inquiries by public agencies physically located outside of Glenn County, GCJPA was renamed Golden State Risk Management Authority effective July 1, 2000. GSRMA is a risk-sharing insurance pool that offers a full line of programs to cover the many unique exposures of public entities throughout the State of California, including, but not limited to, cemetery districts, special districts (water, sewer, and lighting), fire districts, school districts, counties and cities. A seven person Board, as established in its Bylaws, governs GSRMA.

The purpose of this investment policy is to identify various policies and procedures that will foster a prudent and systematic investment program designed to seek GSRMA's objectives of safety, liquidity and yield through a diversified investment portfolio. This policy also serves to organize and formalize GSRMA's investment-related activities, while complying with all applicable statutes governing the investment of public funds.

This investment policy was endorsed and adopted by the GSRMA's Board of Directors and is effective as of the 8th day of July, 2015, and replaces any previous versions.

II. SCOPE

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

- Proceeds of debt issuance shall be invested in accordance with GSRMA'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.
- Any other funds specifically exempted by the Board of Directors.

POOLING OF FUNDS

Except for cash in certain restricted and special funds, GSRMA will consolidate cash and reserve balances from all funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration.

III. OBJECTIVES

GSRMA's overall investment program shall be designed and managed with a degree of professionalism worthy of the public trust. The overriding objectives of the program are to preserve principal, provide sufficient liquidity, and manage investment risks, while seeking a market-rate of return.

- **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.

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

- **YIELD.** 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.

IV. DELEGATION OF AUTHORITY

Authority to manage the GSRMA's investment program is derived from California Government Code, Sections 53600 *et seq.*

The Board of Directors is responsible for the management of Authority's funds, including the administration of this investment policy. Management responsibility for the cash management of Authority funds is hereby delegated to the Risk Manager.

The Risk Manager will be responsible for all transactions undertaken and will establish a system of procedures and controls to regulate the activities of subordinate employees. Such procedures will include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Risk Manager.

The Authority 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 Authority's investment portfolio in a manner consistent with the Authority's objectives. External investment advisers may be granted discretion to purchase and sell investment securities in accordance with this investment policy.

The Authority's overall investment program shall be designed and managed with a degree of professionalism that is worthy of the public trust. The Authority recognizes that in a diversified portfolio, occasional measured losses may be inevitable and must be considered within the context of the overall portfolio's return and the cash flow requirements of the Authority. The Risk Manager and other authorized persons responsible for managing Authority funds acting in accordance with written procedures and the investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments.

V. PRUDENCE

Pursuant to California Government Code, Section 53600.3, all persons authorized to make investment decisions on behalf of GSRMA 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."

VI. ETHICS AND CONFLICTS OF INTEREST

All participants in the investment process shall acts as custodians of the public trust. Investment officials shall recognize that the investment portfolio is subject to public review and evaluation. Thus employees and officials involved in the investment process shall refrain from personal business activity that create a conflict of interest or the appearance of a conflict with proper execution of the investment program, or impairs their ability to make impartial investment decisions. Employees and investment officials shall disclose to the Risk Manager any material financial interests in financial institutions that conduct business within their jurisdiction, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the Authority.

VII. INTERNAL CONTROLS

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

Periodically, as deemed appropriate by GSRMA and/or the Board of Directors, an independent analysis by an external auditor shall be conducted to review internal controls, account activity and compliance with policies and procedures.

VIII. AUTHORIZED FINANCIAL INSTITUTIONS, DEPOSITORIES, AND BROKER/DEALERS

To the extent practical, the Risk Manager shall endeavor to complete investment transactions using a competitive bid process whenever possible. GSRMA's Risk Manager will determine which financial institutions are authorized to provide investment services to GSRMA. It shall be GSRMA's policy to purchase securities only from authorized institutions and firms.

The Risk Manager shall maintain procedures for the establishing a list of authorized broker/dealers and financial institutions which are approved for investment purposes that are selected through a process of due diligence determined by GSRMA. These institutions may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15c3-1 (uniform net capital rule).

Institutions eligible to transact investment business with GSRMA include:

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

- Nationally or state-chartered banks.

- The Federal Reserve Bank.

- Direct issuers of securities eligible for purchase.

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

All financial institutions which desire to become qualified bidders for investment transactions (and which are not dealing only with the investment adviser) must supply the Risk Manager with a statement certifying that the institution has reviewed the California Government Code, Section 53600 *et seq*. and GSRMA's investment policy.

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.

EXTERNAL INVESTMENT ADVISERS

Selection of broker/dealers used by an external investment adviser retained by GSRMA 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, the investment adviser shall make their best efforts to document quotations for comparable or alternative securities. If qualitative characteristics of a transaction, including, but not limited to, complexity of the transaction, or sector expertise of the broker, prevent a competitive selection process, investment advisers shall use brokerage selection practices as described above.

IX. COLLATERALIZATION

CERTIFICATES OF DEPOSIT (CDS). GSRMA 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.

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

- 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.
- 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.
- GSRMA shall receive monthly statements of collateral.

X. DELIVERY, SAFEKEEPING AND CUSTODY

DELIVERY-VERSUS-PAYMENT (DVP). Settlement of all investment transactions will be completed using standard delivery-vs.-payment procedures.

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 GSRMA's portfolio shall be held in safekeeping in GSRMA's name by a third party custodian, acting as agent for GSRMA under the terms of a custody agreement executed by the bank and GSRMA. All investment transactions will require a safekeeping receipt or acknowledgment generated from the trade. A monthly report will be received by GSRMA from the custodian listing all securities held in safekeeping with current market data and other information.

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 mutual funds, since the purchased securities are not deliverable.

XI. AUTHORIZED INVESTMENTS

GSRMA's investments are governed by California Government Code, Sections 53600 *et seq*. Within the investments permitted by the Code, GSRMA 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.

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. At the time of the investment's maturity or liquidation, such funds shall be reinvested only as provided in the current policy.

An appropriate risk level shall be maintained by primarily 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 financial institutions.

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

   - The securities are rated "A" or higher by at least one nationally recognized statistical rating organization.
   - No more than 5% of the portfolio may be invested in any issuer.
   - No more than 30% of the portfolio be in Municipal Securities.
   - The maximum maturity does not exceed five years.

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 that GSRMA may invest in U.S. Treasuries, provided that:

   - The maximum maturity is five 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 that GSRMA may invest in Federal Agency or Government-Sponsored Enterprises (GSEs), provided that:

   - No more than 25% of the portfolio may be invested in any Agency/GSE issuer.
   - The maximum maturity does not exceed five years.

4. **BANKER'S ACCEPTANCES**, provided that:

- They are issued by institutions which have short-term debt obligations rated "A-1" or higher by at least one nationally recognized statistical-rating organization; or long-term debt obligations which are rated "A" or higher by at least one nationally recognized statistical rating organization.
- No more than 40% of the portfolio may be invested in Banker's Acceptances.
- No more than 5% of the portfolio may be invested in any issuer.
- The maximum maturity does not exceed 180 days.

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

    - The amount per institution is limited to the maximum covered under federal insurance.
    - No more than 20% of the portfolio will be invested in a combination of federally insured and collateralized time deposits.
    - The maximum maturity does not exceed five years.

6. **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:

    - No more than 20% of the portfolio will be invested in a combination of federally insured and collateralized time deposits.
    - The maximum maturity does not exceed five years.

7. **CERTIFICATE OF DEPOSIT PLACEMENT SERVICE (CDARS)**

    - No more than 30% of the total portfolio may be invested in a combination of Certificates of Deposit, including CDARS.
    - The maximum maturity does not exceed five years.

8. **NEGOTIABLE CERTIFICATES OF DEPOSIT (NCDS)**, provided that:

    - The amount of the NCD insured up to the FDIC limit does not require any credit ratings.
    - For any amount above the FDIC insured limit they must be issued by institutions which have short-term debt obligations are rated "A-1" or higher by at least one nationally recognized statistical rating organization; or long-term obligations are rated "A" or higher by at least one nationally recognized statistical rating organization.
    - No more than 30% of the total portfolio may be invested in NCDs.
    - No more than 5% of the portfolio may be invested in any issuer.

- The maximum maturity does not exceed five years.

9. **REPURCHASE AGREEMENTS** collateralized with securities authorized under by 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 GSRMA may invest, provided that:

    - Securities used as collateral for Repurchase Agreements will be delivered to GSRMA's custodian.
    - Repurchase Agreements are subject to a Master Repurchase Agreement between GSRMA 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).
    - The maximum maturity does not exceed one year.

10. **COMMERCIAL PAPER**, provided that:

    - The issuer is a corporation organized and operating in the United States with assets in excess of $500 million.
    - The securities are rated "A-1" or higher by at least one nationally recognized statistical rating organization.
    - They are issued by corporations which have long-term obligations are rated "A" or higher by at least one nationally recognized statistical rating organization.
    - No more than 25% of the portfolio may be invested in Commercial Paper.
    - No more than 5% of the portfolio may be invested in any issuer.
    - The maximum maturity does not exceed 270 days.

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

    - GSRMA may invest up to the maximum permitted amount in LAIF.
    - LAIF's investments in instruments prohibited by or not specified in GSRMA's policy do not exclude it from GSRMA's list of allowable investments, provided that the fund's reports allow the Risk Manager to adequately judge the risk inherent in LAIF's portfolio.

12. **LOCAL GOVERNMENT INVESTMENT POOLS**

    - Other LGIPs permitted by the Authority.

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

    - 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.
    - The securities are rated "A" or higher by at least one nationally recognized statistical rating organization.

- No more than 30% of the total portfolio may be invested in MTNs.
- No more than 5% of the portfolio may be invested in any issuer.
- The maximum maturity does not exceed five years.

14. **ASSET-BACKED, MORTGAGE-BACKED, MORTGAGE PASS-THROUGH SECURITIES, AND COLLATERALIZED MORTGAGE OBLIGATIONS**, provided that:

    - The securities are rated “AA” or higher by a nationally recognized statistical rating organization.
    - They are issued by an issuer which has long-term obligations rated “A” or higher by at least one nationally recognized statistical rating organization.
    - No more than 20% of the total portfolio may be invested in these securities.
    - No more than 5% of the portfolio may be invested in any Asset-Backed or Commercial Mortgage security issuer. There is no issuer limitation on any Mortgage security where the issuer is the US Treasury or a Federal Agency/GSE.
    - The maximum maturity does not exceed 5 years.

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

    - 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 nationally recognized statistical rating organizations; 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.
    - No more than 20% of the total portfolio may be invested in Money Market Mutual Funds.
    - No more than 10% of the portfolio may be invested in any Fund.

16. **SUPRANATIONALS** provided that:
    - Issues are unsubordinated obligations issued by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank.
    - The securities are rated “AA” or higher by a nationally recognized statistical rating organization.
    - No more than 30% of the total portfolio may be invested in these securities.
    - No more than 10% of the portfolio per issuer
    - The maximum maturity does not exceed 5 years.

XII. MAXIMUM MATURITY

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

GSRMA will not invest in securities maturing more than five years from the date of trade settlement, unless the Board of Directors has by resolution granted authority to make such an investment.

XIII. INVESTMENT POOLS/MUTUAL FUNDS

A thorough investigation of the pool/mutual fund is required prior to investing, and on a continual basis. The Authority shall develop a due diligence process which will answer the following general questions:

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.
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?

XIV. PROHIBITED INVESTMENT VEHICLES AND PRACTICES

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

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

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

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

- Purchasing or selling securities on margin is prohibited.

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

- The purchase of foreign currency denominated securities is prohibited.

XV. RISK MANAGEMENT AND DIVERSIFICATION

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. GSRMA will mitigate credit risk by adopting the following strategies:

- The diversification requirements included in the "Authorized Investments" section of this policy are designed to mitigate credit risk in the portfolio.

- No more than 5% of the total portfolio may be invested in securities of any single issuer per each category in Section XI of this policy, except where the issuer is the US Government, its Agencies and GSEs or where the security is Money Market Mutual Funds or Local Government Investment Pools.

- GSRMA may elect to sell a security prior to its maturity and record a capital gain or loss in order to improve the quality, liquidity or yield of the portfolio in response to market conditions or the Authority's risk preferences.

- If the credit ratings of any security owned by GSRMA are downgraded to a level below the quality required by this investment policy, it will be GSRMA's policy to review the credit situation and make a determination as to whether to sell or retain such securities in the portfolio.

  - If a security is downgraded, the Risk Manager 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.

  - If a decision is made to retain a downgraded security in the portfolio, its presence in the portfolio will be monitored and reported to the Board of Directors at each Board of Directors' meeting.

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. GSRMA 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. GSRMA 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 cashflow purposes.

GSRMA 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. GSRMA, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

- GSRMA will maintain a minimum of six months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements.

- The maximum percent of callable securities (does not include “make whole call” securities as defined in the Glossary) in the portfolio will be 20%.

- The maximum stated final maturity of individual securities in the portfolio will be five years, except as otherwise stated in this policy.

- The duration of the portfolio will at all times be approximately equal to the duration (typically, plus or minus 20%) of a Market Benchmark, an index selected by GSRMA based on GSRMA’s investment objectives, constraints and risk tolerances.

XVI. REVIEW OF INVESTMENT PORTFOLIO

The Risk Manager shall periodically, but no less than quarterly, review the portfolio to identify investments that do not comply with this investment policy and establish protocols for reporting major and critical incidences of noncompliance to the Board of Directors.

XVII. PERFORMANCE EVALUATION

The investment portfolio shall be designed to attain a market-average rate of return throughout budgetary and economic cycles, taking into account the Authority’s risk constraints, the cash flow characteristics of the portfolio, and state and local laws, ordinances or resolutions that restrict investments.

The Risk Manager shall monitor and evaluate the portfolio’s performance relative to market benchmark, which will be included in the Risk Manager’s quarterly report. The Risk Manager shall select an appropriate, readily available index to use as a market benchmark.

XVIII. REPORTING

INVESTMENT REPORTS

Investment reports will be submitted by the Risk Manager to the Board of Directors at each Board of Directors’ Meeting. These reports will disclose, at a minimum, the following information about the characteristics of GSRMA’s portfolio:

1. An asset listing showing par value, cost and accurate and complete market value of each security, type of investment, issuer, and interest rate.

2. All transactions for the period.

3. A one-page summary report that shows:
   a. Average maturity of the portfolio and modified duration of the portfolio;
   b. Maturity distribution of the portfolio;
   c. Average portfolio credit quality; and,
   d. Time-weighted total rate of return for the portfolio for the prior one month, three months, twelve months, year to date, and since inception compared to GSRMA's market benchmark returns for the same periods;

4. A statement of compliance with investment policy, including a schedule of any transactions or holdings which do not comply with this policy or with the California Government Code, including a justification for their presence in the portfolio and a timetable for resolution.

5. A statement that GSRMA has adequate funds to meet its cash flow requirements for the next six months.

ANNUAL REPORTS
A comprehensive annual report will be presented to the Governing Board. This report will include comparisons of GSRMA's return to the market benchmark return, suggest policies and improvements that might enhance the investment program, and will include an investment plan for the coming year.

XIX. REVIEW OF INVESTMENT POLICY

The investment policy will be reviewed and adopted at least annually within 120 days of the end of the fiscal year to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends.

Any recommended modifications or amendments shall be presented by Staff to the Board of Directors for their consideration and adoption.

Prepared by:

____
Risk Manager

Approved:

____
<Name>, Attorney at Law
Attorney for GSRMA

Approved:

<Name>, <Title>
Board of Directors

Date:

GLOSSARY OF INVESTMENT TERMS

AGENCIES. Shorthand market terminology for any obligation issued by *a government-sponsored entity (GSE)*, or a *federally related institution*. Most obligations of GSEs are not guaranteed by the full faith and credit of the US government. Examples are:

FFCB. The Federal Farm Credit Bank System provides credit and liquidity in the agricultural industry. FFCB issues discount notes and bonds.

FHLB. The Federal Home Loan Bank provides credit and liquidity in the housing market. FHLB issues discount notes and bonds.

FHLMC. Like FHLB, the Federal Home Loan Mortgage Corporation provides credit and liquidity in the housing market. FHLMC, also called "FreddieMac" issues discount notes, bonds and mortgage pass-through securities.

FNMA. Like FHLB and FreddieMac, the Federal National Mortgage Association was established to provide credit and liquidity in the housing market. FNMA, also known as "FannieMae," issues discount notes, bonds and mortgage pass-through securities.

GNMA. The Government National Mortgage Association, known as "GinnieMae," issues mortgage pass-through securities, which are guaranteed by the full faith and credit of the US Government.

PEFCO. The Private Export Funding Corporation assists exporters. Obligations of PEFCO are not guaranteed by the full faith and credit of the US government.

TVA. The Tennessee Valley Authority provides flood control and power and promotes development in portions of the Tennessee, Ohio, and Mississippi River valleys. TVA currently issues discount notes and bonds.

ASKED. The price at which a seller offers to sell a security.

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.

COMMERCIAL PAPER. The short-term unsecured debt of corporations.

COST YIELD. The annual income from an investment divided by the purchase cost. Because it does not give effect to premiums and discounts which may have been included in the purchase cost, it is an incomplete measure of return.

COUPON. The rate of return at which interest is paid on a bond.

CREDIT RISK. The risk that principal and/or interest on an investment will not be paid in a timely manner due to changes in the condition of the issuer.

CURRENT YIELD. The annual income from an investment divided by the current market value. Since the mathematical calculation relies on the current market value rather than the investor’s cost, current yield is unrelated to the actual return the investor will earn if the security is held to maturity.

DEALER. A dealer acts as a principal in security transactions, selling securities from and buying securities for his own position.

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

DELIVERY VS. PAYMENT (DVP). A securities industry procedure whereby payment for a security must be made at the time the security is delivered to the purchaser’s agent.

DERIVATIVE. Any security that has principal and/or interest payments which are subject to uncertainty (but not for reasons of default or credit risk) as to timing and/or amount, or any security which represents a component of another security which has been separated from other components (“Stripped” coupons and principal). A derivative is also defined as a financial instrument the value of which is totally or partially derived from the value of another instrument, interest rate, or index.

DISCOUNT. The difference between the par value of a bond and the cost of the bond, when the cost is below par. Some short-term securities, such as T-bills and banker’s acceptances, are known as discount securities. They sell at a discount from par, and return the par value to the investor at maturity without additional interest. Other securities, which have fixed coupons, trade at a discount when the coupon rate is lower than the current market rate for securities of that maturity and/or quality.

DIVERSIFICATION. Dividing investment funds among a variety of investments to avoid excessive exposure to any one source of risk.

DURATION. The weighted average time to maturity of a bond where the weights are the present values of the future cash flows. Duration measures the price sensitivity of a bond to changes in interest rates. (See modified duration).

FEDERAL FUNDS RATE. The rate of interest charged by banks for short-term loans to other banks. The Federal Reserve Bank through open-market operations establishes it.

FEDERAL OPEN MARKET COMMITTEE. A committee of the Federal Reserve Board that establishes monetary policy and executes it through temporary and permanent changes to the supply of bank reserves.

LEVERAGE. Borrowing funds in order to invest in securities that have the potential to pay earnings at a rate higher than the cost of borrowing.

LIQUIDITY. The speed and ease with which an asset can be converted to cash.

LOCAL AGENCY INVESTMENT FUND (LAIF). A voluntary investment fund open to government entities and certain non-profit organizations in California that is managed by the State Treasurer's Office.

LOCAL GOVERNMENT INVESTMENT POOL. Investment pools that range from the State Treasurer's Office Local Agency Investment Fund (LAIF) to county pools, to Joint Powers Authorities (JPAs). These funds are not subject to the same SEC rules applicable to money market mutual funds.

MAKE WHOLE CALL. A type of call provision on a bond that allows the issuer to pay off the remaining debt early. Unlike a call option, with a make whole call provision, the issuer makes a lump sum payment that equals the net present value (NPV) of future coupon payments that will not be paid because of the call. With this type of call, an investor is compensated, or "made whole."

MARGIN. The difference between the market value of a security and the loan a broker makes using that security as collateral.

MARKET RISK. The risk that the value of securities will fluctuate with changes in overall market conditions or interest rates.

MARKET VALUE. The price at which a security can be traded.

MARKING TO MARKET. The process of posting current market values for securities in a portfolio.

MATURITY. The final date upon which the principal of a security becomes due and payable.

MEDIUM TERM NOTES. Unsecured, investment-grade senior debt securities of major corporations which are sold in relatively small amounts on either a continuous or an intermittent basis. MTNs are highly flexible debt instruments that can be structured to respond to market opportunities or to investor preferences.

MODIFIED DURATION. The percent change in price for a 100 basis point change in yields. Modified duration is the best single measure of a portfolio's or security's exposure to market risk.

MONEY MARKET. The market in which short-term debt instruments (T-bills, discount notes, commercial paper, and banker's acceptances) are issued and traded.

MORTGAGE PASS-THROUGH SECURITIES. A securitized participation in the interest and principal cash flows from a specified pool of mortgages. Principal and interest payments made on the mortgages are passed through to the holder of the security.

MUNICIPAL SECURITIES. Securities issued by state and local agencies to finance capital and operating expenses.

MUTUAL FUND. An entity which pools the funds of investors and invests those funds in a set of securities which is specifically defined in the fund's prospectus. Mutual funds can be invested in various types of domestic and/or international stocks, bonds, and money market instruments, as set forth in the individual fund's prospectus. For most large, institutional investors, the costs associated with investing in mutual funds are higher than the investor can obtain through an individually managed portfolio.

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.