Redevelopment Agency
December 4, 2007

Honorable Mayor and Members
Of the Torrance City Council
City Hall
Torrance, California

Members of the Agency:

SUBJECT: Adopt a resolution to establish the Torrance Redevelopment Agency Investment Policy for 2008

RECOMMENDATION

Recommendation of the Redevelopment Agency Treasurer and Redevelopment Agency Staff that the Redevelopment Agency adopt the attached resolution to establish the Torrance Redevelopment Agency Statement of Investment Policy for 2008.

FUNDING

Not Applicable

BACKGROUND AND ANALYSIS

As specified in the guidelines, prior to submittal of the Torrance Redevelopment Agency Statement of Investment Policy to the Redevelopment Agency, the Investment Policy must be reviewed and evaluated for its completeness and relevance by the Investment Advisory Committee. Also, the City Attorney's office reviews Policy for compliance with all governing laws and regulations.

On November 27, 2007, the Agency Treasurer presented the 2008 Statement of Investment Policy to the Investment Advisory Committee with no recommended changes.

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The Committee was in concurrence with the recommendation and directed the Agency Treasurer to bring forth the Policy to the Redevelopment Agency for approval and adoption.

Respectfully submitted,

Linda M. Barnett
Agency Treasurer

CONCUR:

Eric Tsao
Investment Committee Member

Ron Pohl
Investment Committee Member

LeRoy J. Jackson
Investment Committee Member

ATTACHEMENTS:
(1) Resolution

RESOLUTION NO. 2007-___

A RESOLUTION BY THE TORRANCE REDEVELOPMENT AGENCY ESTABLISHING THE REDEVELOPMENT AGENCY STATEMENT OF INVESTMENT POLICY FOR 2008 IN ACCORDANCE WITH CERTAIN GUIDELINES

WHEREAS, the California State Government Code Sections 53600 (the "Code") et seq. vest the City Council with the authority to invest City Surplus Funds; and

WHEREAS, the code also provides the Agency with the authority to delegate its investments duties to the Agency Treasurer; and

WHEREAS, the Agency Treasurer and the Torrance Redevelopment Agency have determined the proper investment portfolio for the 2008; and

WHEREAS, the Torrance Redevelopment Agency Statement of Investment Policy (Exhibit A) is intended to establish the policies for prudent investments of the Agency funds;

NOW, THEREFORE, BE IT RESOLVED THAT THE TORRANCE REDEVELOPMENT AGENCY DOES HEREBY RESOLVES THE FOLLOWING:

1 All monies entrusted to the Agency Treasurer will be pooled in a diversified portfolio, and the Agency Treasurer and staff will observe, review and react to changing conditions that affect the Pool;

2. The investment philosophy shall be made in the context of the "prudent investor rule";

3. The objectives of the Policy shall be SAFETY, LIQUIDITY AND RETURN;

4. The Agency shall have an independent advisory committee consisting of the City Manager, Finance Director and City Attorney or their appointed designee that meets monthly and reviews investment and strategy areas;

5. The authorized investments, and their maximum limits, shall be noted in the attached Statement of Investment Policy;

6. The listing of qualified dealers and institutions shall be clearly outlined in the Policy;

7. The safekeeping of securities, investment controls, discussion of policy review and indemnification of investment officials shall be included in the Policy;

8. The Policy is approved in the form attached as Exhibit A.

Introduced, approved and adopted this 4 day of December 2007.

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Agency Chairperson Frank Scotto

APPROVED AS TO FORM:
JOHN FELLOWS III, Agency Attorney

by ______________________________
Ronald T. Pohl, Assistant Agency Attorney

ATTEST:

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Sue Herbers, CMC
Agency Clerk

Exhibit A

CITY OF TORRANCE
REDEVELOPMENT AGENCY

STATEMENT OF INVESTMENT POLICY

REDEVELOPMENT AGENCY

2008

PREPARED BY THE AGENCY TREASURER'S OFFICE

Linda M. Barnett, C.C.M.T.
Agency Treasurer

Adopted by the Torrance Redevelopment Agency on
December 4, 2007

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1.0 Policy

It is the policy of the:

Torrance Redevelopment Agency

(Hereafter referred to as the "Agency") to predicate their investment policies, procedures, and practices upon the following three principles: (1) compliance with all Federal, State and local laws governing the investment of monies under the control of the Agency Treasurer; (2) protection of the principal monies entrusted to the Agency; and (3) generate a market rate of return within the parameters of this Statement of Investment Policy.

For the purposes of this policy, "Investment Officers" shall be defined as the Agency Treasurer and the Deputy Agency Treasurer.

This policy shall be effective 1 January 2007 through 31 December 2007, unless amended.

2.0 Scope

This policy shall apply to all funds that are under the Agency Treasurer's control including but not limited to, the general fund; special revenue funds; debt service funds; capital project funds; enterprise funds; and trust and agency funds. These funds are accounted for in the Agency's Comprehensive Annual Financial Report. The City's Deferred Compensation Plan shall be excluded from the scope of this policy.

Except for cash in certain restricted and special funds, the Agency 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. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

3.0 Prudence

Pursuant to California Government Code Section 53600.3, Investment Officers, as trustees of public monies, shall adhere to the "prudent investor" standard when managing the Agency's investment portfolio. They shall invest "...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."

Investment Officers who follow the provisions of this policy and who exercise due diligence shall be relieved of personal responsibility for a security's credit risk or market price risk: provided, that they report substantial deviations from expectations to the Agency Director and the Investment Advisory Committee in a timely manner, and that they take appropriate action to control adverse developments.

"Substantial deviations" shall be defined as either a decline of 10 percent or more in the market value of a security due to issuer default or a credit risk downgrade; or the sale of a security prior to maturity at 10 percent or more below its acquisition cost.

4.0 Objectives

The Agency's investment objectives, in order of priority, shall be:

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

Credit Risk, the risk of loss due to the failure of the issuer of the security, shall be mitigated by investing in only the highest quality securities; by diversifying investments; and by pre-qualifying broker-dealers and public depositories; and

Market Risk, the risk of loss due to a decline in bond prices because of rising market interest rates, shall be mitigated by structuring the portfolio so that issues mature concurrently with the Agency's anticipated cash requirements, thereby eliminating the need to sell securities prematurely on the open market.

Liquidity. An adequate percentage of the portfolio shall be maintained in liquid, short-term securities that can be converted to cash, if necessary, to meet disbursement requirements. Since all cash requirements cannot be anticipated, the portfolio should consist largely of securities with active secondary markets.

Yield. Yield shall be considered only after the basic requirements of safety and liquidity have been meet. Whenever possible and in a manner consistent with the objectives of safety and liquidity, a yield higher than the market rate of return shall be sought.

5.0 Delegation of Authority

California Government Code Sections 53607 and 53608 authorize the legislative body of a local agency to invest, deposits, and provide for the safekeeping of the local agency's funds or to delegate those responsibilities to the treasurer of the local agency.

Charter Provision Section 630 and subsequent resolution delegates the authority to invest, deposit, and provide for the safekeeping of the Agency's public monies to the Agency Treasurer.

The Agency Treasurer and the Deputy Agency Treasurer shall have exclusive authority to buy and sell securities on behalf of the Agency. The Deputy Agency Treasurer may execute investment transaction on behalf of the Agency only if the Agency Treasurer has previously authorized the transactions.

6.0 Investment Procedures

The Agency Treasurer shall establish written procedures for the operation of the Agency's investment program that are consistent with the provisions of this policy. The procedures shall include reference to safekeeping, PSA repurchase agreements, banking service contracts, and collateral/depository agreements. Such procedures shall 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 under the procedures that the Agency Treasurer establishes.

7.0 Ethics and Conflicts of Interest

Investment Officers involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Investment Officers shall disclose any material interest in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Investment Officers shall refrain from undertaking personal investment transactions with the same individual with which business is conducted on behalf of the City of Torrance Redevelopment Agency.

8.0 Authorized Financial Institutions, Depositories, and Broker/Dealers

The Agency Treasurer shall maintain a list of financial institutions and depositories authorized to provide investment services. In addition, a list will be maintained of approved security broker/dealers selected by creditworthiness (e.g., a minimum capital requirement of $10,000,000 and at least five years of operation). These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) rule 15C3-1 (uniform net capital rule).

All financial institutions and broker/dealers who desire to become qualified for investment transactions must supply the following as appropriate:

Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines.

Proof of National Association of Securities Dealers (NASD) certification (not applicable to Certificate of Deposit counterparties).

8.0.3 Proof of state registration

8.0.4 Completed broker/dealer questionnaire (not applicable to Certificate of Deposit counterparties)

8.0.5 Certification of having read and understood and agreeing to comply with the Torrance Redevelopment Agency investment policy.

8.0.6 Evidence of adequate insurance coverage.

The number of primary and regional broker/dealers on the authorized list shall not exceed a combined total of six at any single time. The Agency shall accept and review new broker/dealer applications only when there is an immediate need to fill a vacancy on the authorized list.

9.0 Authorized and Suitable Investments

The Agency Treasurer shall be authorized to invest in the following financial instruments pursuant to California Government Code Section 53600 et seq. The Agency's investment policy is more conservative than state law.

No.	Type of Investment	% Authorized	Other Restrictions
1.	United States Treasury bills, notes, bonds, or certificates of indebtedness, or those for which the full faith and credit of the United States are pledged for the payment of principal and interest.	100%	Maximum maturity: 5 years
2.	Federal Agency or United States government-sponsored enterprise ("GSE") obligations, participation, or other instruments, including those issued by or fully guaranteed as to principal and interest by Federal Agencies or by GSE.	75%	Maximum maturity: 5 years No more than 30% of the portfolio may be invested in any one issuer (excluding the proceeds of tax-exempt bonds).
3.	Bonds issued by the local agency, 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.	10%	Maximum maturity: Greater than 5 years as approved by Agency.
4.	Banker's Acceptances ("BA") issued by commercial banks.	20%	Rated "A-1 or higher by S&P or "P-1" by Moody's. Maximum maturity: 180 days No more than 5% of the portfolio may be invested in

			any one BA issuer.
5.	Negotiable Certificates of Deposit ("NCD") issued by a nationally- or state-chartered bank, a savings association, a federal association, or by a state-licensed branch of a foreign bank.	20%	Long-term debt rated "AA-" or higher by S&P or by Moody's. Maximum maturity: 5 years
6.	Time Certificates of Deposit ("TCD") issued by qualified public depositories.	10%	TCDs exceeding $100,000 must be collateralized. TCDs must be centralized at one location for each bank or S&L. Maximum maturity: 1 year If TCD is uncollateralized, than no more than $98,000 may be invested.
7.	Repurchase Agreements ("RP") sold by authorized brokers.	10%	Maximum maturity: 30 days Collateral must be United States Treasury, federal Agency, or GSE obligations. Zero coupon and stripped coupon instruments are not acceptable as collateral. Collateral must be valued at 102% of cost and adjusted weekly. Agency's custodian must hold collateral. An authorized broker must file a Public Securities Association (PSA) Master Repurchase Agreement with the Agency Treasurer.
8.	Commercial Paper ("CP") issued by general corporations organized and operating in the United States with assets exceeding $500 million.	15%	Rated "A-1" by S&P or "P-1" by Moody's. Maximum maturity: 270 days

			No more than 10% of the outstanding CP of any one issuer may be purchased.
9.	Medium-Term Notes issued by corporations organized and operating in the United States, or by depository institutions operating in the United States and licensed by the United States or by any state.	20%	Rated "AA-" or higher by S&P and by Moody's. No more than 10% of the portfolio may be invested in any one issuer.
10.	State of California Local Agency Investment Fund ("LAIF") that is managed by the State Treasurer's Office.	See note	$40 million limit per account with LAIF, except for bond trustee accounts (no limit).

10.0 Prohibited Investments

Investment Officers shall not invest public monies in financial instruments that are not authorized under this policy.

Prohibited investments shall include, but shall not be limited to, equity securities, bond mutual funds, reverse repurchase agreements, and derivative contracts (forwards, futures, and options). Securities with high price volatility or limited marketability and common stocks and share of beneficial interest.

Investment Officers shall not engage in securities lending, short selling, or other hedging strategies.

LAIF shall be exempt from the prohibitions on derivative contracts, derivative securities, reverse repurchase agreements, securities lending, short selling, and other hedging strategies.

11.0 Investment Pools/Money Market Mutual Funds

A thorough investigation of the pool/fund is required prior to investing, and on a continual basis. All State or County Personnel that manage an investment pool or Investment Advisors the offer money market mutual funds must supply the following as appropriate:

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

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

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

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

11.0.5 A schedule for receiving statements and portfolio listings.

11.0.6 Verification on whether or not reserves or retained earnings are utilized by the pool/fund.

11.0.7 A fee schedule and when and how it is assessed.

11.0.8 An eligibility of the pool/fund for bond proceeds and whether it will accept such proceeds.

Collateralization

Investment Officers shall ensure that all demand deposits and all non-negotiable certificates of deposit that exceed $100,000 shall be fully collateralized with securities authorized under state law and under this Investment Policy. Collateral may be waived for the first $100,000 since this will be insured by the Federal Deposit Insurance Corporation. Any amount on deposit over $100,000 plus accrued interest, however, shall be collateralized with United States Treasury or federal agency securities at a constant margin ratio of 110 percent or with mortgage-backed collateral at a constant margin ratio of 150 percent.

Collateralized investments and demand deposits may require substitution of collateral. The Agency Treasurer must approve all requests from financial institutions for substitution of collateral that involve interchanging classes of security.

An independent third party with which the Agency has a current custodial agreement shall always hold the collateral. The independent third party shall provide the Agency Treasurer with a safekeeping receipt that the Treasurer shall retain.

13.0 Safekeeping and Custody

Investment Officers shall conduct all security transactions on a delivery-versus-payment ("DVP") or on a receipt-versus-payment ("RVP") basis. A third-party bank trust department ("Custodian") that acts as an agent for the Agency under the terms of a custody agreement executed between both parties shall hold the securities.

The only exception to the foregoing shall be securities purchases made with:

Local government investment pools.

Money Market mutual funds.

No securities broker or investment advisor shall have access to Agency monies, accounts, or investments. Any transfer of monies to or through a securities broker must have the Agency Treasurer's prior written approval. If the Agency Treasurer is unavailable, then the Deputy Agency Treasurer must authorize the transfer, in writing.

The Agency shall require Broker Trade Confirmations for all trades. Investment Officers shall review these confirmations immediately upon receipt, for conformity with the terms of the Agency's Trade Sheets.

14.0 Diversification

Investment Officers shall diversify the Agency's investment portfolio by security type and by issuer, except for bond reserve monies; bond escrow monies, and any other monies that the Agency designates.

15.0 Maximum Maturities

Investment Officers shall not invest in securities with maturities exceeding five years. The Agency, however, may approve longer maturities for the investment of bond reserve, bond escrow, and other funds if the maturities of such investments are expected to coincide with the expected use of the funds.

16.0 Portfolio Re-Balancing

If portfolio percentage constraints are violated due to a temporary imbalance in the portfolio, then Investment Officers shall hold the affected securities to maturity in order to avoid capital losses.

If no capital losses would be realized upon sale, however, than Investment Officers shall consider re-balancing the portfolio after evaluating the expected length of time that it will be imbalance.

Portfolio percentage limits are in place in order to ensure diversification of the Agency investment portfolio; a small temporary imbalance will not significantly impair that strategy.

17.0 Credit Downgrading

This policy sets forth minimum credit risk criteria for each type of security. This credit risk criteria applies to the initial purchase of a security; it does not automatically force the sale of a security if its credit risk ratings fall below policy limits.

If a security is downgraded below the minimum credit risk criteria specified in this policy, then Investment Officers shall evaluate the downgrade on a case-by-case basis in order to determine the security should be held or sold.

The Agency Treasurer shall inform the Investment Advisory Committee at its next monthly meeting of the credit downgrade and of the Investment Officers decision to hold or sell the downgraded security.

Investment Officers shall review the credit standing of all securities in the Agency's investment portfolio annually, at a minimum.

18.0 Bond Proceeds

The Agency Treasurer shall segregate the gross proceeds of tax-exempt bonds from the Agency general pool and shall keep them in a separate pool. They shall be invested pursuant to the instructions in the respective bond indentures of trust. If the bond indenture authorizes investments that conflict with this policy, then such investments shall be made in accordance with the bond indenture. All securities shall be held in third-party safekeeping with the bond trustee ("Trustee") and all DVP and RVP rules shall apply. The Trustee shall be represented on the authorized list (see page 15).

Investment Officers shall use competitive offerings, whenever practical, for all investment transactions that involve the gross proceeds of tax-exempt bonds. The Agency shall obtain a minimum of three competitive offers. Any exceptions to this policy shall be documented and shall be reported to the Investment Advisory Committee at its next monthly meeting.

The Agency is required under the "U.S. Tax Reform Act of 1986" to perform annual arbitrage calculations and to rebate excess earnings to the United States Treasury from the investment of the gross proceeds of tax-exempt bonds that were sold after the effective date of that law. The Agency Treasurer may contract with qualified outside financial consultants to provide the necessary technical expertise that is required to comply with this law.

19.0 Internal Controls

The Agency Treasurer shall ensure that all investment transactions comply with the Agency's policy, and shall establish internal controls that are designed to prevent losses due to fraud, negligence, and third-party misrepresentation.

Internal controls deemed most important shall include: avoidance of collusion; separations of duties and administrative controls; separating transaction authority from accounting and record keeping; custodial safekeeping; clear delegation of authority; management approval and review of investment transactions; specific limitations regarding securities losses and remedial action; written confirmation of telephone transactions; documentation of investment transactions and strategies; and monitoring of results.

The Agency Treasurer shall establish a process of independent review by an external audit firm of the Agency's investment program every three years. The external auditor shall review the program's management in terms of compliance with the internal controls that are specified in the Agency's Treasury Policies and Procedures Manual.

An Investment Advisory Committee consisting of City officials shall be responsible for reviewing the Agency investment reports, transactions, policies, procedures, and strategies, on a monthly basis. The City Manager; City Finance Director; City Attorney; City Treasurer; and Deputy City Treasurer; or their designees shall sit on this committee.

20.0 Performance Standards

The investment portfolio shall be designed with the objective of obtaining a rate of return throughout budgetary and economic cycles, commensurate with investment risk constraints and cash flow needs.

21.0 Market Yield (Benchmark)

The Agency's investment portfolio shall be passively managed with portfolio securities being held to maturity. On selected occasions, however, the Agency's portfolio may be actively managed for purposes of improving portfolio risk structure, liquidity, or yield in response to market conditions or to meet Agency requirements.

The Agency shall adopt a benchmark that approximates the composition and weighted-average maturity of the Agency portfolio, in order to measure whether or not the Agency's portfolio yields are matching or surpassing the market yield.

22.0 Reporting

The Agency Treasurer shall provide the Investment Advisory Committee and the Agency with a monthly investment report within 30 days of each month-end or at the next schedules Agency meeting following an Investment Committee meeting.

Pursuant to Government Account Standards Board ("GASB") Statement Number 40, as amended March 2003, the monthly investment report shall:

22.0.1 Organize individual securities by investment type (e.g., U.S. Treasuries, corporate bonds, commercial paper, etc.). Dissimilar investments (e.g., U.S. Treasury bills and Treasury strips) should not be aggregated.

22.0.2 List credit risk ratings for each security, money market fund, or investment pool from at least two nationally recognized statistical rating organizations. If the security, money market fund, or investment pool has no rating, then it shall be shown as "unrated".

22.0.3 Disclose the amount of individual securities and corresponding issuers if they exceed five percent of net plan assets, except for securities guaranteed by the U.S. Government, money market funds, and external investment pool.

22.0.4 Use the specific identification method to reflect interest-rate risk by investment type and amount.

This report shall include a complete portfolio inventory with details on issue, par value, book value, coupon/rate, original settlement date of purchase, final maturity date, CUSIP number, average weighted yield, average days to maturity, and market value (including source of market valuation). The report will include a statement on compliance or noncompliance with the Agency's Investment Policy and a statement on whether there are or are not sufficient funds to meet the Agency's anticipated cash requirements for the next six months.

23.0 Investment Policy Adoption

The Agency Treasurer shall submit a Statement of Investment Policy to the Investment Advisory Committee and the Agency annually for their review and adoption.

24.0 Regulatory Submission

The Agency Treasurer shall provide the California Debt and Investment Advisory Commission ("CDIAC") with:

Second and fourth quarter fiscal year investment reports within 60 days of those quarter-ends.

The Agency's Statement of Investment Policy within 60 days of 31 December or within 60 days of any amendment thereto.

All submissions to CDIAC shall be sent return receipt, certified mail.

Appendix A: List of Authorized Financial Institutions

The Agency Treasurer's Office is authorized to transact investment and depository business with the following financial institutions. Investment and depository transactions with firms other than those appearing on this list is prohibited.

PRIMARY DEALERS
Morgan Stanley & Company, Inc.
Citigroup Global Markets, Inc.

SECONDARY DEALERS
Higgins Capital Management, Inc.
Great Pacific Securities
Stone & Youngberg LLC
Wedbush Morgan Securities

PUBLIC DEPOSITORIES
Bank of America
Union Bank of California
Preferred Bank
First Tennessee National Bank

CUSTODIAN
Union Bank of California

TRUSTEE
Bank of New York

Appendix B: Glossary

AGENCIES. Federal agency and instrumentality securities.

ASKED. The price at which securities are offered.

BANKER'S ACCEPTANCE ("BA"). A draft, bill, or exchange accepted by a bank or a trust company. Both the issuer and the accepting institution guarantee payment of the bill.

BID. The price offered by a buyer of securities (when one sells securities, one asks for a bid). See "Offer".

BROKER. A broker brings buyers and sellers together so that he can earn a commission.

CERTIFICATE OF DEPOSIT ("CD"). A time deposit with a specific maturity, as evidenced by a certificate. Large-denomination CDs are typically negotiable.

COLLATERAL. Securities, evidence of deposit, or other property which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.

COMPREHENSIVE ANNUAL FINANCIAL REPORT ("CAFR"). The official annual report for the City of Torrance. It included combined statements for each individual fund and account group, which prepared in conformity with GAAP. It also includes supporting schedules that are 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, which evidences interest due on a payment date.

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: (1) delivery versus payment (DVP); and (2) delivery versus receipt (DVR). DVP is delivery of securities with an exchange of money for the securities. DVR is delivery of securities with an exchanged of a signed receipt for the securities.

DERIVATIVES. (1) Financial instruments that are linked to, or derived from, the movement of one or more underlying indexes or securities, and may include a leveraging factor; or (2) financial contracts based upon a notional amount whose value is derived from an underlying index or security (e.g., interest rates, foreign exchange rates, equities, or commodities).

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

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

DIVERSIFICATION. Dividing investment funds among a variety of securities that offer independent returns.

FEDERAL CREDIT AGENCIES. Agencies of the Federal Government that were established to supply credit to various classes of institutions and individuals (e.g., S&Ls, small business firms, students, farmers, farm cooperative, and exporters).

FEDERAL DEPOSIT INSURANCE CORPORATION ("FDIC"). A federal agency that insures bank deposits, currently up to $100,000 per deposit.

FEDERAL FUNDS RATE. The rate of interest at which Fed funds is 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 NATIONAL MORTGAGE ASSOCIATION ("FNMA"). FNMA, like GNMA, was chartered under the Federal National Mortgage Association Act of 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. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. 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 assumes and guarantees that all security holders will receive timely payment of principal and interest.

FEDERAL OPEN MARKET COMMITTEE ("FOMC"). The FOMC consist of seven members of the Federal Reserve Board and five of the 12 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 United States created by Congress and consisting of a seven-member Board of Governors in Washington, D.C., 12 regional banks, and about 5,700 commercial banks that are members of the system.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATIONS ("GNMA" or "Ginnie Mae"). Securities that influence the volume of bank credit that is guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. The full faith and credit of the U.S. Government protect a security holder. Ginnie Mae securities are backed by the FHA, VA, or FMHM mortgages. The term "pass-through" is often used to describe Ginnie Maes.

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"). Monies from local governmental units may be remitted to the California State Treasurer for deposit in this special fund for the purpose of investment.

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

MASTER REPURCHASE AGREEMENT. A written contract covering all future transactions between the parties to repurchase-reverse repurchase agreements, that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer (lender) to liquidate the underlying securities in the event of default by the seller (borrower).

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

MONEY MARKET. The market in which sort-term debt instruments (e.g., bills, commercial paper, and banker's acceptances) are issued and traded.

OFFER. The price asked by a seller of securities (when one buys securities, one asks 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.

PORTFOLIO. A collection of securities that an investor holds.

PRIMARY DEALER. A group of government securities dealers that 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.

PRUDENT INVESTOR RULE. An investment standard. A fiduciary, such as a trustee, may invest in a security if it is one that would be bought by a prudent investor acting in like capacity, who is seeking reasonable income and preservation of capital.

QUALIFIED PUBLIC DEPOSITORIES. A financial institution that: (1) does not claim exemption from the payment of any sales, compensating use, or ad valorem taxes under the laws of this state; (2) has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability; and (3) has been approved by the Public Deposit Protections Commission to hold public deposits.

RATE OF RETURN. The yield obtainable on a security based on its purchase price or it current market price.

REPURCHASE AGREEMENT ("RP" OR "REPO"). A holder of securities sells them to an investor with an agreement to repurchase the securities at a fixed price on a fixed date. The security "buyer", in effect, lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions. Exception: when the Fed is said to be doing RP, it is lending money (increasing bank reserves).

SAFEKEEPING. A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

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

SECURITIES AND EXCHANGE COMMISSION. An agency created by Congress to administer securities legislation for the purpose of protecting investors in securities transactions.

SEC RULE 15c3-1. See "Uniform Net Capital Rule".

STRUCTURED NOTES. Notes issued by instrumentality's (e.g., FHLB, FNMA, SLMA) and by corporations, that have imbedded options (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns) in their debt structure, The market performance of structured notes is affected by fluctuating interest rates; the volatility of imbedded options; and shifts in the yield curve.

TREASURY BILLS. A non-interest bearing discount security that is issued by the U.S. Treasury to finance the national debt. Most T-bills are issued to mature in three months, six months, or one year.

TREASURY BONDS. Long-term, coupon-bearing U.S. Treasury securities that are issued as direct obligations of the U.S. Government, and having initial maturities of more than 10 years.

TREASURY NOTES. Medium-term, coupon-bearing U.S. Treasury securities that are issued as direct obligations of the U.S. Government, and having initial maturities of two to 10 years.

UNIFORM NET CAPITAL RULE. SEC requirement that member firms, as well as non-member broker-dealers in securities, maintain a maximum ratio of indebtedness-to-liquid capital of 15 to one. Also called net capital rule and net capita ratio. Indebtedness covers all money that is owed to a firm, including margin loans and commitments to purchase securities (one reason that new public issues are spread among members of underwriting syndicates). Liquid capital includes cash and assets easily converted to cash.

YIELD. The rate of annual income return on an investment, expressed as a percentage. (a) INCOME YIELD is obtained by dividing the current dollar income by the current market price for the security. (b) NET YIELD OR YIELD TO MATURITY is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.