City of Indian Wells Statement of Investment Policy

Re-adopted on May 21, 2020

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Investment Policy Certification

CALIFORNIA MUNICIPAL TREASURERS ASSOCIATION

Investment Policy Certification

Issued on 03/08/2016

City of Indian Wells

The California Municipal Treasurers Association certifies that the investment policy of the City of Indian Wells complies with the current State statutes governing the investment practices of local government entities located within the State of California.

Over 50 Years of Excellence

Pamela Arends-King
President

3/10/2016
Date

1.0 Policy

It is the policy of the City of Indian Wells to invest public funds in a manner, which will provide the maximum security of the City's capital while meeting the daily cash flow demands of the City. The policy conforms to all state and local statutes governing the investment of public funds; and beyond that, to maximize return within an acceptable and defined level of risk. The City's policy is to deposit and invest public funds in a manner that shall provide:

- Safety of principal
- Liquidity to meet all City obligations and requirements that may be reasonably anticipated
- A risk-based market rate of return

This policy intends to provide guidelines for the prudent investment of the City's temporarily idle cash in all Funds and outline the policies for maximizing the efficiency of the City's cash management system.

2.0 Scope

This Investment policy applies to all financial assets of the City of Indian Wells. These funds are accounted for in the City's Comprehensive Annual Financial Report and include:

- The General Fund
- Special Revenue Funds
- Debt Service Funds
- Capital Project Funds
- Agency Funds

Included in these funds are the following Component Units of the City of Indian Wells; and, accordingly are encompassed by this investment policy:

- The City of Indian Wells Successor Agency
- The City of Indian Wells Housing Authority
- The City of Indian Wells' Fire Access Maintenance District
- The City of Indian Wells Lighting and Landscaping District(s)
- The City of Indian Wells Assessment District(s)

The City's Investment Policy does not apply to the following:

- Funds held in trust in the City's name in pension or other post-retirement benefit programs;
- Cash and Investments held in lieu of retention by banks or other financial institutions for construction projects;
- Short or long-term loans made to other entities by the City; and Short term (Due to/from) or long-term (Advances from/to) obligations made between the City and its funds.

Investment of Bond Proceeds

California Code Section 5922 (d) governs the investment of bond proceeds and reserve funds in accordance with bond indenture provisions.

- Arbitrage Requirement - The US Tax Reform Act of 1986 requires the City to perform arbitrage calculations as required and return excess earnings to the US Treasury from investments of proceeds of bond issues sold after the effective date of this law. These arbitrage calculations may be contracted with an outside source to provide the necessary technical assistance to comply with this regulation. Investable funds subject to the 1986 Tax Reform Act will be kept segregated from other funds and records will be kept in a fashion to facilitate the calculations.

The City's investment position relative to the new arbitrage restrictions is to continue pursuing the maximum yield on applicable investments while ensuring the safety of capital and liquidity. It is the City's position to continue maximization of yield and to rebate excess earnings, if necessary.

3.0 Fiscal Prudence

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 City, 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 City.

Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, direction and intelligence exercise in the management their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

It is the City's full intent, at the time of purchase, to hold all investments until maturity to ensure the return of all invested principal. Staff anticipates market prices of securities purchased will vary depending on economic conditions, interest rate fluctuations, or individual security credit factors. Such temporary variations in market value will inevitably result in measurable gains or losses at any specific point in time.

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

4.0 Objective

The principle factors of Safety, Credit Risk, Market Rate Risk, Liquidity and Return on Investment shall be taken into consideration, in the specific order listed, when making investment decisions.

1. **Safety of Principal -** Safety of principal is the foremost objective of the investment program. Investments of the City of Indian Wells seek to ensure the preservation of capital in the overall portfolio. To obtain this objective, the City will mitigate credit risk and interest rate risk.

2. **Credit Risk -** Credit risk is the risk of loss due to the failure of the issue of a security. Credit risk will be mitigated by:

    a. Limiting investments to the safest types of securities
    b. By pre-qualifying the financial institutions with which it will do business
    c. By diversifying the investment portfolio in order that potential losses on individual securities do not unduly harm the City's capital base and cash flow.

3. **Market Rate Risk -** Market Risk, defined as market value fluctuations due to overall changes in interest rates shall be mitigated by limiting the average maturity of the investment portfolio to less than 5years, with a maximum maturity of any one security of 10 years. The portfolio shall be structured based on liquidity needs to avoid the need to sell securities prior to maturity.

4. **Liquidity -** The investment portfolio will remain liquid to meet all operating requirements, which might be reasonably anticipated. This is accomplished by striving to have securities mature at the same time cash is needed to meet anticipated demands (static liquidity). Additionally, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity).

5. **Return on Investment -** The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, considering the City's investment risk constraints and the cash flow characteristics of the portfolio. Return on Investment is of secondary importance compared to the safety and liquidity objectives described above. Investments are limited to relatively low risk securities, as

herein defined, in anticipation of earning a fair return relative to the risk assumed. While it occasionally may be necessary or strategically prudent of the City to sell a security prior to maturity to meet unanticipated cash needs or to restructure the portfolio, this policy specifically prohibits trading securities for the sole purpose of speculating on the future direction of interest rates.

5.0 Delegation of Authority

Authority to manage the investment program is derived from California Government Code Section 53600, et seq.; the City's Municipal Code; and City Council's Policy Manual.

Responsibilities of the Finance Department

The Finance Department is charged with the responsibility for maintaining custody of all public funds and securities belonging to or under the control of the City and for the deposit and investment of those funds in accordance with the principles of sound treasury management, applicable laws and ordinances, and this investment policy.

Responsibilities of the City Treasurer

The City Treasurer is responsible for investing all City Funds in accordance with the California Government Code, Sections 53600 et seq. and 53635 et seq. Investment practices shall conform to the prudent man rule (Civil Code Sect. 2261, et seq.).

The City Treasurer shall establish written procedures for the operation of the investment program consistent with this investment policy. Procedures should include reference to safekeeping, repurchase agreements, wire transfer agreements, collateral/depository agreements and banking service contracts. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. The City Treasurer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the City Treasurer.

6.0 Ethics and Conflicts of Interests

Elected officials and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial decisions.

Employees and Elected officials shall disclose to the City Manager any material interests in financial institutions that conduct business with the City of Indian Wells, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the City's portfolio. Employees and Elected officials shall subordinate their personal investment transactions to those of the City of Indian Wells particularly about the time of purchases and sales.

7.0 Authorized Financial Dealers and Institutions

Authorized Financial Dealers and Institutions defined under California Government Code Section 53601.5 shall be allowed to conduct business with the City. Authorized Financial Dealers and Institutions defined under California Government Code Section 53601.5 shall be defined as an institution licensed by the State of California as a broker-dealer, as defined in Section 25004 of the California Corporations Code, or a member of a federally regulated securities exchange, a national or state-chartered bank, a savings association or federal association or a brokerage firm designated as a primary government dealer by the Federal Reserve Bank.

The City Treasurer will maintain a list of financial institutions authorized to provide investment services conforming to the California Government Code Section 53601.5. These may include "primary" dealers or regional dealers that qualify under Securities & Exchange Commission Rule 15C3-1 (uniform net Capital rule). No public deposit shall be made except in a qualified public depository as established by state laws.

All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the City Treasurer with the following: audited financial statements, proof of National Association of Security Dealers certification, proof of State of California registration, and certification of having read the City's investment policy. A current (for the fiscal year most recently ended) audited financial statement is required to be on file for each financial institution and broker/dealer in which the City invests.

8.0 Safekeeping and Custody

To protect against fraud or embezzlement or losses caused by collapse of an individual securities dealer, all securities owned by the City shall be held in safekeeping by a third-party bank trust department, acting as agent for the City under the terms of a custody agreement. All trades executed by a dealer will settle delivery vs. payment (DVP) through the City's safekeeping agent. Securities held in custody for the City shall be independently audited on an annual basis to verify investment holdings. The only exception to the foregoing shall be depository accounts and securities purchases made with: LAIF, time certificates of deposit and money market mutual funds, since the purchased securities are not deliverable.

9.0 Investment Diversification and Percentage Limitations

Investments shall be diversified among institutions, types of securities and maturities to maximize safety and yield with changing market conditions. The City Treasurer will diversify investments by investment type and institution in accordance with the limitations of the authorized investments.

Diversification

- No more than 70% of the City's total investment portfolio will be invested in a single security type or with a single financial institution.

- The City Treasurer shall take great care not to exceed the maximum 70% diversification limit; however, due to routine fluctuations in the amount of cash held in Local Agency Investment Funds (LAIF) or other short-term investments, the City may at times temporarily exceed the maximum 70% diversification limit.

Percentage Limitations

- The City Treasurer shall not exceed the maximum investment percentage of the portfolio by investment type at the time of purchase of the security. Due to routine fluctuations in the amount of cash held in LAIF or other short-term investments, the City may at times temporally exceed the maximum investment percentage of the portfolio by investment type. The City Treasurer shall not be required to sell any investment type to maintain the maximum investment percentage of the portfolio by investment type limit.

10. Authorized and Suitable Investments

Investments of City funds are governed by the California Government Code Sections 53600 et seq, as amended from time to time.

Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum par value per name	Credit/Minimum Quality Requirements
US Treasury Bills, Bonds and Notes	5 years – See Maximum Maturity requirements	0-70%	None	Full faith and credit of the United States Government
Federal Agency Securities	5 years – See Maximum Maturity requirements	0-70%	$15,000,000	Implied guarantee of the US Government. Federal Agency Securities have a AAA rating.
Local Agency Bonds	5 years – See Maximum Maturity requirements	0-20%	$5,000,000	Shall be rated in a rating category of "A" or its equivalent or better by a nationally recognized rating service such as S&P or Moodys.
State of California Obligations	5 years – See Maximum Maturity requirements	0-20%	$5,000,000	Shall be rated in a rating category of "A" or its equivalent or better by a nationally recognized rating service such as S&P or Moodys.
CA Local Agency Obligations	5 years – See Maximum Maturity requirements	0-20%	$5,000,000	Shall be rated in a rating category of "A" or its equivalent or better by a nationally recognized rating service such as S&P or Moodys.
Money Market Funds	N/A	0-20%	10% per single issue	Multiple requirements including highest ranking by two nationally recognized rating agencies, must have fund advisor registered with the SEC, have more than $500 million under management, etc.
Certificates of Deposit – Private Placement Certificate of Deposit Account Registry Service (CDARS), Negotiable Certificates of Deposit, Non-negotiable Certificates of Deposit	5 years	0-30%	$250,000 per Issuer	Federal Deposit Insurance Corporation (FDIC) Insured limited to $250,000 per issuer.
Repurchase Agreements	30 days	0-10%	$2,000,000	Signed Security Loan Agreement in file. Reverse Repurchase Agreements are specifically not authorized under this investment policy.
Local Agency Investment Fund	N/A	0-60%	$20,000,000 (per entity)	Investment of funds in the California LAIF which allows the State Treasurer to invest through the Pooled Money Investment Account
Medium-term Corporate Bonds	5 years	0-20%	2,000,000	Shall be rated in a rating category of "A" or its equivalent or better by a nationally recognized rating service such as S&P or Moodys.

11.0 Prohibited Investments

Pursuant to California Government Code Section 53601.6, as amended from time to time, the City shall not invest any funds in inverse floaters, range notes, or interest only strips that are derived from a pool of mortgages. In addition, the City shall not invest funds in any security that could result in zero interest accrual if held to maturity.

12.0 Review of Investment Portfolio

The securities held by the City must be in compliance with Authorized and Suitable Investments at the time of purchase. The City Treasurer shall establish procedures to report to the City Council, major and critical incidences of noncompliance identified through the review of the portfolio.

13.0 Investment Pools/ Money Market Funds

The City may invest in the Local Agency Investment Fund (LAIF), a special fund in the California State Treasury created and governed pursuant to Government Code Sections 16429.1 et seq. LAIF limits investments to $65 million from any one public agency by State law; however, the City's investment policy limits investments to $20 million. The California Government Code states that moneys placed for deposit in LAIF are in trust in the custody of the State Treasurer and cannot be borrowed or withheld from the City. Further, the right to withdraw deposited money from the LAIF upon demand may not be altered, impaired, or denied in any way by any state official or agency based upon the State's failure to adopt a budget by July1 of each new fiscal year.

A thorough investigation of the pool/fund is required prior to investing, and on a continual basis. The purpose of this investigation is to determine the suitability of a pool or fund and evaluate the risk of placing funds with that pool or fund.

The investigation will, at a minimum, obtain the following:

- A description of eligible investment securities, and a written statement of investment policy and objectives.
- A description of interest calculations and how it is distributed, and how gains and losses are treated.
- A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced, and the program audited.
- A description of who may invest in the program, how often, what size deposit and withdrawal are allowed.
- A schedule for receiving statements and portfolio listings
- A description of how the pool/fund maintain reserves, retained earnings, etc. or is all income after expenses distributed to participants
- A fee schedule that discloses when and how fees are assessed.

- The eligibility of the pool/fund to invest in bond proceeds and a description of its practices.

Money market mutual funds must be registered with the Securities and Exchange Commission and which comply with rule 2a7 of the Investment Company Act of 1940. The dollar weighted average maturity of the portfolio shall be less than ninety (90) days and the portfolio is managed to maintain a one dollar ($1.00) share price.

The fund shall meet either of the following criteria:

- Attained the highest ranking or the highest letter and numerical rating provided by not less than two Nationally Recognized Statistical-Rating Organizations
- Retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience managing money market mutual funds with assets under management more than five hundred million dollars ($500,000,000).

14.0 Collateralization

Collateralization will be required on Repurchase Agreements.

- Repurchase Agreements - To anticipate market changes and provide a level of security for all funds, the collateralization level for repurchase agreements will be 102% of market value of principal and accrued interest. The collateral cannot be mortgaged-backed securities.

15.0 Maximum Maturities

The City of Indian Wells will attempt to match its investments with anticipated cash flow requirements. To the extent possible, the City Treasurer shall maintain investments in the portfolio equal to the amount of two years current General Fund operating reserves maturing at no more than five (5) years from the date of purchase. Once this requirement is met, a maximum of 30% of the portfolio may be invested for more than five (5) years but not to exceed ten (10) years consisting of those investments listed in Government Code Section 53601 where there is no limitation specified therein regarding the term or remaining maturity of the instrument. Investments greater than five (5) years from the date of purchase shall be brought to the City Council for review and approval prior to purchase. Reserve funds from Bond proceeds may be invested in securities exceeding five (5) years if the maturity of such investments is made to coincide as practicable with the expected use of funds.

16.0 Internal Control

The City Treasurer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft or misuse. The internal control structure is designed to provide reasonable, but not absolute, 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. Accordingly, the City Treasurer shall establish an annual process of independent review by an external auditor. This review will provide internal control by assuring compliance with policies and procedures.

17.0 Maturity Structure

The weighted average maturity of the pooled portfolio shall not exceed four years. In addition to the four-year maturity average, the portfolio shall be structured for liquidity purposes to maintain $5,000,000 of invested funds maturing within 360 days.

18.0 Performance Standards

The investment portfolio shall be managed in accordance with the parameters specified within this policy and always within consistently safe and prudent treasury management procedures.

Market Yield (Benchmark)

The City's overall investment strategy is passive: Investments are generally held to maturity. The City portfolio shall be compared to a benchmark to determine whether market yields are being achieved. The LAIF apportionment rate and the two-year U.S. Treasury Note shall be considered useful benchmarks of the City's portfolio performance.

Marking to Market

The market value of the portfolio shall be calculated monthly. This will ensure that review of the investment portfolio, in terms of value and price volatility, is performed. In defining market value, consideration shall be given to pronouncements from the Government Accounting Standards Board (GASB) that address the reporting of investment assets and investment income for all investment portfolios held by governmental entities. The fair value of all securities reported in the City's portfolio is based on currently quoted market prices.

19.0 Reporting

The City Treasurer shall prepare monthly Treasurer's Report that provides a clear picture of the status of the current investments. The Treasurer's Report is prepared in a manner that will allow the City Manager and the City Council to ascertain whether investment activities during the reporting period have deviated from the City's investment policy. The monthly Treasurer's Report will include the City portfolio, Fiscal Agent portfolio, and Bond Proceeds portfolio(s).

The following information shall be required in each monthly investment portfolio report:

- A listing of individual securities held at the end of the reporting period
- Percentage of Portfolio by Investment Type
- Investments Stated Rate and Book Value

- Unrealized gains or losses resulting from appreciation depreciation by listing the cost and market value of securities over one-year in duration
- Average rate of return on City's investments
- Maturity aging by type of investment
- Market value of Securities

20.0 Investment Policy Adoption

The City of Indian Wells Investment Policy shall be adopted by minute order of the City Council of the City of Indian Wells. The Policy shall be reviewed annually by the City Council and any modifications made thereto must be approved by the City Council.

APPENDIX "A"

GLOSSARY OF INVESTMENT TERMS

AGENCY: A debt security issued by a federal or federally sponsored agency. Federal agencies are backed by the full faith and credit of the U.S. Government (i.e. Government National Mortgage Association). Federally sponsored agencies (FSA's) are backed by each agency with a market perception that there is an implicit government guarantee (i.e. Federal National Mortgage Association).

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

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

BOND PROCEEDS: The money paid to the issuer by the purchaser or underwriter of a new issue of municipal securities. These moneys are used to finance the project or purpose for which the securities were issued and to pay certain costs of issuance as may be provided in the bond contract.

BOOK VALUE: The value at which a debt security is shown on the holder's balance sheet. Book value is often acquisition cost plus/minus amortization and accretion, which may differ significantly from the security's current value in the market.

BROKER: Someone who brings buyers and sellers together and is compensated for his/her service.

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity 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.

CREDIT QUALITY: The measurement of the financial strength of a bond issuer. This measurement helps an investor to understand an issuer's ability to make timely interest payments and repay the loan principal upon maturity. The higher the credit quality of a bond issuer, the lower the interest rate paid by the issuer because the risk of default is lower. Credit quality ratings are provided by a Nationally Recognized Statistical-Rating Organization.

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

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

CURRENT YIELD (CURRENT RETURN): A yield calculation determined by dividing the annual interest received on a security by the current market price of that security.

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

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).

DIVERSIFICATION: Dividing investment funds among a variety of security types by sector, maturity and quality ratings offering independent returns.

DURATION: A measure of the timing of the cash flows, such as the interest payments and the principal repayment, to be received from a given fixed-income security. This calculation is based on three variables: term to maturity, coupon rate, and yield to maturity. The duration of a security is a useful indicator of its price volatility for given changes in interest rates.

FAIR VALUE: The amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

FEDERAL CREDIT AGENCIES: Agencies of the Federal Government set up to supply credit to various classes of institutions and individuals, e.g., S&L's, small-business firms, students, farmers, farm co-operatives, and exporters.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits currently up to $250,000 per deposit.

FEDERAL HOME LOAN BANKS (FHLB): Government sponsored wholesale banks (currently 12 regional banks) that lend funds and provide correspondent banks services to member commercial banks, thrift institutions, credit unions and insurance companies.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA): 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.

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 United States created by Congress and consisting of a seven-member Board of Governors in Washington, D.C., twelve Regional Banks and about 5,700 commercial banks that are members of the system.

FINANCIAL INDUSTRY REGULATORY AUTHORITY (FINRA): A self-regulatory organization (SRO) responsible for governing business between brokers, dealers and the investing public.

GOVERNMENT ACCOUNTING STANDARDS BOARD (GASB): A standard-setting body, associated with the Financial Accounting Foundation, which prescribes standard accounting practices for governmental units.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA or Ginnie Mae): Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. Security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA, or FMHA mortgages. The term "pass-throughs" is often used to describe Ginnie Maes.

GOVERNMENT SECURITIES: An obligation of the U.S. government, backed by the full faith and credit of the government. These securities are regarded as the highest quality of investment securities available in the U.S. securities market. See "Treasury Bills, Notes, and Bonds."

INTEREST RATE RISK: The risk associated with declines or rises in interest rates which cause an investment in a fixed-income security to increase or decrease in value.

INTERNAL CONTROLS: An internal control structure designed to ensure that the assets of the entity are protected from loss, theft, or misuse. The internal control structure is 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. Internal controls should address the following points:

- **Control of collusion** - Collusion is a situation where two or more employees are working in conjunction to defraud their employer.
- **Separation of transaction authority from accounting and record keeping** - By separating the person who authorizes or performs the transaction from the people who record or otherwise account for the transaction, a separation of duties is achieved.
- **Custodial safekeeping** - Securities purchased from any bank or dealer including appropriate collateral (as defined by state law) shall be placed with an independent third party for custodial safekeeping.
- **Avoidance of physical delivery securities** - Book-entry securities are much easier to transfer and account for since actual delivery of a document never takes place. Delivered securities must be properly safeguarded against loss or destruction. The potential for fraud and loss increases with physically delivered securities.
- **Clear delegation of authority to subordinate staff members** - Subordinate staff members must have a clear understanding of their authority and responsibilities to avoid improper actions. Clear delegation of authority also preserves the internal control structure that is contingent on the various staff positions and their respective responsibilities.

- **Written confirmation of transactions for investments and wire transfers** - Due to the potential for error and improprieties arising from telephone and electronic transactions, all transactions should be supported by written communications and approved by the appropriate person. Written communications may be via fax if on letterhead and if the safekeeping institution has a list of authorized signatures.
- **Development of a wire transfer agreement with the lead bank and third-party custodian** - The designated official should ensure that an agreement will be entered into and will address the following points: controls, security provisions, and responsibilities of each party making and receiving wire transfers.

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): Chapter 730, Statutes of 1976 of the State of California, established the Local Agency Investment Fund. This fund enables local governmental agencies to remit money not required for immediate needs to the State City Treasurer for the purpose of investment. To derive the maximum rate of return possible, the State City Treasurer has elected to invest these monies with State monies as a part of the Pooled Money Investment Account. Each local governmental unit has the exclusive determination of the length of time its money will be on deposit with the State City Treasurer. At the end of each calendar quarter, all earnings derived from investments are distributed by the State Controller to the participating government agencies in proportion to each agency's respective amounts deposited in the Fund and the length of time such amounts remained therein. Prior to the distribution, the State's costs of administering the program are deducted from the earnings.

MARK-TO-MARKET: The process whereby the book value or collateral value of a security is adjusted to reflect its current market value.

MARKET RISK: The risk that the value of a security will raise or decline because of changes in market conditions.

MARKET VALUE: The current price at which a security is trading and could be purchased or sold at that point in time.

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase-reverse repurchase agreements that establish 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 a financial obligation is due and payable.

MONEY MARKET MUTUAL FUND: Mutual funds that invest solely in money market instruments (short-term debt instruments, such as Treasury bills, commercial paper, bankers' acceptances, repos and federal funds).

MUTUAL FUND: An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments. Mutual funds are regulated by the Investment Company Act of 1940 and must abide by Securities and Exchange Commission (SEC) disclosure guidelines.

NATIONALLY RECOGNIZED STATISTICAL-RATING ORGANIZATION (NRSRO): Standard and Poor's, Moody's, and Fitch Financial Services are examples of such organizations.

OFFER: An indicated price at which market participants are willing to sell a security or commodity. Also, referred to as the "Ask price."

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 $1,000 increments per bond.

PORTFOLIO: Combined holding of more than one stock, bond, commodity, real estate investment, cash equivalent, or other asset. The purpose of a portfolio is to reduce risk by diversification.

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

PRIMARY DEALER: A group of government securities dealers who submit daily reports of market activity 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.

PRINCIPAL: (1) The face amount or par value of a debt instrument. (2) One who acts as a dealer buying and selling for his own account.

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 or the current income return.

REINVESTMENT RISK: The risk that a fixed-income investor will be unable to reinvest income proceeds from a security holding at the same rate of return currently generated by that holding.

REPURCHASE AGREEMENT (RP OR REPO): A holder of securities sells these securities to an investor with an agreement to repurchase them 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 the buyer for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money that is increasing bank reserves.

REVERSE REPURCHASE AGREEMENT: An agreement of one party (for example, a financial institution) to purchase securities at a specified price from a second party (such as a public agency) and a simultaneous agreement by the first party to resell the securities at a specified price to the second party on demand or at a specific date.

RISK: Degree of uncertainty of return on an asset.

RULE 2A-7 OF THE INVESTMENT COMPANY ACT: Applies to all money market mutual funds and mandates such funds to maintain certain standards, including a 13-month maturity limit and a 90-day average maturity on investments, to help maintain a constant net asset value of one dollar ($1.00).

SAFEKEEPING SERVICE: 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 vault for protection and security.

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

SECURITIES LENDING: An agreement under which a local agency agrees to transfer securities to a borrower who, in turn, agrees to provide collateral to the local agency. During the term of the agreement, both the securities and the collateral are held by a third party. At the conclusion of the agreement, the securities are transferred back to the local agency in return for the collateral.

STRUCTURED NOTES: Notes issued by Government Sponsored Enterprises, (FHLB, FNMA, FHLMC, etc.), and Corporations that have imbedded options, (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns), into their debt structure. Their market performance is impacted by the fluctuation of interest rates, the volatility of the imbedded options and shifts in the shape of the yield curve.

SWAP: Trading one asset for another.

TOTAL RETURN: The sum of all investment income plus changes in the capital value of the portfolio.

TREASURY BILLS: Short-term U.S. government non-interest-bearing discounted debt securities with maturities of no longer than one year and issued in minimum denominations of $10,000. Auctions of three- and six-month bills are weekly, while auctions of one-year bills are monthly. The yields on these bills are monitored closely in the money markets for signs of interest rate trends.

TREASURY BOND: A long-term coupon-bearing U.S. Treasury security issued as a direct obligation of the U.S. Government and having an initial maturity of more than 10 years and issued in minimum denominations of $1,000.

TREASURY NOTE: A medium-term coupon-bearing U.S. Treasury security issued as a direct obligation of the U.S. Government and having an initial maturity of from one to ten years and issued in denominations ranging from $1,000 to $1 million or more.

UNIFORM NET CAPITAL RULE: Securities and Exchange Commission (SEC) Rule 15C3-1 outlining requirements 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 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.

VOLATILITY: A degree of fluctuation in the price and valuation of securities.

YIELD: The current rate of return on an investment security generally expressed as a percentage of the security's current price. (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.