



## **CITY OF HAWTHORNE** **INVESTMENT POLICY**

### **A. POLICY:**

The purpose of this document is to provide guidelines for the prudent investment of the City of Hawthorne's (hereinafter “City”) funds and to outline the policies needed to maximize the efficiency of the City's cash management system.

The Treasurer shall invest idle public funds in a manner that recognizes that safety of principal is the top priority. The primary duty and responsibility of the Treasurer is to protect, preserve and maintain cash and investments placed in his/her trust on behalf of the citizens of the community. The second priority is liquidity. It is the duty of the Treasurer to maintain an adequate percentage of the portfolio in short-term securities which can be converted to cash if necessary to meet disbursement requirements. A high yield on investments ranks third in priority in the City's investment strategy. Yield will be considered only after the basic requirements of safety and liquidity have been met. This strategy will be carried out in conformity with state statutes, local laws, and City Council ordinances or resolutions. The Treasurer is required to both: (1) file quarterly investment reports with the City Council; and (2) seek City Council approval whenever a) city investment strategy is changed, or b) when city funds are invested in new financial institutions, or c) types of investments are changed from previous investments.

### **B. SCOPE:**

This investment policy applies to the following funds which are accounted by the City's:

- 1) General Fund
- 2) Special Revenue Funds
- 3) Capital Project Funds
- 4) Proprietary Funds
- 5) Trust and Agency Funds
- 6) Any new fund created by the Council, unless specifically exempted by the Council.

All monies entrusted to the Treasurer shall be invested in accordance to California Government Code Sections 53601, 53602 and 53635.

**This policy shall not apply to investments held by the administrators of the City's IRS Code Section 457 deferred compensation program and bond proceeds.** These funds shall be invested in accordance with the related current contractual provisions or bond covenant.

**C. PRUDENCE:**

The Treasurer shall invest public funds in the context of the "prudent person standard" which states, "investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of 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."

The Treasurer shall adhere to and be evaluated according to the aforesaid "prudent person standard" in the performance of his/her duties as the manager of public funds.

Additionally, investment officers acting in accordance with written procedures and the investment policy, and exercising due diligence shall be relieved of personal responsibility for an individual securities 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.

**D. INVESTMENT OBJECTIVE:**

It is the City's policy to permit selection of investments from among those authorized by the California Government Code Sections 16429.1 and 53600-53684. The primary objectives, in priority order of investment activities, shall be:

**1. Safety:**

Safety of principal is the foremost objective of the investment program. The Treasurer shall seek to avoid capital losses for all investment transactions made. The portfolio shall be diversified to insure that potential losses on the individual securities do not exceed the income generated from the remainder of the portfolio. Additionally, the Treasurer shall insure the safety of invested funds by limiting interest and credit rate risks.

**2. Interest Rate Risk:**

The risk that the market value of the portfolio securities will fall due to an increase in general interest rates:

Interest rate risk will be mitigated by:

- i. Structuring the City's portfolio so that securities mature to meet the City's cash demands for ongoing operations, thereby precluding the need to sell securities on the open market prior to their maturity.
- ii. Investing primarily in shorter-term securities.

**3. Credit risk:**

The risk of loss due to the failure of the security or backer.

Credit risk will be mitigated by:

- i. Limiting investments to the types of securities authorized by this policy.
- ii. Diversifying the investment portfolio.

**4. 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. In accordance with Government Code Section 53601, no investment shall be made in any security that at the time of the investment has a remaining term in excess of five years unless the Council has granted express authority to make that investment.

In addition, it is the City's policy that investments with remaining terms to maturity in excess of one year shall have an active secondary market.

**4. Yield:**

Yield should become a consideration only after the basic requirements of safety and liquidity have been met.

**5. Return on Investment:**

The investment portfolio shall be designed to attain a market-average rate of return throughout budgetary and economic cycles, taking into account the City's risk constraints, IRS arbitrage rebate requirements, the cash flow characteristics of the portfolio and State statutes, local laws, ordinances or resolutions that restrict investments. The City's portfolio management approach is one that prohibits speculation based on anticipated interest rate movements. The City's approach is to buy investments with the intention of holding the investment to maturity.

**6. Legal Requirement:**

The City's investment portfolio shall be designed with the objective of meeting all legal requirements set forth by Federal, State and local laws.

**7. DELEGATION OF AUTHORITY:**

The City Treasurer is designated as the investment officer of the City. The responsibility for the investment program rests with the Treasurer. The Treasurer will be responsible for all transactions undertaken and establishing a system of internal controls and standard operating procedures to regulate the activities of subordinate officers. A designee of the Treasurer(s) is responsible for these transactions in the absence of the Treasurer.

**8. INVESTMENT TRAINING:**

The Treasurer and Deputy Treasurer(s) may attend at least one training session within twelve months after taking office or being appointed, and at least annually thereafter. The training session should be sponsored by a professional organization, such as, but not limited to: Government Finance Officers Association (GFOA), California Society of Municipal Finance Officers (CSMFO), Association of Public Treasurers of the United States & Canada (APT US & C), California Municipal Treasurers Association (CMTA). Attendance shall be in accordance with any other city policies or protocols for attendance of meetings or events at public expense, including the City's Reimbursement Policy and only when funds are appropriated in the City's budget. Training must include some or all of the following components: investment controls, security risks, strategy risks, market risks, and compliance with Federal, State and local laws.

**9. ETHICS AND CONFLICTS OF INTERESTS:**

The Treasurer shall avoid any transaction that might impair public confidence in the City's ability to govern effectively. Officers and employees involved in the investment process shall refrain from business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the Council any material financial interests in financial institutions that conduct business within this jurisdiction, 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 officers shall subordinate their personal investment transactions to those of the City of Hawthorne, particularly with regard to the time of purchase and sales.

**G. AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS:**

In recommending financial institutions for deposits or investment of City funds, the Treasurer shall consider the credit worthiness of institutions. The Treasurer shall continue to monitor, by obtaining and reviewing currently available financial statements, financial institutions' credit characteristics and financial history throughout the period in which City funds are deposited or invested. Additionally, the Treasurer shall maintain a list of financial institutions authorized to provide investment services.

In addition, if utilized, a list will also be maintained of approved security broker/dealer selected by credit worthiness who is authorized to provide investment services in the State of California. These may include "primary" dealers or regional dealers that qualify under Securities & Exchange Commission Rule 15C3-1. No public deposit shall be made except in a qualified public depository as established by the State of California.

A copy of the City's Investment Policy shall be provided to each approved financial institution or broker/dealer the City conducts business with. A signed agreement from each, agreeing to abide by the City's Investment Policy, shall be maintained by the Treasurer or City Clerk Department.

**H. AUTHORIZED AND SUITABLE INVESTMENTS:**

**1. Treasuries:**

Securities that represent direct obligations of the U.S. Treasury can be of three types: Bills, Notes, Certificates of indebtedness or Bonds. They differ based on the term to maturity and the method of interest payment. Treasuries are actual obligations of the U.S. Government and, as such, are backed by the "full faith and credit" of the Federal government. There is no portfolio limit for this investment vehicle as authorized in Government Code Section 53601(b). % Authorized: 100%. Maximum maturity: 5 years.

**2. Federal Agencies:**

Securities that represent an obligation of several agencies or instrumentalities which administer selected lending programs of the U.S. Government. These agencies include the Federal Home Loan Mortgage Corporation (FHLMC) or (Freddie Mac), Government National Mortgage Association (GNMA or Ginnie Mae), Federal Land Bank and Federal Farm Credit Bank. These securities are obligations of the agencies themselves, but there is an implied guarantee by the U.S. Government. Obligations of these agencies are backed by large pools of residential mortgage loans or agricultural real estate loans. Government Code Section 53601(f). % Authorized: 75%. Maximum maturity: 5 years. No more than 30% of the portfolio may be invested on any one issuer (excluding the Proceeds of tax-exempt bonds).

**3. Certificates of Deposit:**

These instruments are placed with commercial banks or savings and loan associations. They allow the City the flexibility to select the exact amount and day of maturity. CD's are subject to collateralization requirements for any amounts in excess of FDIC Insurance. Collateralization requirements for amounts exceeding \$100,000 will be 110% of the deposit in government securities or 150% of pools of mortgage loans. There is no portfolio limit for this investment vehicle as authorized in Government Code Section 53649.

**4. Negotiable Certificates of Deposits (“NCD”):**

These are issued by a national or state chartered bank, a saving association, a federal association (as defined by Section 5102 of the Financial Code), or by a state-licensed branch of a foreign bank. NCD's are unsecured obligations of the financial institution, bank, or savings and loan, bought at par value with a promise to pay face value, plus accrued interest, at maturity. Purchases of NCD's shall not exceed 30% of the Agency's monies that may be invested pursuant to this section. (Government Code Section 53601(i)). Restrictions: Maturities range from two weeks to five years.

**5. Bankers Acceptances (“BA”):**

These instruments essentially are a bill of exchange or time draft drawn on and accepted by a commercial bank. They are used to facilitate the shipment and storage of goods both internationally and within the United States. They are collateralized by the goods being shipped as well as the credit worthiness of the issuing institution. These instruments may not exceed 40% of the City's portfolio. They range in maturities from 30 to 180 days as authorized in Government Code Section 53601(g).

**6. Commercial Paper (“CP”):**

These instruments are issued by leading industrial and financial firms to raise working capital. These negotiable instruments are purchased at a discount to par value. Local agencies are permitted by state law to invest in commercial paper of "prime quality" of the highest ranking or of the highest better and numerical rating as provided by a nationally recognized statistical rating service (“NRSRO”). (Government Code Section 53601(h)). The entity that issues the commercial paper shall meet all of the following conditions in either paragraph (1) or (2):

- (1) The entity meets the following criteria: A) Is organized and operating in the United States as a general corporation; B) Has total assets in excess of five hundred million dollars (\$500,000,000). C) Has debt, other than commercial paper, if any, that is rated “A” or higher by NRSRO.
- (2) The entity meets the following criteria: A) Is organized within the United States as a special purpose corporation, trust or limited liability company; B) has program wide credit enhancements including, but not limited to, overcollateralization, letters of credit, or a surety bond. C) has commercial paper that is rated A-1 or higher, or the

equivalent, by an NRSRO.

Eligible commercial paper shall have a maximum security of 270 days or less. Local agencies, other than counties or a city and county, may invest no more than 25% of their monies in eligible commercial paper.

**7. Local Agency Investment Fund (LAIF) Demand Deposits :**

LAIF is a special fund in the State Treasury created by Assembly Bill 3107, passed in 1977. This law permits a local government official, with the consent of the governing body of that agency, to remit or invest money in its treasury not required for its immediate need, to the State Treasurer for deposit in this fund. Principal may be withdrawn on a one-day notice. Interest earned is paid quarterly. The fees charged are limited to one-quarter of one percent of the earnings of the fund. \$50 million limit per account with LAIF, except for bond trustee accounts (no limit).

**8. Passbook Savings Account:**

These accounts pay a low rate of interest, compounded daily on their balances. This account allows the transfer of money from checking to savings and earn short-term on odd amounts of money that are not available for longer investments.

**9. Repurchase Agreements (“RP”) sold by authorized brokers:**

These investments are essentially agreements between the local agency and seller for the purchase of securities on or before a specified date for a specified amount. Repurchase agreements must be sold by authorized brokers. Investments in a repurchase agreement shall be made only upon prior approval of the Council as authorized in Government Code Section 53635. Investments in repurchase agreements may be made, on an investment authorized in Government Code Section 53601(j), when the term of the agreement does not exceed one year. The market value of securities that underlie a repurchase agreement shall be valued at 102 percent or greater of the funds borrowed against those securities and the value shall be adjusted no less than quarterly. Since the market value of the underlying securities is subject to daily market fluctuations, the investments in repurchase agreement shall be in compliance if the value of the underlying securities is brought back up to 102 percent no later than the next business day. Reverse repurchase agreements or securities lending agreements may be utilized only when all of the following conditions are met: 1) the security to be sold using a reverse repurchase agreement or securities lending agreement has been owned and fully paid for by the local agency for a minimum of 30 days prior to the sale. The total of all reverse repurchase agreements and securities lending agreements on investments owned by the local agency does not exceed 20 percent of the base value of the portfolio. The agreement does not exceed a term of 92 days, unless the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity date of the same security. City custodian must hold collateral. An Authorized broker must file a Public Securities Association (“PSA”)

Master Repurchase Agreement with the City Treasurer. % Authorized: 10%.

**10. Mutual Funds or Money Market Funds:**

These investment instruments essentially represent "shares of beneficial interests issued by diversified management companies." Mutual Funds qualifying for City investment must restrict their portfolios to issues approved by the same state investment statute that defines investment alternatives for Cities. Additionally, these Mutual Funds must adhere to Federal statutes regarding the size of the Mutual Fund and its safety. Investment in this vehicle may not exceed 20% of the City's portfolio as authorized in Government Code Section 53601(l).

**11. Medium Term Notes:**

These investment instruments represent an obligation of a domestic corporation or depository institution having a rating of "A" or better by an NRSRO. Government Code Section 53601(k). Medium Term Notes must be 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. Notes may not have a maturity in excess of five years. % authorized: 30%. No more than 5% of the portfolio may be invested in any one issuer.

**12. Certain Asset-Backed Securities:**

These investments include mortgage pass-through securities, collateralized mortgage obligations, mortgage-backed or other pay-through bond or equipment lease-backed certificates of a maximum of five years maturity. Securities eligible for investment under this classification shall be issued by an issuer's debt as provided by a nationally recognized rating service and rated in a category of "AA" or its equivalent or better by a nationally recognized rating service. Investment in this vehicle cannot exceed 20% of the City's portfolio and is authorized in Government Code Section 53601(o).

**13. Local Government Investment Pools**

Shares of beneficial interest issued by a joint powers authority organized pursuant to Section 6509.7 that invests in the securities and obligations authorized in subdivisions (a) to (q), inclusive. Each share shall represent an equal proportional interest in the underlying pool of securities owned by the joint powers authority. To be eligible under this section, the joint powers authority issuing the shares shall have retained an investment adviser that meets all of the following criteria:

- (1) The adviser is registered or exempt from registration with the Securities and Exchange Commission.
- (2) The adviser has not less than five years of experience investing in the securities and obligations authorized in subdivisions (a) to (q), inclusive.



**(3) The adviser has assets under management in excess of five hundred million dollars (\$500,000,000).**

**14. Supranationals**

**United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank, with a maximum remaining maturity of five years or less, and eligible for purchase and sale within the United States. Investments under this subdivision shall be rated “AA” or better by an NRSRO and shall not exceed 30 percent of the agency’s moneys that may be invested pursuant to this section. and as authorized in Government Code Section 53601 (q)**

**J. INELIGIBLE INVESTMENTS AND PROHIBITED TRANSACTIONS:**

- 1. Borrowing for investment purposes (or leverage).**
- 2. Reverse Repurchase Agreements, as defined by California Government Code Sections 53601(i) and 53635(i).**
- 3. Investments known as structured notes (e.g. inverse floaters, averaged floaters, structured certificates of deposit, equity-linked securities).**
- 4. Investment in any instrument that is commonly considered a “derivative” instrument (e.g. options, futures, swaps, caps, floors, collars). No investment prohibited by Government Code Sections 53601.6 or 53631.5 shall be permitted.**
- 5. All investments shall be in U.S. dollar denominated.**
- 6. Securities that are downgraded below the minimum acceptable rating levels must be reviewed for possible sale within a reasonable amount of time.**
- 7. Investments in supranationals.**

**K. COLLATERALIZATION:**

**Collateralization will be required on two types of investments:**

**(1) Certificates of deposits (2) Repurchase agreements. Reverse repurchase agreement investments must have Council approval. By state law, any bank or savings and loan doing business with a government agency must provide dedicated collateral for any governmental deposits it holds in excess of \$100,000 insured by The Federal Deposit Insurance Corporation or Federal Savings & Loan Insurance Corporation. The collateralization process requires that the securities that serve as collateral be placed in a safekeeping account established with the Federal Home Loan Bank or bank's trust department approved by the Administrator of Local Agencies (A State of California Official). The collateral must consist only of the following securities:**

i. **Governmental Securities**

Federal, State, or Local government obligations with a market value of at least 10% in excess of the deposits being secured.

ii. **Mortgage Loans**

These mortgage loans must have a market value of at least 150% of the value of the deposits being secured.

Collateral will always be held by an independent third party with whom the City has a current custodial agreement. A clearly marked evidence of ownership, safekeeping receipt, must be supplied to the City and retained by the Treasurer.

**L. SAFEKEEPING:**

All security transactions, including collateral agreements, entered into by the City shall be conducted on a delivery-versus-payment (DVP) basis. Securities will be held by a third-party custodian designated by the Treasurer.

Repurchase agreements may be entered into on a safekeeping basis only if a master agreement with the bank or trust department providing the safekeeping is first obtained and it very clearly establishes that the bank/trust is acting as third party agent for the Treasurer, not the financial institution arranging the repurchase agreements. Such third party safekeeping arrangements will be documented with a signed agreement between the Treasurer and that the financial institution does not have access to them under any circumstances.

All securities owned by the City will be held by a third party except the collateral for time deposits in banks and savings and loans. Collateral for time deposits in banks should be held in the City's name in the bank's Trust Department, or alternately in the Federal Reserve Bank. Collateral for time deposits in savings and loans is held by the Federal Home Loan Bank or an approved Agent of Depository.

**M. DIVERSIFICATION:**

It is the policy of the City to diversify its investment portfolio to avoid incurring unreasonable and avoidable risks or loss resulting from over concentration of assets in a specific maturity, insurer, or class of securities, with the exception of U.S. Treasury Securities and authorized pools. No more than 50% of the City's total investment portfolio will be invested in a single security type or with a single financial institution, with the exception of U.S. Treasury Securities and authorized pools.

**N. MAXIMUM MATURITIES:**

California Government Code Section 53601 prohibits investments in securities that at the

time of investment have a term of maturity in excess of five years unless the Council has granted authority.

To the extent possible, the Treasurer will attempt to match its investments with anticipated cash flow requirements.

**O. INTERNAL CONTROL:**

The City Treasurer shall establish appropriate procedures designed to provide proper control over investments and the deposit of cash received from other departments. The City's independent auditors shall review annually the City's investment internal controls. The auditor will review those controls designed to prevent loss of public funds arising from fraud, employee error, misrepresentation of third parties, unanticipated changes in financial markets, or imprudent actions by employees and/or officers of the City.

**P. Controls Deemed Most Important - Include:**

- 1) Control of collusion
- 2) Separation of duties
- 3) Separating transaction authority from accounting and recordkeeping
- 4) Custodial safekeeping
- 5) Clear delegation of authority
- 6) Specific limitations regarding securities losses and remedial action
- 7) Written confirmation of telephone transactions
- 8) Minimizing the number of authorized investment officials
- 9) Documentation of transactions and strategies
- 10) Code of ethics and standards

**O. PERFORMANCE STANDARDS:**

The City's investment portfolio will be designed with the objective of exceeding the average Federal Funds rate. The investment program shall seek to augment returns above this threshold, consistent with risk limitations identified herein and prudent investment principles.

The Treasurer's objective is to safely maximize the City investments at all times.

**R. REPORTING:**

The Treasurer shall submit a quarterly investment report to the Council. This report shall disclose the following:

- Purpose of report
- Investments by totals
- Date of purchase
- Description of investment(s)
- Cusip number

- **Coupon, if applicable.**
- **Maturity date**
- **Ratings**
- **Market yield, if sold early.**
- **Market price**
- **Accrued interest**
- **Par value**
- **Cost basis**
- **Market value**
- **Issuer Name**
- **Statement of compliance with investment policy.**

**S. INVESTMENT PROCEDURES and POLICY REVIEW:**

- **The Treasurer shall make investments using investment strategies that preserve the cash flow requirements of the City.**
- **The Treasurer shall regularly review the Investment Policy, and shall incorporate any State of California Legislative actions that impacts allowable investment type, maturities, or per-cent allocation.**
- **The Treasurer shall regularly review banking procedures related to investments.**

- **The Treasurer shall regularly review investment reports submitted to the City by the Local Agency Investment Fund (LAIF), Trustees, and any other entities engaged to invest funds on behalf of the City.**
- **The Treasurer shall submit the Investment Portfolio and Investment Policy as required with the passage of Chapter 687, Statutes of 2000 (AB 943, Dura), to the California Debt and Investment Advisory Commission for review and evaluation of City investment practices.**

**California Debt and Investment Advisory Commission (CDIAC) was created in 1981 with the passage of Chapter 1088, Statutes of 1981 (AB 1182, Costa). This legislature established CDIAC as the state's clearinghouse for public debt issuance information and required it to assist state and local agencies with the monitoring issuances, and management of public debt. The Commission's name was changed to the California Debt and Investment Commission with the passage of Chapter 833, Statutes of 1996 (AB 1197, Takasugi) and its mission was expanded to cover public investments.**

**INVESTMENT POLICY ADOPTION**

**The City's investment policy shall be adopted by resolution of the Council and any modifications made thereto must be approved by the City Council.**

**This Investment Policy and its guidelines supersede any previous Investment Policy.**

\_\_\_\_\_  
**L. David Patterson**  
**City Treasurer**

**This policy was duly affirmed by the authority of the City Council of the City of Hawthorne on the \_\_\_\_ day of \_\_\_\_\_, 2015.**

\_\_\_\_\_  
**Mayor, Chris Brown**

**ATTEST:**

\_\_\_\_\_  
**City Clerk, Norb Huber**

## Glossary

Excerpt from the California Municipal Treasurers Investment Policy Certification Program and Application 2013  
(Second Edition)

(Note: All words of a technical nature should be included. Following is an example of common treasury terminology.)

**AGENCIES:** Federal agency securities and/or Government-sponsored enterprises.

**ASKED:** The price at which securities are offered.

**BANKERS' ACCEPTANCE (BA):** A draft or bill of exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

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

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

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

**CERTIFICATE OF DEPOSIT (CD):** A time deposit with a specific maturity evidenced by a Certificate. Large- denomination CD's 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 of the (entity). It includes five combined statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

**COUPON:** (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value.

(b) A certificate attached to a bond evidencing interest due on a payment date.

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

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

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

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

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

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

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

**DURATION:** A measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years. Rising interest rates mean falling bond prices, while declining interest rates mean rising bond prices.

**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 financial institutions, students, farmers, farm cooperatives, and exporters.

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

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

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

**FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA):** FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. 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):** 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., 12 regional banks and about 5,700 commercial banks that are members of the system.

**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 FHA mortgages. The term “pass-throughs” 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 GOVERNMENT INVESTMENT POOL (LGIP):** The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment.

**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 short-term debt instruments (bills, commercial paper, bankers’ acceptances, etc.) are issued and traded.

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

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

**PORTFOLIO:** Collection of securities held by an investor.

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

**PRUDENT PERSON RULE:** An investment standard. In some states the law requires that a fiduciary, such as a trustee, may invest money only in a list of securities selected by the custody state—the so-called legal list. In other states the trustee may invest in a security if it is one which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

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

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

**REPURCHASE AGREEMENT (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 him for this.

**REVERSE REPURCHASE AGREEMENT (REVERSE REPO):** A reverse-repurchase agreement (reverse repo) involves an investor borrowing cash from a financial institution in exchange for securities. The investor agrees to repurchase the securities at a specified date for the same cash value plus an agreed upon interest rate. Although the transaction is similar to a repo, the purpose of entering into a reverse repo is quite different. While a repo is a straightforward investment of public funds, the reverse repo is a borrowing.

**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 & EXCHANGE COMMISSION:** Agency created by Congress to protect investors in securities transactions by administering securities legislation.

**SEC RULE 15(C)3-1:** See Uniform Net Capital Rule.

**STRUCTURED NOTES:** Notes issued by Government Sponsored Enterprises (FHLB, FNMA, SLMA, etc.) and Corporations, which 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.

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

**TREASURY BONDS:** Long-term coupon-bearing U.S. Treasury securities 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 issued as direct obligations of the U.S. Government and having initial maturities from two to 10 years.

**UNIFORM NET CAPITAL RULE:** Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness

to liquid capital of 15 to 1; also called net capital rule and net capital ratio. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash. City of Hawthorne Investment Policy

**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.