ORDINANCE NO. 120643

Amending Chapter 2, Code of Ordinances, by repealing Sections 2-1611 and 2-1950, and enacting in lieu thereof new sections of like name and subject matter relating to the City's investment policy.

WHEREAS, the City's Investment Committee is charged with setting and monitoring investment policy for investment of public funds, providing general guidance for City investments, and implementing necessary monitoring systems; and

WHEREAS, the Investment Committee reviewed the investment policy as codified in Section 2-1950 at its regularly scheduled meeting on June 21, 2012, and approved changes to said policy to clarify certain language as well as modify the scope of permitted investments; NOW, THEREFORE,

BE IT ORDAINED BY THE COUNCIL OF KANSAS CITY:

Section 1. That Chapter 2, Code of Ordinances of the City of Kansas City, Missouri, is hereby amended by repealing Sections 2-1611, Investment committee, and 2-1950, Investment policy, and enacting in lieu thereof new sections of like number and subject matter, to read as follows:

**Sec. 2-1611. Investment committee**.

In accordance with state law (as amended from time to time), and as defined by section 2-1950 of the Code of Ordinances of the City of Kansas City, Missouri, the investment committee shall establish an investment policy that reflects best practices for the prudent investment of taxpayer funds, including, but not limited to, investing taxpayer funds legally, safely, and with regard to the liquidity needs of the city. The investment policy shall be approved by the city council. Subsequently, the investment committee may make administrative changes to the policy, notifying the chair of the city council standing committee cognizant of investment matters of such changes. Substantive changes to the policy must be approved by the city council. The investment committee shall meet on a regular basis to approve the investment activities.

**Sec. 2-1950. Investment Policy**.

(a) *Policy.*

(1) It is the policy of the City of Kansas City, Missouri (the "City") to invest public funds in a manner which will provide maximum security with the highest investment return while meeting the daily operating cash flow requirements of the City and conforming to all Missouri statutes, City Charter, City Administrative Code, and City General Code of Ordinances governing the investment of public funds.

(2) The City's investment policy shall be adopted by resolution of the City of Kansas City, Missouri Investment Committee. The policy shall be reviewed on an annual basis by the Director of Finance and any modifications made thereto must be approved by the Investment Committee.

*(b) Authority.*

(1) Authority to manage the City's investment program is derived from Article IV, Division 2, Section 407 of the City Charter (Exhibit 1), and Chapter 2, Article XI, Sections 2-1611 through 2-1615 of the Code of Ordinances of the City of Kansas City, Missouri, (Exhibit 2).

(2) Management responsibility for the investment program is hereby delegated to the Director of Finance, who shall establish procedures for the operation of the investment program, consistent with this investment policy. Procedures include (but are not limited to): Depository Trust Agreements, Safekeeping Agreements, Wire Transfer Agreements, and Banking Service Contracts, (see Exhibits 3, 4, 5, and 6, respectively). Agreements shall include explicit delegation of authority to persons responsible for acting on behalf of the City. No person may engage in an investment transaction except as provided under terms of this policy and the procedures established by the Director of Finance. The Director of Finance authorizes the City Treasurer or his/her designee (Exhibit 19) to initiate investment transactions on behalf of the City. The Director of Finance shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

(3) The Investment Committee shall be composed of a member of the City Council who serves on the Finance Committee as appointed by the Mayor, the Director of Finance, the City Treasurer, the City Manager, and the City Attorney, or their respective designees. The Investment Committee shall set and monitor policies, provide general guidance for city investments and implement necessary monitoring mechanisms. The Committee will meet regularly to review performance, policy, procedures, market conditions, and legislation.

*(c) Prudence.*

(1) 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.

(2) The standard of prudence to be used by investment officials shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with the investment policy and written procedures and exercising due diligence 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 fashion and appropriate action is taken to control adverse developments.

(3) The "prudent person" concept discourages speculative transactions; it attaches primary significance to the preservation of capital and secondary importance to the generation of income and capital gains. The "prudent person" is expected to be a reasonably well informed person, not a professional investor or market maker, who is obligated to act responsibly.

(d) *Ethics and Conflict of Interest.* Officers 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 investment decisions. Employees and investment officials shall disclose to the Director of Finance 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 of Kansas City, Missouri's portfolio. Employees and officers shall subordinate their personal investment transactions to those of the City of Kansas City, Missouri, particularly with regard to the timing of purchases and sales.

*(e) Scope.*

(1) This policy applies to all City of Kansas City, Missouri, monies identified as idle, surplus, and reserve as defined in Article IV, Division 2, Section 407 of the City Charter, (Exhibit 1), Chapter 2, Article XI, Section 2-1612 of the City Code of Ordinances, (Exhibit 2) and in written legal opinions by the City Attorney or designee.

(2) Funds included in the investment policy are accounted for in the City of Kansas City, Missouri Comprehensive Annual Financial Report and include (but are not limited to):

a. General Fund

b. Special Revenue Funds

c. Debt Service Funds

d. Capital Projects Funds

e. Internal Service Funds

f. Trust and Agency Funds

g. Enterprise Funds

(3) Funds of other agencies who act as conduit issuers for bonds secured by the City's annual appropriation pledge subject to this policy include (but are not limited to): Kansas City Municipal Assistance Corporation (KCMAC), Land Clearance for Redevelopment Authority (LCRA), Port Authority of Kansas City, Missouri (Port Authority), Industrial Development Authority (IDA), and Tax Increment Financing Commission (TIF). Permitted investments are identified within the bond documents for specific issues and approved by each agency's governing body.

(4) Pension and retirement funds are directed by investment policies implemented by the Employee Retirement Pension System Board of Trustees and the Firefighters Pension System Board of Trustees and are therefore not included in the scope of this policy.

(f) *Objectives.* The primary objectives, in priority order, of the City of Kansas City, Missouri's investment activities shall be:

(1) Legality. The Director of Finance and those authorized by him or her will invest the City's excess funds only within the legal guidelines set forth by the Constitution and Statutes of the State of Missouri, City Charter and the City Code of Ordinances. Any investment alternative outside these guidelines is not permissible. Furthermore, the City of Kansas City, Missouri seeks to promote and support the objectives of US foreign policy regarding terrorism. Accordingly, investments in companies or their subsidiaries or affiliated entities that are known to sponsor terrorism or aid the government in countries that are known to sponsor terrorism are prohibited.

(2) Safety. Safety of principal is the foremost objective of the investment program. Investments of the City of Kansas City, Missouri 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 interest rate risk.

a. *Credit Risk*. The City of Kansas City, Missouri, will minimize credit risk, the risk of loss due to the failure of the security issuer or backer, by:

1. Establishing a pre-approved list of financial institutions and companies to which the City will be restricted when purchasing commercial paper.

2. Conducting regular credit monitoring and due diligence of these issuers.

3. Pre-qualifying the financial institutions and broker/dealers with which the City will do business for broker services and repurchase agreements.

4. Diversifying the portfolio with respect to maturity, issuer, and security type so that potential losses on individual securities will be minimized.

b. *Interest Rate Risk*. The City of Kansas City, Missouri, will minimize the risk that the market value of securities in the portfolio will materially fall due to changes in general interest rates, by:

1. Targeting an effective duration of less than 1.5 and an effective weighted average maturity of less than 2.5 years.

2. Holding at least 30% of the portfolio's total market value in securities with a maturity of 12 months or less.

c. *Liquidity*. The City of Kansas City, Missouri's investment portfolio will remain sufficiently liquid to enable the City of Kansas City, Missouri to meet all operating requirements which might be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with anticipated cash needs. Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets.

d. *Return on investment*. The City of Kansas City, Missouri's investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the City's investment risk constraints and liquidity needs. The City of Kansas City, Missouri's investment strategy is active. The benchmark basis used by the City Treasurer to determine whether market yields are being achieved shall be The Bank of America Merrill Lynch 1-3 year index, or any successor index.

*(g) Authorized and Suitable Investments.*

(1) The City of Kansas City, Missouri is empowered by City Charter to invest in the following types of securities:

a. *United States Treasury Securities (Bills, Notes, Bonds and Strips)*. United States Agency/GSE Securities. The City may invest in obligations issued or guaranteed by any agency of the United States Government and in obligations issued by any government sponsored enterprise (GSE) which have a liquid market and a readily determinable market value that are described as follows:

1. U.S. Govt. Agency Coupon and Zero Coupon Securities.

2. U.S. Govt. Agency Discount Notes.

3. U.S. Govt. Agency Callable Securities. Restricted to securities callable at par only.

4. U.S. Govt. Agency Step-Up Securities. The coupon rate is fixed for an initial term. At the step-up date, the coupon rate rises to a new, higher fixed interest rate.

5. U.S. Govt. Agency Floating Rate Securities. Restricted to coupons with no interim caps that reset at least quarterly and that float off of only one index.

6. U.S. Govt. Agency/GSE Mortgage Backed Securities (MBS, CMO, Pass-Thru Securities). Restricted to securities with final maturities of five (5) years or less or have the final projected payment no greater than five (5) years when analyzed in a +300 basis point interest rate environment.

b. *Repurchase Agreements*. The City may invest in contractual agreements between the City and commercial banks or primary government securities dealers. The Securities Industry & Financial Markets Association's (or any successor's) guidelines for the Master Repurchase Agreement will be used and will govern all repurchase agreement transactions (Exhibit 18). All repurchase agreement transactions will be either physical delivery or tri-party.

c. *Bankers' Acceptances.* The City may invest in bankers' acceptances issued by domestic commercial banks possessing the highest credit rating issued by Moody's Investor Services, Inc. or Standard and Poor's Corporation.

d. *Commercial Paper.* The City may invest in commercial paper issued by domestic corporations, which has received the highest short-term credit rating issued by Moody's Investor Services, Inc. or Standard and Poor's Corporation. Eligible paper is further limited to issuing corporations that have total assets in excess of five hundred million dollars ($500,000,000) and are not listed on Credit Watch with negative implications by any nationally recognized credit rating agency at the time of purchase.

e. *Municipal Securities (State and Local Government Obligations).* The City may invest in municipal obligations that are issued in either tax-exempt or taxable form.

f. Any full faith and credit obligations of the State of Missouri rated at least A or A2 by Standard & Poor's or Moody's.

g. Any full faith and credit obligations of any city, county or school district in the state of Missouri rated at least AA or Aa2 by Standard & Poor's or Moody's.

h. Any full faith and credit obligations or revenue bonds of the City of Kansas City, Missouri rated at least A or A2 by Standard & Poor's or Moody's.

i. Any full faith and credit obligation of any state or territory of the United States of America rated at least AA or Aa2 by Standard & Poor's or Moody's.

j. Any full faith and credit obligations of any city, county or school district in any state or territory of the United States of America rated AAA or Aaa by Standard & Poor's or Moody's.

k. Any revenue bonds issued by the Missouri Department of Transportation rated at least AA or Aa2 by Standard & Poor's or Moody's.

l. Any municipal obligation that is pre-refunded or escrowed to maturity as to both principal and interest with escrow securities that are fully guaranteed by the United States Government, without regard to rating by Standard & Poor's or Moody's.

(2) To provide for the safety and liquidity of the City of Kansas City, Missouri's funds, the investment portfolio will be subject to the following restrictions:

a. Borrowing for investment purposes ("leverage") is prohibited.

b. Instruments known as Structured Notes (e.g. inverse floaters, leverage floaters, equity-linked securities) are not permitted. Investment in any instrument which is commonly considered a "derivative" instrument (e.g. options, futures, swaps, caps, floors, and collars) is prohibited.

c. Contracting to sell securities not yet acquired in order to purchase other securities for purposes of speculating on developments or trends in the market is prohibited.

d. It is the policy of the City of Kansas City, Missouri to actively manage the investment portfolio within the constraints outlined in this investment policy versus an exclusive "buy and hold" philosophy. The prohibition of speculative investments precludes pursuit of gain or profit through unusual risk. However, trading in response to changes in market value or market direction is warranted under an active portfolio management strategy.

*(h) Basis of Award.*

(1) Generally, investment transactions will be conducted through a competitive offer/bid process consisting of at least three offers/bids from those broker/dealers on the City's approved broker/dealer list. Exceptions to this requirement include (but are not limited to):

a. Market conditions or limited inventory situations may result in an immediate purchase from one broker/dealer without utilizing the competitive bid process so the security can be obtained in a timely manner. Securities purchased in this fashion must have, at a minimum, documentation attached reflecting the current interest rate environment and a brief explanation regarding all pertinent information relevant to the transaction.

b. Security transactions initiated to either increase income or restructure various segments of the portfolio, i.e. "securities swaps", will be evaluated on their own merit and potential profitability. For purposes of this policy, "securities swaps" shall mean the sale of one or more currently held securities and the immediate purchase of one or more replacement securities.

c. From time to time the U.S. Government and certain Government Sponsored Enterprises initiate "buyback" or "tender" programs. It is the intent of this policy to allow the City to participate in such buyback or tender programs to the extent the participation in the program benefits the City's investment program.

(2) Comparison to market price will be performed by the Treasury Division Investment staff through a nationally recognized financial publication or service (i.e., The Wall Street Journal, Bloomberg or DTN) providing daily market pricing.

*(i) Securities lending.*

(1) The City may temporarily exchange securities held in the portfolio for cash or other authorized securities of at least equal value with no maturity more than one year beyond the maturity of any of the traded obligations.

(2) Securities lending may be transacted through the City's custodial bank, through a third party lender, or directly with approved broker/dealers. Direct broker/dealers must have a signed Bond Market Association Securities Lending Agreement on file with the City.

(3) All securities being transferred must be delivered versus payment.

(4) Securities lending transactions may be entered into for periods of 90 days or less.

(5) The City Treasurer shall develop cash collateral investment guidelines for the reinvestment of any collateral made by the City's securities lending agent and is responsible for periodic monitoring of these investments for compliance.

(j) *Special investment programs.* The City of Kansas City, Missouri may initiate special investment programs from time to time, including, but not limited to, the City-Wide Time Deposit Program, the Linked-Deposit Program, and the Loan Loss Reserve Deposit Program, to encourage equal community investment.

*(k) Diversification.*

(1) The City of Kansas City, Missouri will diversify its investments by security type and institution. The City's investment portfolio shall be diversified by:

(2) Continuously investing a portion of the portfolio in readily available funds to ensure that appropriate liquidity is maintained in order to meet ongoing obligations.

(3) Limiting investments in securities that have a higher credit risk.

(4) Investing in securities of varying maturities.

(5) The following guidelines represent maximum limits established for diversification by instrument:

a. U.S. Treasuries and securities having principal and/or interest guaranteed by the U.S. government .................................... 100%

b. Collateralized time and demand deposits ............................ 100%

c. U.S. Government agencies and government-sponsored enterprises (including mortgage-backed securities) ............ 80%

d. Collateralized repurchase agreements ............................ 50%

e. U.S. Government agency callable securities ............................ 30%

f. Commercial Paper ............................ 30%

g. In addition, the City's portfolio may not contain commercial paper of any one corporation, the total value of which exceeds 2% of the City's aggregate investment portfolio.

h. Bankers' Acceptances ............................ 30%

i. Certificates of Deposit ............................ 25%

j. Municipal Securities (State and Local Government Obligations)............30%

k. In addition, the City's portfolio may not contain municipal obligations of any one issuer, the total value of which exceeds two percent (2%) of the City's aggregate investment portfolio, unless the obligation is pre-refunded or escrowed to maturity with securities guaranteed by the United States Government.

(l) *Maturities.* To the extent possible, the City of Kansas City, Missouri will attempt to match its investments with anticipated cash flow requirements. In accordance with Chapter 2, Article XI, Section 2-1612 of the City Code of Ordinances (Exhibit 2) and except for certain mortgage-backed securities as defined in Section VII.A.2.f (above), and except for state and local government obligations that are pre-refunded to a call date earlier than the maturity date, the City of Kansas City, Missouri will not directly invest in securities with a stated final maturity date more than five (5) years from the date of purchase.

*(m) Authorized Dealers and Financial Institutions.*

(1) The City Treasurer will maintain a list of financial institutions authorized, in accordance with Banking Institution Selection Criteria (Exhibits 7 & 17) to provide investment services.

(2) The City Treasurer will maintain a list of security dealers authorized, in accordance with the Security Dealers Selection Criteria (Exhibit 8) to provide investment services. If the Dealer satisfies all of the requirements,

they will be added to the list of firms eligible to provide investment services to the City.

(3) Periodic reviews of the financial condition and registration of qualified bidders will be conducted by the City Treasurer.

*(n) Investment Program Management*.

(1) *Collateralization.*

a. Collateralization, pursuant to Missouri Revised Statutes 2000, Chapter 110, Sections 110.010 through 110.020, (Exhibit 9), City Code of Ordinances Chapter 2, Article XI, Section 2-1614, (Exhibit 10), or contractual agreement, will be required on demand deposit accounts, money market banking accounts, certificates of deposit and time deposits.

b. Collateral which is accepted, at the discretion of the Director of Finance, is specified in the Missouri Revised Statutes, Chapter 30, Section 30.270 (Exhibit 11).

c. Collateral shall have a market value equal to one hundred two (102) percent of the amount of the City investment less any amount insured by the Federal Deposit Insurance Corporation, or other governmental agency performing similar functions.

d. Securities pledged as collateral will always be held by the Federal Reserve Bank with whom the City of Kansas City, Missouri has a current Custodial Agreement (Exhibit 13). A clearly marked evidence of ownership, Safekeeping Receipt (Exhibit 16) must be supplied to the City of Kansas City, Missouri and retained.

e. The right of collateral substitution is granted.

(2) *Safekeeping and Custody*.

a. All security transactions entered into by the City of Kansas City, Missouri shall be conducted on a delivery-versus-payment (DVP-delivery of securities with an exchange of money for the securities) basis.

b. Any security transaction performed on a “free delivery” (or delivery versus receipt- delivery of securities with an exchange of a signed receipt for the securities) basis must be pre-approved by the City Treasurer or Director of Finance.

c. Securities will be held in the City's name by a third party trust custodian designated by the Director of Finance and evidenced by safekeeping receipts, City Code of Ordinances Chapter 2, Article XI, Section 2-1613, (Exhibit 13).

(3) *Internal Control.*

a. The Director of Finance has established and implemented internal controls within the Treasury Division to prevent loss of public funds arising from fraud, employee error, misrepresentation by third parties, or imprudent actions by employees of the Treasury Division. Internal controls most important to protect the City's assets are:

b. The Director of Finance shall designate in writing those individuals in addition to the Director of Finance and City Treasurer, within the Treasury Division, who are authorized to invest City monies. Such authorization letters shall be delivered to each authorized financial institution or security dealer.

c. Those individuals making an investment of City monies with an authorized financial institution or security dealer shall provide instruction for delivery of the security being purchased. In addition, the safekeeping financial institution shall be provided details for the security purchase and to deliver payment upon delivery of the security.

d. Those individuals making the investment of City monies shall provide details of said investment to personnel within the Treasury Division for entry into the investment portfolio records.

e. Investment personnel shall be responsible for accounting for all investment transactions in the City's financial system. The Cash Management Section will verify and reconcile all investment transactions to the City's general ledger and to the City's bank accounts.

f. With regard to bank-to-bank ("draw down") wires and outgoing wire transfers, authorized Treasury Division personnel may initiate all bank-to-bank wires and all wire transfers. All wire transfers must be approved by a secondary approver prior to final processing by the bank.

g. The City's investment portfolio shall be subject to an annual audit by an independent audit firm of the City. In addition, the investment portfolio records shall be available to the City Auditor for audit at any time.

(4) *Reporting.*

a. The Treasury Division is charged with the responsibility of preparing the following monthly investment reports:

1. Monthly Investment Portfolio Report; listing of all investment transactions by type, security description, average maturity date, cost, acquisition date, and yield. (Exhibit 14).

2. Investment and Bank Account Recap Report for monthly financial reports submitted to City Council; totals by category, security definition, and purpose. (Exhibit 15).

3. The market value of the portfolio shall be calculated monthly and a Statement of Market Value shall be issued at least monthly to the Investment Committee of the City. This will ensure that a review of the investment portfolio, in terms of value and price volatility, has been performed.

b. The Treasury Division will also maintain all security transaction activity reports.

(o) *Glossary.* (Definitions provided by Municipal Treasurers' Association of the United States and Canada, the Investment Guidelines for Missouri Political Subdivisions, the GFOA's Investing Public Funds, and by Bloomberg.)

(1) *Accretion.* The periodic upward adjustment of the principal value of a fixed income security purchased at a discount from its par value or maturity value.

(2) *Accrued interest*. The accumulated interest due on a bond as of the last interest payment made by the issuer.

(3) *Agency.* A debt security issued by a federal or federally sponsored agency.

(4) *Amortization.* The opposite of accretion. The periodic downward adjustment of the principal value of a fixed-income security purchased at a premium from its par value or maturity value.

(5) *Asked.* The indicated price at which a seller is willing to sell a security or commodity.

(6) *Average life.* The average length of time that an issue of serial bonds and/or term bonds with a mandatory sinking fund feature is expected to be outstanding

(7) *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.

(8) *Basis point.* A unit of measurement used in the valuation of fixed-income securities equal to 1/100 of 1 percent of yield.

(9) *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.

(10) *Bid.* The indicated price at which a buyer is willing to purchase a security or commodity.

(11) Book value. The value at which a security is carried on the inventory lists or other financial records of an investor.

(12) *Broker.* A broker brings buyers and sellers together for a commission paid by the initiator of the transaction or by both sides; he does not position. In the money market, brokers are active in markets in which banks buy and sell money and in inter-dealer markets.

(13) *Buyback.* In the fixed income sense, a program in which an issuer offers to repurchase its debt obligations at market prices.

(14) *Callable bond.* A bond that the issuer has the right to redeem prior to maturity. Some callable bonds may be redeemed on one call date while others have multiple call dates. Some callable bonds may be redeemed at par while others can only be redeemed at a premium.

(15) *Call risk.* The risk to a bondholder that a bond may be redeemed prior to maturity.

(16) *Certificate of deposit (CD).* A deposit of funds, in a bank or savings and loan association, for a specified term that earns interest at a specified rate or rate formula, evidenced by a certificate. They may be for terms as short as 1 week or as long as or longer than 10 years.

(17) *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.

(18) *Commercial paper*. Unsecured, short-term promissory notes issued by corporations for specific amounts and with specific maturity dates. Firms with lower ratings or firms without well-known names usually back their commercial paper with guarantees or bank letters of credit. Commercial paper may be sold on a discount basis or may bear interest. Terms can be as short as 1 day and usually do not exceed 270 days.

(19) *Comprehensive annual financial report (CAFR).* The official annual report for the City of Kansas City, Missouri. It includes five combined statements for each individual fund and account group prepared in conformity with Generally Accepted Accounting Principles (GAAP). It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provision, extensive introductory material, and a detailed Statistical Section.

(20) *Convexity*. A measure of a bond's price sensitivity to changing interest rates. A high convexity indicates greater sensitivity of a bond's price to interest rate changes.

(21) 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.

(22) Credit risk. The risk to an investor than an issuer will default in the payment of interest and/or principal on a security.

(23) Current yield. A yield calculation determined by dividing the annual interest received on a security by the current market price of that security.

(24) Dealer. A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his own account.

(25) *Dealer bank*. A bank that continuously deals in government and agency securities.

(26) *Debenture*. A bond secured only by the general credit of the issuer.

(27) *Delivery versus payment*. There are two methods of delivery of securities: delivery versus payment and delivery versus receipt (also called "free"). 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.

(28) *Derivative security.* A financial instrument created from, or whose value depends upon, one or more underlying assets or indexes of asset values.

(29) *Discount.* The difference between the cost price of a security and its value at 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.

(30) *Discount rate.* The rate of interest at which the Federal Reserve Bank lends overnight money to commercial banks who are members of the Federal Reserve System.

(31) *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.

(32) *Diversification.* Dividing investment funds among a variety of securities offering independent returns.

(33) *Duration.* See Modified Duration.

(34) *Effective duration.* See Modified Duration.

(35) *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 cooperatives and exporters.

(36) *Federal Deposit Insurance Corporation (FDIC).* A federal agency that insures bank deposits for public funds, currently up to $100,000 per time deposit and $100,000 per demand deposit.

(37) *Federal funds rate.* The rate of interest at which banks lend excess funds to other banks. This rate is currently pegged by the Federal Reserve through open market operations.

(38) *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.

(39) *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 included 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.

(40) *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.

(41) *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.

(42) *Government agency.* An agency of the federal government whose debt obligations are unconditionally backed by the full faith and credit of the United States of America. Examples include: GNMA.

(43) *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 FHA, VA or FmHA mortgages. The term "pass-throughs" is often used to describe Ginnie Mae securities.

(44) *Government sponsored enterprises (GSE's).* An agency of the federal government whose debt obligations are not unconditionally backed by the full faith and credit of the United States of America, but a market perception that there is an implicit government guarantee. Examples include: FHLB, FFCB, FNMA, FHLMC, SLMA, FMAC and TVA.

(45) *Interest rate.* See "Coupon (a)."

(46) *Interest rate risk.* The risk associated with declines or rises in interest rates which causes an investment in a fixed-income security to increase or decrease in value.

(47) *Investment policy*. A concise and clear statement of the objectives and parameters formulated by an investor or investment manager for a portfolio of investment securities.

(48) *Investment grade obligations*. An investment instrument suitable for purchase by institutional investors under the prudent person rule. Investment-grade is restricted to those obligations rated BBB or higher by a nationally recognized rating agency.

(49) *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, securities are said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

(50) *Local governmental 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.

(51) *Mark to market*. The process whereby the book value or collateral value of a security is adjusted to reflect its current market value.

(52) *Market risk*. The risk that the value of a security will rise or decline as a result of changes in market conditions.

(53) *Market value*. The price at which a security is trading and could presumably be purchased or sold.

(54) *Master repurchase agreement*. A written contract covering all future transactions between the parties to purchase/repurchase securities. The master agreement governs each specific repo transaction and 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.

(55) *Maturity*. The date upon which the principal or stated value of an investment becomes due and payable.

(56) *Modified (effective) duration*. The percentage price change of a security or a basket of securities for a given change in yield. The higher the modified duration of a security, the higher its risk.

(57) *Money market*. The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

(58) *Mortgage-backed securities.* Securities created whereby the issuer pools numerous home mortgages that it owns and then issues one security, or tranches of securities, secured by the underlying mortgages.

(59) *National Association of Securities Dealers (NASD).* A self-regulatory organization of brokers and dealers in the over-the-counter securities business.

(60) *Nominal yield*. The stated rate of interest that a bond pays its current owner, also known as the coupon rate or interest rate.

(61) *Offers.* See "Asked."

(62) *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.

(63) *Operating funds.* Includes all investable funds of the political entity with the exception of bond proceeds, retirement funds and self-insurance funds. Investable funds shall include all fund balances and surplus funds.

(64) *Par.* The face value or principal value of a bond, typically $1,000 per bond.

(65) *Portfolio.* Collection of securities held by an investor.

(66) *Premium*. The amount by which the price paid for a security exceeds its par value.

(67) *Primary dealer.* A group of government securities dealers and banks that can buy and sell government securities while working directly with the Federal Reserve Bank of New York. Primary dealers include Securities and Exchange Commission (SEC) registered securities broker-dealers, banks and a few unregulated firms.

(68) *Prime rate*. A preferred interest rate charged by commercial banks to their most creditworthy customers. Many interest rates are keyed to this rate.

(69) *Prudent person rule.* An investment standard in which a trustee may invest in a security if it is one which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

(70) *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.

(71) *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.

(72) *Regional dealer.* A securities broker/dealer that operates primarily in a specific geographic area of the country.

(73) *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 being generated by that holding.

(74) *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 him for this. Dealers use RPs extensively to finance their positions. Exception: When the Fed is said to be doing RPs, it is lending money, that is, increasing bank reserves.

(75) *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 vault for protection.

(76) *Sec Rule 15C3-1.* See Uniform Net Capital Rule.

(77) Secondary market. A market made for the purchase and sale of outstanding debt issues following the initial distribution.

(78) *Securities & Exchange Commission (SEC).* Agency created by Congress to protect investors in securities transactions by administering securities legislation.

(79) *Structured notes.* Notes issued by Government Sponsored Enterprises (FHLB, FNMA, FHLMC, 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.

(80) *Swap.* The exchange of securities for a realized profit greater than if the security was held to maturity or to restructure the maturity characteristics of the portfolio.

(81) *Tender.* To formally bid on a security or to surrender one's shares in response to such a bid.

(82) *Total return.* The sum of all investment income plus changes in the capital value of the portfolio.

(83) *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.

(84) *Treasury bonds.* Long term U.S. Treasury securities having initial maturities of more than ten years.

(85) *Treasury notes.* Intermediate term coupon bearing U.S. Treasury securities having initial maturities from two to ten years.

(86) *Uniform net capital rule.* A Securities and Exchange Commission regulation that outlines the net capital ratio, which is all monies due to the firm, including margin loans, divided by liquid assets. Member firms *must maintain a ratio of at least 15 to 1.*

(87) *Volatility.* A degree of fluctuation in the price and valuation of securities.

(88) *Weighted average maturity (WAM).* The average maturity, on a dollar weighted basis, of all the securities that comprise a portfolio. As applied to mortgage-backed securities, it is the average maturity of the principal repayments of that particular security.

(89) *Yield.* The rate of annual income return on 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.

(90) *Yield to call.* The rate of return the investor receives from a bond assuming the bond is redeemed prior to its stated maturity date.

(91) *Yield to maturity.* The rate of return yielded by a debt security held to maturity when both interest payments and the investor's potential capital gain or loss are included in the calculation of return.

(92) *Zero coupon securities.* An investment security that is issued at a discount and makes no periodic interest payments. The rate of return consists of gradual accretion of the principal of the security and is payable at par upon maturity. U.S. Treasury Bills, Federal Agency Discount Notes, and Commercial Paper are all issued in zero coupon form.

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Approved as to form and legality:

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Stephen Walsh
Assistant City Attorney