

# **THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA**

## **STATEMENT OF INVESTMENT POLICY FISCAL YEAR 2021/22**

**June 08, 2021**

### **I. POLICY**

This Statement of Investment Policy (Policy) is intended to outline the guidelines and practices to be used in managing the Metropolitan Water District of Southern California's (District) investment portfolio. District funds not required for immediate cash disbursements will be invested in compliance with the Government Code of the state of California (California Government Code).

### **II. INVESTMENT AUTHORITY**

As authorized by Section 53607 of the California Government Code, authority to invest or reinvest funds of the District is hereby delegated by the Board of Directors to the Treasurer, for a period of one-year, who shall thereafter assume full responsibility for the investment program until the delegation of authority is revoked or expires. Subject to review, the Board of Directors may renew the delegation of authority each year. The Treasurer may delegate the day-to-day investment activities to their designee(s) but not the responsibility for the overall investment program.

The Treasurer may also delegate the day-to-day execution of investments to registered investment managers through written agreements. The investment manager(s), in coordination with the Treasurer, will manage on a daily basis the District's investment portfolio pursuant to the specific and stated investment objectives of the District. The investment manager(s) shall follow this Policy, the specific investment guidelines provided to each investment manager, and such other written instructions provided by the Treasurer or their designee(s). The investment manager(s) may be given discretion to acquire and dispose of assets in their designated account, but the investment manager(s) shall not be permitted to have custodial control over the District's investment portfolio.

### **III. STATEMENT OF OBJECTIVES**

In accordance with California Government Code Section 53600.5, and in order of importance, the Treasurer shall adhere to the following three criteria:

1. **Safety of Principal.** Investments shall be undertaken which first seek to ensure the preservation of principal in the portfolio. The Treasurer shall ensure that each investment transaction is evaluated or cause to have evaluated each potential investment, seeking both quality in issuer and in underlying security or collateral, and shall diversify the portfolio to reduce exposure to loss. Diversification of the portfolio will be used in order to reduce exposure to principal loss.
2. **Liquidity.** Investments shall be made whose maturity date is compatible with cash flow requirements of the District and which will permit easy and rapid conversion into cash without substantial loss of principal.
3. **Return on Investment.** Investments shall be undertaken to produce an acceptable rate of return after first considering safety of principal and liquidity and the prudent investor standard.

## **IV. SCOPE**

This Policy applies to all funds and investment activities under the direct authority of the District and accounted for in the Comprehensive Annual Financial Report, except for the employee's retirement and deferred compensation funds. In addition, deposits with banks under the California Government Code's "Deposit of Funds" provisions are excluded from this Policy's requirements. Funds of the District will be invested in compliance with the provisions of, but not necessarily limited to securities specified in the California Government Code Section 53601 et seq. and other applicable statutes. Investments will be in accordance with these policies and written administrative procedures. Investment of the District's bond proceeds shall be subject to the conditions and restrictions of bond documents and are not governed by this Policy.

## **V. PRUDENT INVESTOR STANDARD**

Pursuant to California Government Code Section 53600.3, all persons authorized to make investment decisions on behalf of the District are trustees and therefore fiduciaries subject to the "prudent investor standard". The prudent investment standard obligates a trustee to ensure that "when investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law."

## **VI. SAFEKEEPING AND CUSTODY**

To protect against potential losses caused by the collapse of individual securities dealers, all investment transactions involving deliverable securities will be conducted on a delivery versus payment (DVP) basis. All deliverable securities owned by the District, including collateral on repurchase agreements, shall be held in safekeeping by a third party bank trust department acting as agent for the District under the terms of a custody agreement executed by the bank and the District. All financial institutions that provide safekeeping services for the District shall be required to provide reports or safekeeping receipts directly to the Controller to verify securities taken into their possession. The Controller shall also maintain evidence of the District ownership in non-deliverable securities (e.g. LAIF, CAMP, and Time CDs).

## **VII. INVESTMENT TRANSACTIONS**

Information concerning investment opportunities and market developments will be gained by maintaining contact with the financial community. Confirmations for investment transactions will be sent directly to the Controller for audit. When practical, the Treasurer shall solicit more than one quotation on each trade.

## **VIII. REPORTING**

If the Board delegates responsibility of the investment program to the Treasurer, then in accordance with the Metropolitan Water District Administrative Code, Section 5114, the Treasurer shall submit a monthly report to the Executive Secretary of the Board of Directors via the General Manager indicating the types of investment by fund and date of maturity, and shall provide the current market value of all securities, rates of interest, and expected yield to maturity. The Treasurer shall also submit a monthly summary report to the Board of Directors via the General Manager showing investment activity, including yield and earnings, and the status of cash by depository.

In addition, the monthly report shall also include a statement denoting the ability to meet the District's expenditure requirements for the next six (6) months. The report shall also state compliance of the portfolio to this Policy, or manner in which the portfolio is not in compliance. In the event of non-compliance, staff will prepare a report for the Board that details the compliance issue, provides analysis, and provides a recommendation to bring the portfolio back into compliance with this Policy.

## **IX. PERFORMANCE STANDARDS**

The investment portfolio shall be managed with the objective of obtaining a rate of return throughout budgetary and economic cycles, commensurate with the investment risk constraints and the cash flow needs of the District. The District will employ an active management approach that allows for the sale of securities prior to their scheduled maturity dates. Securities may be sold for a variety of reasons, such as to increase yield, lengthen or shorten maturities, to take a profit, or to increase investment quality. In no instance shall a transaction be used for purely speculative purposes. The District recognizes that in a diversified portfolio occasional measured losses are inevitable and must be considered within the context of the overall portfolio's structure and expected investment return, with the proviso that adequate diversification and credit analysis have been implemented.

Because the composition of the portfolio fluctuates, depending on market and credit conditions, various appropriate indices selected by the Treasurer will be used to monitor performance.

## **X. INVESTMENT GUIDELINES AND ELIGIBLE SECURITIES**

The District is governed by the California Government Code, Sections 53600 et seq. Within the context of these limitations, the investments listed below are authorized.

The District is prohibited from investing in any investment authorized by the California Government Code but not explicitly listed in this Policy without the prior approval of the Board of Directors. Some of the limitations on investments set forth below are more stringent than required by the California Government Code and have been included to better manage the credit risks specific to the District's portfolio. Under the provisions of California Government Code Sections 53601.6, the District shall not invest any funds covered by this Investment Policy in inverse floaters, range notes, mortgage-derived, interest-only strips or any investment that may result in a zero interest accrual if held to maturity, except as authorized by Code Section 53601.6.

### **1. US Treasury Obligations**

United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

- Maximum allocation: 100% of the portfolio
- Maximum maturity: Five (5) years, except as otherwise permitted by this Policy
- Credit requirement: N.A.

### **2. Federal Agency Obligations**

Federal agency or United States government-sponsored enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises.

- Maximum allocation: 100% of the portfolio
- Maximum maturity: Five (5) years, except as otherwise permitted by this Policy
- Credit requirement: N.A.

### **3. Banker's Acceptances**

Bills of exchange or time drafts drawn on and accepted by a commercial bank, typically created from a letter of credit issued in a foreign trade transaction.

- Maximum allocation: Forty percent (40%) of the portfolio; five percent (5%) with any one issuer
- Maximum maturity: One-hundred eighty (180) days
- Credit requirement: A-1 or its equivalent or better by a Nationally Recognized Statistical Rating Organization (NRSRO).
- Issued by banks with total deposits of over one billion dollars (\$1,000,000,000)
- Issued by banks from offices in the USA.

### **4. Commercial Paper**

Commercial paper is defined as short-term, unsecured promissory notes issued by financial and non-financial companies to raise short-term cash. Financial companies issue commercial paper to support their consumer and/or business lending; non-financial companies issue for operating funds.

- Maximum allocation: Forty percent (40%) of the portfolio; five percent (5%) with any one issuer
- Maximum maturity: Two hundred seventy (270) days
- Credit requirement: Highest ranking or highest letter and number rating as provided by an NRSRO.
- Entity issuing the commercial paper must meet the conditions of California Government Code Section 53601(h)(1) or (2).

### **5. Medium Term Corporate Notes**

All corporate and depository institution debt securities (not to include other investment types specified in Code) issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States.

- Maximum allocation: Thirty percent (30%) of the portfolio; five percent (5%) with any one issuer
- Maximum maturity: Five (5) years
- Credit requirement: A or its equivalent or better by an NRSRO.

### **6. Negotiable Certificates of Deposit**

Issued by a nationally or state-chartered bank, a savings association or a federal association, a state or federal credit union, or by a federally licensed or state-licensed branch of a foreign bank.

- Maximum allocation: Thirty percent (30%) of the portfolio, five percent (5%) with any one issuer
- Maximum maturity: Five (5) years
- Credit requirement: A (long-term) or A-1 (short-term) or their equivalents or better by an NRSRO
- Issued by banks with total deposits of one billion dollars (\$1,000,000,000) or more

### **7. Bank Deposit**

Insured or collateralized time certificates of deposits, saving accounts, market rate accounts, or other bank deposits.

- Maximum limit: Thirty percent (30%) of the portfolio for all deposits
- Maximum maturity: Five (5) years

- Credit requirement: All deposits must be collateralized as required by California Government Code Sections 53630 et seq. The Treasurer may waive collateral for the portion of any deposits that is insured pursuant to federal law.
- Deposits are limited to a state or national bank, savings association or federal association, a state or federal credit union, or a federally insured industrial loan company, located in California.
- Deposits must meet the conditions of California Government Code Sections 53630 et seq.

Pursuant to Government Code 53637, the District is prohibited from investing in deposits of a state or federal credit union if a member of the District's Board of Directors, or any person at the District with investment decision-making authority, serves on the board of directors or committee of the state or federal credit union.

## **8. Money Market Mutual Funds**

Shares of beneficial interest issued by diversified management companies that are money market funds registered with the SEC.

- Maximum maturity: N/A
- Maximum allocation: Twenty percent (20%) of the portfolio
- Credit requirement: Highest ranking by not less than two NRSROs or must retain an investment advisor that meets specified requirements
- The use of money market funds is limited to Government money market funds that provide daily liquidity and seek to maintain a stable Net Asset Value (NAV)

## **9. State of California, Local Agency Investment Fund (LAIF)**

LAIF is a pooled investment fund overseen by the State Treasurer, which operates like a money market fund, but is for the exclusive benefit of governmental entities within the state. The maximum investment amount authorized by the Local Agency Investment Fund (LAIF) is set by the California State Treasurer's Office. The LAIF is held in trust in the custody of the State of California Treasurer. The District's right to withdraw its deposited monies from LAIF is not contingent upon the State's failure to adopt a State Budget.

- Maximum limit: The current limit set by LAIF for operating accounts
- Maximum maturity: N/A
- Credit requirement: N/A

## **10. Municipal Bonds and Notes**

Municipal obligations issued by the State of California, any other of the states in the union, or a local agency within the State of California. This may include bonds, notes, warrants, or other evidences of indebtedness including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by an authorized entity.

- Maximum limit: Thirty percent (30%) of the portfolio; five percent (5%) with any one issuer
- Maximum maturity: Five (5) years
- Credit requirement: A (long-term) or A-1 (short-term) or their equivalents or better by an NRSRO
- Must be issued by State of California, any of the other 49 states, or a California local agency

## **11. Repurchase Agreement**

A repurchase agreement is a purchase of authorized securities with terms including a written agreement by the seller to repurchase the securities on a future date and price.

- Maximum allocation: Twenty percent (20%) of the portfolio
- Maximum maturity: Two hundred seventy (270) days
- Master Repurchase Agreement must be on file
- Limited to primary dealers or financial institutions rated in a rating category of “A” or its equivalent or higher by an NRSRO.
- Fully collateralized at market value of at least one hundred two percent (102%) with US government or federal agency securities

## **12. California Asset Management Program (CAMP)**

Shares of beneficial interest issued by a joint powers authority organized pursuant to Section 6509.7.

- Maximum allocation: Forty percent (40%) of the portfolio
- Maximum maturity: N/A
- Credit requirement: AAAM or its equivalent or better by an NRSRO
- Joint powers authority has retained an investment adviser that is registered or exempt from registration with the Securities and Exchange Commission, has five or more years of experience investing in the securities and obligations authorized under California Government Code Section 53601, and has assets under management in excess of five hundred million dollars (\$500,000,000).

## **13. Supranationals**

Securities issued or unconditionally guaranteed by the International Bank for Reconstruction and Development (IBRD), International Finance Corporation (IFC), or Inter-American Development Bank (IADB) and eligible for purchase and sale within the United States.

- Maximum allocation: Thirty percent (30%) of the portfolio
- Maximum maturity: Five (5) years
- Credit requirement: AA or its equivalent or better by an NRSRO.

## **14. Asset-Backed Securities**

A mortgage pass-through security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable pass-through certificate, or consumer receivable-backed bond.

- Maximum allocation: Twenty percent (20%) of the portfolio, five percent (5%) with any one issuer
- Maximum maturity: Five (5) years
- Credit requirement: AA or its equivalent or better by an NRSRO.

# **XI. DIVERSIFICATION**

The District shall seek to diversify the investments within the investment portfolio to avoid incurring unreasonable risks inherent in concentrated holdings in specific instruments, individual financial institutions or maturities. To promote diversification, this Policy sets various percentage holding limits by investment type and issuer. Investment type and issuer percentage limitation listed in this Policy are calculated at the time the security is purchased. Per issuer limits, when listed, are calculated across investment types at the parent company level. Should an investment percentage be exceeded due to instances such as the fluctuation in overall portfolio size, or market valuation changes, the Treasurer is not

required to sell the affected securities. However, no additional investments can be made in that investment type or issuer while it is above the limits established by this Policy.

## **XII. CREDIT RATINGS**

Credit rating requirements for eligible securities in this Policy specify the minimum credit rating category required at the time of purchase without regard to +, -, or 1, 2, 3 modifiers, if any. The security, at the time of purchase, may not be rated below the minimum credit requirement by any of the NRSROs that rate the security.

If a security is downgraded below the minimum rating criteria specified in this Policy, the Treasurer shall determine a course of action to be taken on a case-by-case basis considering such factors as the reason for the downgrade, prognosis for recovery or further rating downgrades, and the market price of the security. The Treasurer shall note in the monthly report any securities which have been downgraded below Policy requirements and the recommended course of action.

## **XIII. MATURITY**

The Treasurer shall maintain a system to monitor and forecast revenues and expenditures so that the District's funds can be invested to the fullest extent possible while providing sufficient liquidity to meet the District's reasonably anticipated cash flow requirements.

The final maturity of any investment in the portfolios shall not exceed five (5) years with certain exceptions:

- The Treasurer is authorized to invest special trust funds in investment with a term to maximum maturity in excess of five years. These funds include, but are not limited to, the Water Revenue Bond Reserve Funds, Escrow Funds, Debt Service Funds, the Iron Mountain Landfill Closure/Post-closure Maintenance Trust Fund, and the Lake Mathews Multi-Species Reserve Trust Fund.
- The core portfolio may hold United States Treasury and Federal Agency securities with maturities in excess of five years.

## **XIV. DURATION**

Duration is a measure of a security's price sensitivity to interest rate changes. It indicates the approximate percentage change of a security's value given a 1% change in interest rates. A portfolio's duration is the weighted average of the individual security durations held in the portfolio.

The investment portfolio is divided into liquidity, core and bond reserves and trust fund portfolios. The Policy's duration limits only apply to the liquidity and core portfolios. The duration of the liquidity portfolio is limited to the duration of the benchmark index plus or minus 0.5 years. The duration of the core portfolio will be limited to the duration of the benchmark index plus or minus 1.5 years. The appropriate benchmark indices will be set by the Treasurer and reported to the Board in the Monthly Treasurer's Report.

## **XV. ADMINISTRATION**

The Treasurer may, at any time, establish more restrictive requirements for securities approved for investment as deemed appropriate in this Policy. These restrictions may include, but are not limited to, higher credit ratings, lower percentage limits by security type or issuer, shorter maturities and additional collateral requirements for collateralized investments.

## **XVI. AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS**

For investments not purchased directly from the issuer, the Treasurer shall select only brokers/dealers who

are licensed and in good standing with the California Department of Securities, the Securities and Exchange Commission, the Financial Industry Regulatory Authority (FINRA) or other applicable self-regulatory organizations. Before engaging in investment transactions with a broker/dealer, the Treasurer shall obtain a signed verification form that attests the individual has reviewed the District's Policy, and intends to present only those investment recommendations and transactions to the District that is appropriate under the terms and conditions of the Policy.

The District's external investment manager(s) may be granted discretion to purchase and sell investment securities in accordance with this Policy. Investment managers may also use their own list of internally-approved issuers, broker-dealers and other financial firms, so long as such managers are registered under the Investment Advisers Act of 1940.

## **XVII. INTERNAL CONTROLS**

The Treasurer or designee shall maintain a system of internal control procedures designed to ensure compliance with the Policy and to prevent losses due to fraud, employee error, and misrepresentations by third parties or unanticipated changes in financial markets. The internal control procedures shall apply to the investment activities of any person with investment decision-making authority acting on behalf of the District. Procedures should include references to individuals authorized to execute transactions or transfers, safekeeping agreements, repurchase agreements, wire transfer agreements, collateral/depository agreements and banking services contracts, as appropriate. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgement by management. As part of the annual audit, the District's external auditor will perform a review of investment transactions to verify compliance with policies and procedures.

## **XVIII. ETHICS AND CONFLICT OF INTEREST**

The Treasurer and designees shall refrain from personal business activity that could conflict with the proper execution and management of the investment program or that could impair their ability to make impartial decisions.

The Treasurer and designees shall disclose to the Ethics Officer and General Counsel any personal financial interests that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions.

## **XVIX. INVESTMENT POLICY**

This Policy shall be reviewed periodically by the Treasurer with any and all modifications made thereto approved by the Board of Directors at a public meeting.



## SUMMARY TABLE OF INVESTMENT GUIDELINES AND ELIGIBLE SECURITIES

The following table is intended to be a summary of the Policy’s requirements in Section X of this Policy. If there is a discrepancy between Section X and this table, the requirements listed in Section X take precedence.

Authorized Investments	Maximum % Holdings	Purchase Restrictions	Maximum Maturity	Credit Quality
US Treasury Obligations	100%	N/A	5 Years <sup>1</sup>	N/A
Federal Agency Obligations	100%	N/A	5 Years <sup>1</sup>	N/A
Bankers’ Acceptance	40%	5% per issuer <sup>2</sup>	180 days	“A-1” or its equivalent or higher by an NRSRO.
Commercial Paper	40%	5% per issuer <sup>2</sup>	270 days	Highest ranking or of the highest letter and number rating as provided for by an NRSRO.
Medium Term Corporate Notes	30%	5% per issuer <sup>2</sup> . US licensed and operating corporations	5 years	“A” or its equivalent or higher by an NRSRO.
Negotiable CD	30%	5% per issuer <sup>2</sup> , National or state chartered bank, S&L, or branch of foreign bank	5 years	“A-1” (short-term) or “A” (long-term) or their equivalents or higher by an NRSRO.
Bank Deposit	30%	See California Government Code Section 53637	5 Years	Collateralized/FDIC Insured in accordance with California Government Code
Money Market Mutual Funds	20%	Gov’t MMF. Stable NAV	Daily Liquidity	Highest ranking by two NRSROs or advisor requirements
Local Agency Investment Fund (“LAIF”)	LAIF limit for operating accounts	Subject to California Government Code Section 16429.1 limitations	N/A	N/A
Municipal Bonds and Notes	30%	5% per issuer <sup>2</sup> . State of California or California agencies or other 49 states	5 Years <sup>1</sup>	“A” or its equivalent or higher by an NRSRO.

Authorized Investments	Maximum % Holdings	Purchase Restrictions	Maximum Maturity	Credit Quality
Repurchase Agreements (“REPO”)	20%	Limited to primary dealers or financial institutions rated “A” or better by a NRSROs	270 days	Collateralized (min 102% of funds invested) with US Government or federal agency securities with maximum 5 year maturities
California Asset Management Program (“CAMP”)	40%	N/A	Daily Liquidity	“AAAm” or its equivalent or higher by a NRSRO
Supranationals	30%	Limited to IBRD, IFC, IADB	5 Years	“AA” or its equivalent or higher by an NRSRO.
Asset-Backed Securities	20%	5% per issuer <sup>2</sup>	5 Years	“AA” or its equivalent or higher by an NRSRO.

Notes:

1. The Treasurer is authorized to invest special trust funds in investment with a term to maximum maturity in excess of five years. These funds include, but are not limited to, the Water Revenue Bond Reserve Funds, Escrow Funds, Debt Service Funds, the Iron Mountain Landfill Closure/Post-closure Maintenance Trust Fund, and the Lake Mathews Multi-Species Reserve Trust Fund.

The core portfolio may be invested in United States Treasury and Federal Agency securities with maturities in excess of five years.

2. Per issuer limits, when listed, are calculated across investment types at the parent company level.

## GLOSSARY

The glossary is provided for general information only. It is not to be considered a part of the Policy for determining Policy requirements or terms.

**AGENCIES:** Federal agency securities and/or Government-sponsored enterprises (GSEs), also known as U.S. Government instrumentalities. Securities issued by Government National Mortgage Association (GNMA) are considered true agency securities, backed by the full faith and credit of the U.S. Government. GSEs are financial intermediaries established by the federal government to fund loans to certain groups of borrowers, for example homeowners, farmers and students and are privately owned corporations with a public purpose. The most common GSEs are Federal Farm Credit System Banks, Federal Home Loan Banks, Federal Home Loan Mortgage Association, and Federal National Mortgage Association.

**ASSET BACKED:** Securities whose income payments and hence value is derived from and collateralized (or “backed”) by a specified pool of underlying assets which are receivables. Pooling the assets into financial instruments allows them to be sold to general investors, a process called securitization, and allows the risk of investing in the underlying assets to be diversified because each security will represent a fraction of the total value of the diverse pool of underlying assets. The pools of underlying assets can comprise common payments credit cards, auto loans, mortgage loans, and other types of assets. Interest and principal is paid to investors from borrowers who are paying down their debt..

**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. This money market instrument is used to finance international trade.

**BASIS POINT:** One-hundredth of one percent (i.e., 0.01%).

**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 investment.

**BOND:** A financial obligation for which the issuers promises to pay the bondholder a specified stream of future cash flows, including periodic interest payments and a principal repayment.

**BOOK VALUE:** The value at which a debt security is shown on the holder’s balance sheet. Book value is acquisition cost less amortization of premium or accretion of discount.

**BROKER:** A broker acts as an intermediary between a buyer and seller for a commission and does not trade for his/her own risk and account or inventory.

**CALLABLE SECURITIES:** A security that can be redeemed by the issuer before the scheduled maturity date.

**CALIFORNIA ASSET MANAGEMENT PROGRAM (CAMP):** A local government investment pool organized as joint powers authority in which funds from California local agency investors/participants are aggregated together for investment purposes.

**CASH EQUIVALENTS (CE):** Highly liquid and safe instruments or investments that can be converted into cash immediately. Examples include bank accounts, money market funds, and Treasury bills.

**CASH FLOW:** An analysis of all changes that affect the cash account during a specified period.

**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.

**COLLATERALIZED MORTGAGE OBLIGATION (CMO):** A type of mortgage-backed security that creates separate pools of pass-through rates for different classes of bondholders with varying maturities, called tranches. The repayments from the pool of pass-through securities are used to retire the bonds in the order specified by the bonds' prospectus.

**COMMERCIAL PAPER:** Short-term, unsecured, negotiable promissory notes of corporations.

**CORPORATE NOTE:** Debt instrument issued by a private corporation.

**COUPON:** The annual rate at which a bond pays interest.

**CREDIT RATINGS:** A grade given to a debt instrument that indicates its credit quality. Private independent rating services such as Standard & Poor's, Moody's and Fitch provide these

**CREDIT RISK:** The risk that an obligation will not be paid and a loss will result due to a failure of the issuer of a security.

**CUSIP:** Stands for Committee on Uniform Securities Identification Procedures. A CUSIP number identifies most securities, including: stocks of all registered U.S. and Canadian companies, and U.S. government and municipal bonds. The CUSIP system—owned by the American Bankers Association and operated by Standard & Poor's—facilitates the clearing and settlement process of securities. The number consists of nine characters (including letters and numbers) that uniquely identify a company or issuer and the type of security.

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

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

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

**DELIVERY VERSUS PAYMENT (DVP):** Delivery of securities with a simultaneous exchange of money for the securities.

**DERIVATIVES:** A financial instrument that is based on, or derived from, some underlying asset, reference date, or index.

**DIRECT ISSUER:** Issuer markets its own paper directly to the investor without use of an intermediary.

**DISCOUNT:** The difference between the cost of a security and its value at maturity when quoted at lower than face value.

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

**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. Duration measures the price sensitivity of a bond to changes in interest rates.

**FACE VALUE:** The principal amount owed on a debt instrument. It is the amount on which interest is computed and represents the amount that the issuer promises to pay at maturity.

**FAIR VALUE:** The amount at which a security could be exchanged between willing parties, other than in a forced or liquidation sale. If a market price is available, the fair value is equal to the market value.

**FANNIE MAE:** Trade name for the Federal National Mortgage Association (FNMA), a U.S. Government sponsored enterprise.

**FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC):** A federal agency that provides insurance on bank deposits, guaranteeing deposits to a set limit per account, currently \$250,000.

**FEDERAL FARM CREDIT BANK (FFCB):** Government-sponsored enterprise that consolidates the financing activities of the Federal Land Banks, the Federal Intermediate Credit Banks and the Banks for Cooperatives. Its securities do not carry direct U.S. government guarantees.

**FEDERAL FUNDS RATE:** The rate of interest at which Federal funds are traded. This rate is considered to be the most sensitive indicator of the direction of interest rates, as it is currently pegged by the Federal Reserve through open-market operations.

**FEDERAL GOVERNMENT AGENCY SECURITIES:** Federal Agency or United States government-sponsored enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises.

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

**GUARANTEED INVESTMENT CONTRACTS (GICS):** An agreement acknowledging receipt of funds, for deposit, specifying terms for withdrawal, and guaranteeing a rate of interest to be paid.

**INDEX:** An index is an indicator that is published on a periodic basis that shows the estimated price and/or yield levels for various groups of securities. Examples of relevant indices for Metropolitan include, but not limited to, ICE BofAML, 3-Month Treasury Bill Index, and ICE BofAML, 1 - 5 years AAA-A US Corporate and Government Index

**INTEREST RATE:** The annual yield earned on an investment, expressed as a percentage.

**INTEREST RATE RISK:** The risk of gain or loss in market values of securities due to changes in interest-rate levels. For example, rising interest rates will cause the market value of portfolio securities to decline.

**INVESTMENT AGREEMENTS:** A contract providing for the lending of issuer funds to a financial institution which agrees to repay the funds with interest under predetermined specifications.

**INVESTMENT GRADE (LONG TERM RATINGS):** The minimum, high quality ratings for long term debt such as corporate notes. Investment Grade ratings are as follows: A3 (Moody's), A- (S&P), and A- (Fitch).

**INVESTMENT PORTFOLIO:** A collection of securities held by a bank, individual, institution or government agency for investment purposes.

**LIQUIDITY:** A liquid asset is one that can be converted easily and rapidly into cash with minimum risk of principal.

**LOCAL AGENCY INVESTMENT FUND (LAIF):** An investment pool sponsored by the State of California and administered/managed by the State Treasurer. Local government units, with consent of the governing body of that Agency, may voluntarily deposit surplus funds for the purpose of investment. Interest earned is distributed by the State Controller to the participating governmental agencies on a quarterly basis.

**LOCAL AGENCY INVESTMENT POOL:** A pooled investment vehicle sponsored by a local agency or a group of local agencies for use by other local agencies.

**MARKET RISK:** The risk that the value of securities will fluctuate with changes in overall market conditions or interest rates. Systematic risk of a security that is common to all securities of the same general class (stocks, bonds, notes, money market instruments) and cannot be eliminated by diversification (which may be used to eliminate non-systematic risk).

**MARKET VALUE:** The price at which a security is currently being sold in the market. See FAIR VALUE.

**MASTER REPURCHASE AGREEMENT:** A written contract covering all future transactions between the parties to repurchase agreements and 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 that the principal or stated value of a debt instrument becomes due and payable.

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

**MODIFIED DURATION:** The percent change in price for a 100 basis point change in yields. This is a measure of a portfolio's or security's exposure to market risk.

**MONEY MARKET:** The market in which short term debt instruments (Treasury Bills, Discount Notes, Commercial Paper, Banker's Acceptances and Negotiable Certificates of Deposit) are issued and traded.

**MORTGAGED BACKED SECURITIES:** A type of security that is secured by a mortgage or collection of mortgages. These securities typically pay principal and interest monthly.

**MUNICIPAL BONDS:** Debt obligations issued by states and local governments and their agencies, including cities, counties, government retirement plans, school Agencies, state universities, sewer agency, municipally owned utilities and authorities running bridges, airports and other transportation facilities

**MUTUAL FUND:** An entity that pools money and can invest in a variety of securities which are specifically defined

in the fund's prospectus.

**NEGOTIABLE CERTIFICATE OF DEPOSIT:** A large denomination certificate of deposit which can be sold in the open market prior to maturity.

**NET PORTFOLIO YIELD:** Calculation in which the 365-day basis equals the annualized percentage of the sum of all Net Earnings during the period divided by the sum of all Average Daily Portfolio Balances.

**NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO):** is a credit rating agency that issues credit ratings that the U.S Securities and Exchange Commission permits other financial firms to use for certain regulatory purposes.

**PAR VALUE:** The amount of principal which must be paid at maturity. Also referred to as the face amount of a bond. See FACE VALUE.

**PORTFOLIO:** The collection of securities held by an individual or institution.

**PREMIUM:** The difference between the par value of a bond and the cost of the bond, when the cost is above par.

**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. These dealers are authorized to buy and sell government securities in direct dealing with the Federal Reserve Bank of New York in its execution of market operations to carry out U.S. monetary policy. Such dealers must be qualified in terms of reputation, capacity, and adequacy of staff and facilities.

**PRIME (SHORT TERM RATING):** High quality ratings for short term debt such as commercial paper. Prime ratings are as follows: P1 (Moody's), A1 (S&P), and F1 (Fitch).

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

**PRIVATE PLACEMENTS:** Securities that do not have to be registered with the Securities and Exchange Commission because they are offered to a limited number of sophisticated investors.

**PROSPECTUS:** A legal document that must be provided to any prospective purchaser of a new securities offering registered with the Securities and Exchange Commission that typically includes information on the issuer, the issuer's business, the proposed use of proceeds, the experience of the issuer's management, and certain certified financial statements (also known as an "official statement").

**PRUDENT INVESTOR STANDARD:** A standard of conduct for fiduciaries. 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.

**PUBLIC DEPOSIT:** A bank that is qualified under California law to accept a deposit of public funds.

**PURCHASE DATE:** The date in which a security is purchased for settlement on that or a later date. Also known as the "trade date".

**RATE OF RETURN:** 1) The yield which can be attained on a security based on its purchase price or its current market price. 2) Income earned on an investment, expressed as a percentage of the cost of the investment.

**REALIZED GAIN (OR LOSS):** Gain or loss resulting from the sale or disposal of a security.

**REPURCHASE AGREEMENT (RP or REPO):** A transaction in which a counterparty or the holder of securities (e.g. investment dealer) sells these securities to an investor (e.g. the District) with a simultaneous agreement to repurchase them at a fixed date. The security "buyer" (e.g. the District) 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 (REVERSE REPO):** The opposite of a repurchase agreement. A reverse repo is a transaction in which the District sells securities to a counterparty (e.g. investment dealer) and agrees to repurchase the securities from the counterparty at a fixed date. The counterparty in effect lends the seller (e.g. the District) money for the period of the agreement with terms of the agreement structured to compensate the buyer.

**RISK:** Degree of uncertainty of return on an asset.

**SAFEKEEPING:** A service which banks offer to clients for a fee, where physical securities are held in the bank's vault for protection and book-entry securities are on record with the Federal Reserve Bank or Depository Trust Company in the bank's name for the benefit of the client. As agent for the client, the safekeeping bank settles securities transactions, collects coupon payments, and redeems securities at maturity or on the call date, if called.

**SECURITIES AND EXCHANGE COMMISSION (SEC):** Agency created by Congress to protect investors in securities transactions by administering securities legislation.

**SECONDARY MARKET:** A market for the repurchase and resale of outstanding issues following the initial distribution.

**SECURITIES:** Investment instruments such as notes, bonds, stocks, money market instruments and other instruments of indebtedness or equity.

**SETTLEMENT DATE:** The date on which a trade is cleared by delivery of securities against funds.

**SPREAD:** The difference between two figures or percentages. It may be the difference between the bid (price at which a prospective buyer offers to pay) and asked (price at which an owner offers to sell) prices of a quote, or between the amount paid when bought and the amount received when sold.

**STRUCTURED NOTE:** A complex, fixed income instrument, which pays interest, based on a formula tied to other interest rates, commodities or indices. Examples include "inverse floating rate" notes which have coupons that increase when other interest rates are falling, and which fall when other interest rates are rising and "dual index floaters", which pay interest based on the relationship between two other interest rates, for example, the yield on the ten-year Treasury note minus the Libor rate. Issuers of such notes lock in a reduced cost of borrowing by purchasing interest rate swap agreements.

**SUPRANATIONALS:** International institutions that provide development financing, advisory services and/or financial services to their member countries to achieve the overall goal of improving living standards through sustainable economic growth. The California Government Code allows local agencies to purchase the 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.



**TIME DEPOSIT:** A deposit with a California bank or savings and loan association for a specific amount and with a specific maturity date and interest rate. Deposits of up to \$250,000 are insured by FDIC. Deposits over \$250,000 are collateralized above the insurance with either government securities (at 110% of par value), first trust deeds (at 150% of par value), or letters of credit (at 105% of par value).

**TOTAL RATE OF RETURN:** A measure of a portfolio's performance over time. It is the internal rate of return which equates the beginning value of the portfolio with the ending value, and includes interest earnings and realized and unrealized gains and losses on the portfolio. For bonds held to maturity, total return is the yield to maturity.

**TRUSTEE OR TRUST COMPANY OR TRUST DEPARTMENT OF A BANK:** A financial institution with trust powers which acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond contract.

**UNDERWRITER:** A dealer which purchases a new issue of municipal securities for resale.

**U.S. GOVERNMENT AGENCY SECURITIES:** Securities issued by U.S. government agencies, most of which are secured only by the credit worthiness of the particular agency. See AGENCIES.

**U.S. TREASURY OBLIGATIONS:** Securities issued by the U.S. Treasury and backed by the full faith and credit of the United States. Treasuries are the benchmark for interest rates on all other securities in the U.S. The Treasury issues both discounted securities and fixed coupon notes and bonds. The income from Treasury securities is exempt from state and local, but not federal, taxes.

**TREASURY BILLS:** Securities issued at a discount with initial maturities of one year or less. The Treasury currently issues three-month and six-month Treasury bills at regular weekly auctions. It also issues very short-term "cash management" bills as needed to smooth out cash flows.

**TREASURY NOTES:** Intermediate-term coupon-bearing securities with initial maturities of one year to ten years.

**TREASURY BOND:** Long-term coupon-bearing securities with initial maturities of ten years or longer.

**UNREALIZED GAIN (OR LOSS):** Gain or loss that has not become actual. It becomes a realized gain (or loss) when the security in which there is a gain or loss is actually sold. See REALIZED GAIN (OR LOSS).

**VOLATILITY:** Characteristic of a security, commodity or market to rise or fall sharply in price within a short-term period.

**WEIGHTED AVERAGE MATURITY:** The average maturity of all the securities that comprise a portfolio that is typically expressed in days or years.

**YIELD:** The annual rate of return on an investment expressed as a percentage of the investment. See CURRENT YIELD; YIELD TO MATURITY.

**YIELD CURVE:** Graph showing the relationship at a given point in time between yields and maturity for bonds that are identical in every way except maturity.

**YIELD TO MATURITY:** Concept used to determine the rate of return if an investment is held to maturity. It takes into account purchase price, redemption value, time to maturity, coupon yield, and the time between interest payments. It is the rate of income return on an investment, minus any premium or plus any discount, with the

adjustment spread over the period from the date of purchase to the date of maturity of the bond, expressed as a percentage.

## RATING DESCRIPTION TABLE

Long Term Debt Ratings			
Credit Quality	Moody's	S&P	Fitch
<b>Strongest Quality</b>	Aaa	AAA	AAA
<b>Strong Quality</b>	Aa1/Aa2/Aa3	AA+/AA/AA-	AA
<b>Good Quality</b>	A1/A2/A3	A+/A/A-	A
<b>Medium Quality</b>	Baa1/Baa2/Baa3	BBB+/BBB/BBB-	BBB
<b>Speculative</b>	Ba1/Ba2/Ba3	BB+/BB/BB-	BB
<b>Low</b>	B1/B2/B3	B+/B/B-	B
<b>Poor</b>	Caa	CCC+	CCC
<b>Highly Speculative</b>	Ca/C	CCC/CCC-/CC	CC
Short Term Debt Ratings			
Credit Quality	Moody's	S&P	Fitch
<b>Strongest Quality</b>	P-1	A-1+	F1
<b>Strong Quality</b>		A-1	
<b>Good Quality</b>	P-2	A-2	F2
<b>Medium Quality</b>	P-3	A-3	F3

Note: Investment Grade ratings apply to securities with at least a medium credit quality or higher by one of the nationally recognize statistical rating organization; anything below the medium credit quality is non-investment grade.