CITY OF SUNNYVALE

INVESTMENT AND CASH MANAGEMENT POLICY

FY 2005/2006

CITY OF SUNNYVALE

Investment and Cash Management Policy

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I. INVESTMENT PHILOSOPHY

A. Policy

The City establishes investment policies that meet its current investment goals. This policy is intended to establish objectives and criteria for the investment of the City's temporarily idle funds and for funds managed by the City's Redevelopment Agency, and to provide guidelines for the City's cash management system.

B. Purpose

This policy is set forth by the City of Sunnyvale (City) for the following purposes:

1. To establish a clear understanding for the City Council, City management, responsible employees, citizens and third parties of the objectives, policies and guidelines for the investment of the City's temporarily idle funds;

2. To offer guidance to investment staff on the investment of City funds; and

3. To establish a basis for evaluating investment results.

C. Objectives

The City's cash management system shall be designed to accurately monitor and forecast expenditures and revenues, to enable the City and its Redevelopment Agency to invest funds to the fullest extent possible.

Idle funds of the City of Sunnyvale shall be invested in accordance with principles of sound treasury management and in accordance with the provisions of California Government Code Section 53600 et seq., the City Charter, the Sunnyvale Municipal Code and this policy.

The objectives of Sunnyvale's investment program are, in order of priority:

1. Safety – Safety of principal is the foremost objective of the investment program. Investments of the City of Sunnyvale shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To attain this objective, diversification is required in order that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio.

2. Liquidity – The City's investment portfolio will remain sufficiently liquid to enable the City of Sunnyvale to meet all operating requirements which might be reasonably anticipated.

3. Return on Investment –The City's investment portfolio shall be designed with the objective of attaining the safety and liquidity objectives first, and then attaining a market rate of return throughout the budgetary and economic cycles, taking into account the City of Sunnyvale's investment risk constraints and the cash flow characteristics of the portfolio.

D. Prudence

The governing body of the City of Sunnyvale, and any staff members authorized to make investment decisions on behalf of the City are trustees and therefore fiduciaries subject to the prudent investor standard. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the City, that a prudent person acting in a like capacity and familiar with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the City. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law.

The Finance Manager (Treasury) and Director of Finance (or his/her designee) are authorized to manage the investment portfolio and acting within the intent and scope of the investment policy and other 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 manner and appropriate action is taken to control adverse developments.

E. Ethics and Conflicts of Interest

Officers and employees involved with 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. The Finance Manager (Treasury), and other designated employees are required to file applicable financial disclosures, as required by the Fair Political Practices Commission.

II. OPERATIONAL AND PROCEDURAL MATTERS

A. Scope

This Investment Policy applies to all funds and investment activities of the City of Sunnyvale with the following exceptions:

1. The City's Deferred Compensation Plan is excluded because it is managed by a third party administrator and invested by individual plan participants;

2. The City participates in the Public Employees Retirement System, and does not manage any retirement funds internally.

3. Proceeds of debt issuance shall be invested in accordance with the general investment philosophy of the City as set forth in this policy; however, such proceeds are invested in accordance with permitted investment provisions of their specific bond indentures.

B. Authorized Financial Dealers and Institutions

1. Institutions eligible to transact investment business with the City include:

   a. Primary government dealers as designated by the Federal Reserve Bank;

   b. Regional broker/dealers headquartered in the State of California;

   c. Nationally or state-chartered banks;

   d. The Federal Reserve Bank; and

   e. Direct issuers of securities eligible for purchase by the City.

2. Public deposits shall be made only in qualified public depositories within the State of California as established by State law. Deposits shall be insured by the Federal Deposit Insurance Corporation, or, to the extent the amount exceeds the insured maximum, shall be collateralized with securities in accordance with state law.

3. A sufficient pool of qualified financial institutions and dealers will be maintained using criteria based on credit worthiness, experience, reference checks, and qualifications under the Securities and Exchange Commission. All financial institutions and dealers who desire to become qualified must supply the following as appropriate:

   a. Audited financial statements

   b. Proof of National Association of Securities Dealers (NASD) certification

   c. Completed broker/dealer questionnaire

   d. Certification of having read and agreeing to comply with the City's Investment Policy

4. It is the policy of the City to require competitive bidding for investment transactions. Whenever possible, at least three financial dealers or institutions will be contacted to provide prices on security purchases and sales.

5. Selection of financial institutions and broker/dealers used by the City shall be at the sole discretion of the City.

C. Delivery vs. Payment

All investment transactions of the City shall be conducted using standard delivery vs. payment procedures.

D. Safekeeping of Securities

To protect against potential losses by collapse of individual securities dealers, and to enhance access to securities, interest payments, and maturity proceeds, all securities owned by the City shall be held in safekeeping by a third party bank trust department, acting as agent for the City under the terms of a custody agreement executed by the bank and by the City.

III. PERMITTED INVESTMENTS AND GUIDELINES TO ACHIEVE POLICY OBJECTIVES

A. Authorized Investments

All investments shall be made in accordance with Sections 53600 *et seq.* of the Government Code of California and as described within this Investment Policy. Permitted investments under this policy shall include:

1. **Securities issued by the US Treasury**, provided that:

    a. There shall be no maximum allowable investment in US Treasury securities; and

    b. As required by Section 53601 of the California Government Code, the City Council hereby grants express authority to the Finance Manager (Treasury) to invest in U.S. Treasury securities with final stated maturities up to seven years.

2. **Securities Issued and fully guaranteed as to payment by an agency of the United States Government,** provided that:

    a. There shall be no maximum allowable investment in such securities; and

    b. As required by Section 53601 of the California Government Code, the City

Council hereby grants express authority to the Finance Manager (Treasury) to invest in U. S. Agency securities with final stated maturities up to seven years.

3. **Banker's acceptances,** provided that:

   a. They are issued by institutions the short term obligations of which are rated a minimum of P1 by Moody's or A1 by Standard & Poor's (S&P); or, if the short term obligations are unrated, the long-term obligations of which are rated a minimum of A by Moody's and S&P;

   b. Their maturity does not exceed 180 days; and

   c. No more than 30% of the total portfolio may be invested in banker's acceptances.

4. **Federally insured time deposits (Non-negotiable certificates of deposit)** in California banks with a maximum maturity of 365 days, provided that:

   a. No more than 20% of the portfolio shall be invested in a combination of federally insured and collateralized time deposits.

5. **Time deposits (Non-negotiable certificates of deposit)** in California banks in excess of insured amounts which are fully collateralized with securities in accordance with California law, provided that:

   a. No more than 20% of the portfolio shall be invested in a combination of federally insured and collateralized time deposits;

   b. They are issued by institutions which have long term debt rated "A" or higher by S&P or "A2" or higher by Moody's; and/or have short term debt rated at least A1 by S&P or P1 by Moody's; and

   c. The maturity of such deposits does not exceed 365 days.

6. **Negotiable certificates of deposit (NCDs),** provided that:

   a. They are issued by institutions which have long term debt rated "A" or higher by S&P and Moody's; and/or have short term debt rated at least A1 by S&P or P1 by Moody's;

   b. The maturity does not exceed 180 days; and

   c. No more than 30% of the total portfolio may be invested in NCDs.

7. **Repurchase agreements** collateralized with securities authorized under Sections III(A1-2) of this policy maintained at a level of at least 102% of the market value of the repurchase agreements, provided that:

   a. The maximum maturity of repurchase agreements shall be 15 days;

   b. No more than 10% of the portfolio shall be invested in repurchase agreements;

   c. Securities used as collateral for repurchase agreements shall be delivered to the City's custodian bank, except that securities used as collateral for the one to seven day repurchase agreements with the City's depository bank may be held in safekeeping by the depository bank's trust department in the name of the City, as evidenced by appropriate receipts of trust; and

   d. The repurchase agreements are the subject of a master repurchase agreement between the City and the provider of the repurchase agreement. The master repurchase agreement shall be substantially in the form developed by the Public Securities Association.

8. **Commercial paper,** provided that:

   a. The maturity does not exceed 180 days from the date of purchase;

   b. No more than 15% of the portfolio is invested in commercial paper; and

   c. The paper is of "prime" quality of the highest ranking or of the highest letter and number rating as provided for by a nationally recognized statistical-rating organization (NRSRO). The entity that issues the commercial paper shall meet all of the following conditions in either paragraph (1) or paragraph (2):

      (1) (A) Is organized and operating in the United States as a general corporation. (B) Has total assets in excess of five hundred million dollars ($500,000,000). (C) Has debt other than commercial paper, if any, that is rated "A" or higher by a nationally recognized statistical-rating organization (NRSRO).

      (2) (A) Is organized within the United States as a special purpose corporation, trust, or limited liability company. (B) Has programwide credit enhancements including, but not limited to, overcollateralization, letters of credit, or surety bond. (C) Has commercial paper that is rated "A-1" or higher, or the equivalent, by a nationally recognized statistical-rating organization (NRSRO).

9. **State of California Local Agency Investment Fund (LAIF)**, provided that:

   a. No more than 20% of the City's funds may be invested in LAIF;

b. It is recognized that LAIF has authority to invest in some instruments that are not permitted for Cities under the California Government Code; and

c. A thorough investigation of the pool/fund is required prior to investing and on a continual basis. City staff will annually perform due diligence analysis of LAIF based on a standardized questionnaire developed to address investment policy and practices.

10. **Corporate medium term notes,** provided that:

a. Such notes have a maximum maturity of five years;

b. Such notes are 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;

c. Such notes are rated in a rating category of "A" or its equivalent or better by Moody's and S&P; and

d. Holdings of medium-term notes may not exceed 30% of the portfolio.

11. **Mortgage pass-through securities and asset-backed securities,** provided that:

a. Such securities shall have a maximum stated final maturity of five years;

b. Such securities are rated AAA by S&P or Aaa by Moody's; and

c. Purchase of securities authorized by this subdivision may not exceed 20 percent of the portfolio.

12. **Money market mutual funds,** provided that:

a. Such funds are registered with the Securities and Exchange Commission and are rated AAA by S&P or Aaa by Moody's;

b. Such funds have retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience investing in the securities and obligations authorized by California Government Code Section 53601 (a through j) and with assets under management in excess of $500 million;

c. Such funds include in their prospectus the statement that one of the investment fund's investment objectives is to seek to maintain a net asset value of $1;

d. Such funds invest only in US Treasury and federal agency securities, and in repurchase agreements backed by US Treasury and federal agency securities; and

e. No more than 10% of the City's funds may be invested in money market mutual funds.

B. Prohibited Investment Vehicles and Practices

1. State law notwithstanding, any investments not specifically described herein are prohibited, including, but not limited to, mutual funds (other than government money market funds as described in Section III A(12), unregulated and/or unrated investment pools or trusts, collateralized mortgage obligations and futures and options.

2. In accordance with Government Code Section 53601.6, investment in inverse floaters, range notes, or mortgage derived interest-only strips is prohibited.

3. Investment in any security that could result in a zero interest accrual if held to maturity is prohibited.

4. Trading securities for the sole purpose of speculating on the future direction of interest rates is prohibited.

5. Purchasing or selling securities on margin is prohibited.

6. The use of reverse repurchase agreements, securities lending or any other form of borrowing or leverage is prohibited.

7. Prohibited investments held in the portfolio at the time of adoption of this policy may be held until maturity at the discretion of the Director of Finance.

C. Risk/Safety

The City recognizes that it is subject to the risks of investing in fixed income securities, especially "market risk," which is the risk that the value of the portfolio will fluctuate with changes in the general level of interest rates, and "credit risk," which is the risk that a security or a portfolio will lose some or all of its value due to a real or perceived change in the ability of the issuer to repay its debt.

1. Mitigating credit risk in the portfolio

a. The diversification requirements included in the Authorized Investments section are designed to mitigate credit risk in the portfolio;

b. No more than 5% of the total portfolio may be invested in securities of any single issuer, other than the US Government, its agencies and instrumentalities, and LAIF. This section does not preclude the investment of up to 10% of the portfolio in short-term repurchase agreements, as defined in Section III (A7) above or money market mutual funds as defined in Section III (A12);

c. The City may elect to sell a security prior to its maturity and record a capital gain or loss in order to improve the quality, liquidity or yield of the portfolio in response to market conditions or the City's risk preferences; and

d. If a security owned by the City is downgraded by either Moody's or S&P to a level below the minimum quality required by this Investment Policy, it shall be the City's policy to sell that security as soon as practicable.

2. **Mitigating market risk in the portfolio**

The City recognizes that, over time, longer-term portfolios achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The City shall mitigate market risk by providing adequate liquidity for short-term cash needs, and by making longer term investments with funds which are not needed for current cashflow purposes. The City further recognizes that certain types of securities, including variable rate securities, securities with principal paydowns prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments. The City, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

a. The City shall maintain a minimum of three months of budgeted operating expenditures in short term investments; and

b. The average maturity of the portfolio shall be no greater than 2.5 years.

D. Liquidity

1. A schedule of major revenues and expenditures for a rolling 12-month period shall be maintained and coordinated from a cash flow standpoint to the extent feasible.

2. Investment maturities shall be timed to provide funds for scheduled expenditures not met by anticipated major revenue receipts.

3. To the extent possible, the Ten Year Resource Allocation Plan shall be used for the cash flow projection purposes, and shall be taken into account in determining long term investment strategy.

E. Return Objectives

1. **Overall objective.** The investment portfolio shall be designed with the overall objective, in order of priority, of safety, liquidity, and return on investment.

2. **Specific objective.** The investment performance objective for the portfolio shall be to earn a market average yield for the reporting period comparable to the yield of a Treasury Security with a similar average life.

IV. RESPONSIBILITY AND REPORTING

A. Delegation of Authority

The City Manager is responsible for directing and supervising the Director of Finance and is also responsible to keep the City Council fully advised as to the financial condition of the City.

The Director of Finance is responsible, by Council delegation, for the custody and investment of City funds and the development of procedures to implement this Investment Policy. This delegation requires that the Director of Finance submit a monthly transaction report to the Council accounting for the investment of funds. The Director of Finance is further responsible for the duties and powers imposed on City Treasurers by the laws of the State of California.

The Finance Manager (Treasury) in Finance is responsible for monitoring investment market information, recommending investment strategy for portfolio diversity and timing of maturities, as well as ensuring compliance with the City's Investment Policy. The Investment staff shall maintain current knowledge of technical and legal requirements regarding municipal investments through continued education and maintain active membership in the California Municipal Treasurers Association (CMTA).

B. Reporting, Disclosure and Program Evaluation

The Director of Finance, as Chief Financial Officer and City Treasurer, is required by State law to file a quarterly investment report with the City Council, the City Manager and Internal Auditor within 30 days following the end of the quarter covered by the report. The report shall include the following information:

1. An asset listing showing par value, cost and accurate and complete market value of each security, type of investment, issuer, and interest rate;

2. A statement of compliance with Investment Policy; and

3. A statement that the City has adequate funds to meet its cash flow requirements for the next six months.

C. Annual Reports

1. The investment policy shall be reviewed and adopted at least annually within 120 days of the end of the fiscal year to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends.

2. A report of portfolio performance for the immediately preceding fiscal year shall be presented as part of the annual investment policy review. This report shall include comparisons of the City's performance compared to the return objectives, and shall include a section on compliance with the investment policy.

V. INTERNAL CONTROL

The Director of Finance has established a system of internal controls to ensure compliance with the Investment Policies of the City and Redevelopment Agency of Sunnyvale and the California Government Code. The internal control procedures include segregation of duties in the different phases of an investment transaction, monthly reconciliation of the investment report to the general ledger, and annual policy compliance review by the City's Internal Auditor. An independent audit is conducted by the City's outside auditors which includes a compliance review of the City's investment activities to the City's Investment Policy, the California Government Code, and Government Accounting Standards Board (GASB) requirements regarding investment disclosures.

VI. INVESTMENT COMMITTEE

The Investment Committee consisting of the City Manager, the Assistant City Manager, and the Director of Finance with staff support, may meet as needed to evaluate the portfolio performance and establish current investment strategies in accordance with the adopted Policy and its objectives.

VII. HISTORY OF COUNCIL ACTIONS

Report to Council No. 85-388

Approved by the City Council on July 30, 1985

Amended by City Council on July 22, 1986

Amended by City Council on August 11, 1987

Amended by City Council on July 18, 1989

Amended by City Council on July 17, 1990

Amended by City Council on July 23, 1991

Amended by City Council on July 28, 1992

Amended by City Council on July 27, 1993

Amended by City Council on August 9, 1994

Amended by City Council on July 25, 1995

Amended by City Council on July 23, 1996

Amended by City Council on July 29, 1997

Amended by City Council on August 4, 1998

Amended by City Council on August 17, 1999

Amended by City Council on September 12, 2000

Amended by City Council on July 31, 2001

Amended by City Council on July 23, 2002

Amended by City Council on August 12, 2003

Amended by City Council on August 17, 2004

City Clerk Certification _____

VIII. GLOSSARY OF INVESTMENT TERMS

Agencies. In the government securities industry, investors frequently refer to all debt instruments issued by U.S. government agencies, departments, and related instrumentalities as *agency* securities. Only those securities backed by the full faith and credit of the U. S. Government are true agency securities.

Generally, the underlying security associated with a U.S. agency is considered to be as risk-free as direct Treasury securities. The key difference in risk with these instruments is their liquidity and marketability, which is diminished as a result of smaller, irregular, and less familiar issues. Only securities issued by the Government National Mortgage Association (Ginnie Mae or GNMA) are widely used by public investors as true agency securities.

U.S. Government Instrumentalities, also known as government sponsored enterprises (GSEs), are financial intermediaries established by the federal government to fund loans to certain groups of borrowers, such as homeowners, farmers, and students. In short, GSEs are privately owned corporations with a public purpose. The most common instrumentalities are:

- Federal Farm Credit System Banks,
- Federal Home Loan Banks (FHLB),
- Federal Home Loan Mortgage Corporation (Freddie Mac or FHLMC),
- Federal National Mortgage Association (Fannie Mae or FNMA)
- Student Loan Marketing Association (Sallie Mae or SLMA), and
- Tennessee Valley Authority (TVA).

GSEs sell securities on a regularly scheduled basis through selling groups, which are chosen groups of dealers that the GSE uses to "bring the paper to the streets." Short-term securities are regularly issued as discount notes with maturities ranging from overnight to 360 days. GSEs also issue securities with fixed interest rates, ranging in maturity from three months to 30 years.

Asked. The price at which a seller offers to sell a security.

Average life. In mortgage-related investments, including CMOs, the average time to expected receipt of principal payments, weighted by the amount of principal expected.

Banker's acceptance. A money market instrument created to facilitate international trade transactions. It is highly liquid and safe because the risk of the trade transaction is transferred to the bank which "accepts" the obligation to pay the investor.

Benchmark. A comparison security or portfolio. A performance benchmark is a partial market index, which reflects the mix of securities allowed under a specific investment policy.

Bid. The price at which a buyer offers to buy a security.

Broker. A broker brings buyers and sellers together for a transaction for which the broker receives a commission. A broker does not sell securities from his own position.

Certificate of Deposit (CD). A time deposit with a specific maturity evidenced by a certificate. Large denomination CDs may be marketable.

Collateral. Securities or cash pledged by a borrower to secure repayment of a loan or repurchase agreement. Also, securities pledged by a financial institution to secure deposits of public monies.

Collateralized Mortgage Obligations (CMO). Classes of bonds which redistribute the cash flows of mortgage securities (and whole loans) to create securities which have different levels of prepayment risk, as compared to the underlying mortgage securities.

Commercial paper. The short-term unsecured debt of corporations.

Coupon. The rate at which a bond pays interest.

Credit risk. The risk that principal and/or interest on an investment will not be paid in a timely manner due to changes in the condition of the issuer.

Current yield. The annual income from an investment divided by the current market value. Since the mathematical 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.

Dealer. A dealer acts as a principal in security transactions, selling securities from and buying securities for his own position.

Debenture. A bond secured only by the general credit of the issuer.

Delivery vs. payment (DVP). A securities industry procedure whereby payment for a security must be made at the time the security is delivered to the purchaser's agent.

Derivative. Any security that has principal and/or interest payments which are subject to uncertainty (but not for reasons of default or credit risk) as to timing and/or amount, or any security which represents a component of another security which has been separated from other components ("Stripped" coupons and principal). A derivative is also defined as a financial instrument the value of which is totally or partially derived from the value of another instrument, interest rate or index.

Discount. The difference between the par value of a bond and the cost of the bond, when the cost is below par. Some short-term securities, such as Treasury Bills and Banker's Acceptances, are known as **discount securities**. They sell at a discount from par, and return the par value to the investor at maturity without additional interest. Other securities, which have fixed coupons trade at a discount

when the coupon rate is lower than the current market rate for securities of that maturity and/or quality.

Diversification. Dividing investment funds among a variety of investments to avoid excessive exposure to any one source of risk.

Duration. The weighted average time to maturity of a bond where the weights are the present values of the future cash flows. Duration measures the price sensitivity of a bond to changes in interest rates. (See modified duration).

Federal funds rate. The rate of interest charged by banks for short term loans to other banks. It is established by the Federal Reserve Bank through open-market operations.

Federal Open Market Committee. A committee of the Federal Reserve Board, which establishes monetary policy and executes it through temporary and permanent changes to the supply of bank reserves.

Liquidity. The speed and ease with which an asset can be converted to cash.

Market risk. The risk that the value of securities will fluctuate with changes in overall market conditions or interest rates.

Market value. The price at which a security can be traded.

Marking to market. The process of posting current market values for securities in a portfolio.

Maturity. The final date upon which the principal of a security becomes due and payable.

Medium Term Notes. 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. Modified duration is the best single 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 and Banker's Acceptances) are issued and traded.

Mortgage pass-through securities. A securitized participation in the interest and principal cashflows from a specified pool of mortgages. Principal and interest payments made on the mortgages are *passed through* to the holder of the security.

Mutual fund. An entity which pools the funds of investors and invests those funds in a set of securities which is specifically defined in the fund's prospectus. Mutual funds can be invested in

various types of domestic and/or international stocks, bonds and money market instruments, as set forth in the individual fund's prospectus. For most large, institutional investors, the costs associated with investing in mutual funds are higher than the investor can obtain through an individually managed portfolio.

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 financial institution (1) that is a trading counterparty with the Federal Reserve in its execution of market operations to carry out U.S. monetary policy, and (2) that participates for statistical reporting purposes in compiling data on activity in the U.S. Government securities market.

Prudent man (person) rule. A standard of responsibility which applies to fiduciaries. In California, the rule is stated as "Investments shall be managed with the care, skill, prudence and diligence, under the circumstances then prevailing, that a prudent person, acting in a like capacity and familiar with such matters, would use in the conduct of an enterprise of like character and with like aims to accomplish similar purposes."

Public Deposits. A bank that is qualified under California law to accept a deposit of public funds.

Realized yield. The change in value of the portfolio due to interest received and interest earned and realized gains and losses. It does not give effect to changes in market value on securities, which have not been sold from the portfolio.

Regional Dealer: A financial intermediary that buys and sells securities for the benefit of its customers without maintaining substantial inventories of securities, and that is not a primary dealer.

Repurchase agreement (RP, Repo). A transaction in which a holder of securities sells those securities to an investor with an agreement to repurchase those securities for a fixed price at an agreed-upon date. A *master repurchase agreement* is a written contract governing all future transactions between the parties and seeks to establish each party's rights in the transactions.

Reverse repurchase agreement. The opposite of a repurchase agreement. The investor owns the securities or collateral and a bank or dealer temporarily exchanges cash for the collateral, for a specified period of time at an agreed-upon interest rate.

Safekeeping. A service to bank customers whereby securities are held by the bank in the customer's name.

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.

Total rate of return. A measure of a portfolio' 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.

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 considered to have no credit risk, and are the benchmark for interest rates on all other securities in the US and overseas. The Treasury issues both discounted securities and fixed coupon notes and bonds.

> **Treasury bills.** All securities issued with initial maturities of one year or less are issued as discounted instruments, and are called Treasury bills. The Treasury currently issues three- and six-month Treasury bills at regular weekly auctions. It also issues "cash management" bills as needed to smooth out cash flows.
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> **Treasury notes.** All securities issued with initial maturities of two to ten years are called Treasury notes, and pay interest semi-annually.
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> **Treasury bonds.** All securities issued with initial maturities greater than ten years are called Treasury bonds. Like Treasury notes, they pay interest semi-annually.

Volatility. The rate at which security prices change with changes in general economic conditions or the general level of interest rates.

Yield to Maturity. The annualized internal rate of return on an investment which equates the expected cash flows from the investment to its cost.