

## **RESOLUTION NO. 2008-15**

### **A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF POULSBO, WASHINGTON, ADOPTING AN INVESTMENT POLICY FOR CITY FUNDS**

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**WHEREAS**, the City Council of the City of Poulsbo deems to have city funds invested in secure depositories and maximize returns on these investments, and

**WHEREAS**, the City Council of the City of Poulsbo desires to maintain an investment policy to guide the investment of city funds to meet these objectives, and

**WHEREAS**, The City of Poulsbo's Finance Director has conducted a thorough review of current Investment policy in an effort to revise and update the policy for investment of City funds, and

**WHEREAS**, the City of Poulsbo's investment policy has been written in accordance with the Washington Municipal Treasurer's Association Model Investment Policy,

**THE CITY COUNCIL OF THE CITY OF POULSBO, WASHINGTON  
RESOLVES AS FOLLOWS:**

**Section 1. Investment Policy Adopted.** The policy for investment of City funds set forth in document entitled "City of Poulsbo Investment Policy" dated July 1, 2008 which is attached hereto as Exhibit "A" and incorporated herein by this reference as if set forth in full is hereby adopted as official policy for investment of City funds.

**Section 2. Repealer.** That the document entitled "City of Poulsbo Investment Policy" replaces previous City of Poulsbo Investment Policy adopted by the City Council Resolution 2001-07 on March 14, 2001.

**RESOLVED** this 15th day of October, 2008.

APPROVED:



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MAYOR, KATHRYN H. QUADE

ATTEST/AUTHENTICATED:



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CITY CLERK, JILL A. BOLTZ

FILED WITH THE CITY CLERK: 10/08/2008  
PASSED BY THE CITY COUNCIL: 10/15/2008  
RESOLUTION NO. 2008-15

## ATTACHMENT A



### City of Poulsbo Legislative Policy

<b>Title:</b> Investment Policy	<b>Page Number:</b> 1 of 14
<b>Department:</b> Finance Department	<b>Effective Date:</b> July 1, 2008
<b>Revised Date:</b> July 1 <sup>st</sup> 2008	<b>Revised by:</b> Finance Director

#### **PURPOSE**

This policy is intended to outline the requirements for maximizing the efficiency of the City's Cash Management System and for prudent investment of the City's Funds, and to provide guidelines for suitable investments. The ultimate goal is to enhance the economic status of the City while protecting its funds. The City's Cash Management System is designed to monitor and forecast expenditures and revenues accurately, thus enabling the Finance Director to invest funds to the fullest extent possible. The Finance Director shall attempt to obtain the highest yield, provided that all investments meet the criteria established for safety and liquidity.

#### **POLICY**

The investment policies and procedures of the Finance Director for the City of Poulsbo are based upon Federal, State and Local law and prudent money management. The primary goals of these policies are:

1. To assure compliance with all Federal, State and local laws governing the investment of monies under the control of the Finance Director.
2. To protect the principal monies entrusted to this office.
3. To generate the maximum amount of investment income within the parameters of this Investment Policy and the guidelines for suitable investments.

All participants in the City's investment process shall act responsibly as custodians of the public trust. Investment officials shall recognize that the investment portfolio is subject to public review and evaluation. The overall program shall be designed and managed with a degree of professionalism that is worthy of the public trust. The implementation of this policy is subject to the following guidelines.

**GUIDELINES****1.0 SCOPE:**

This investment policy applies to the investment of available assets of all City funds under the direct management of the Finance Director and are listed below:

- The General Fund
- Special Revenue Funds
- Capital Project Funds
- Enterprise Funds
- Trust and Agency Funds
- Any new fund created unless specifically exempted

The policy for the Washington State Public Employee Retirement System (PERS) and the Washington State Law Enforcement Officers and the Fire Fighters Retirement System (LEOFF) funds will be as determined by the appropriate boards of Administration and not covered by this Policy.

Funds set aside to defease City debt in conjunction with an advance refunding agreement will be invested in accordance with appropriate bond documents and not necessarily in compliance with this policy. Should bond covenants be more restrictive than this policy, funds will be invested in full compliance with those restrictions.

Funds held by the County Treasurer during tax collection periods shall be governed by the County's investment policies to the extent that they do not conflict with this policy and should be invested by the County Treasurer for the benefit of the City of Poulsbo as stipulated by the City in accordance with RCW 36.29.020.

All investments of the City of Poulsbo must be made in compliance with Federal and State law and in accordance with applicable legal interpretations. Investment of any tax-exempt borrowing proceeds and of any debt service funds must comply with the 1986 Tax Reform Act if the Act applies to the debt issued.

**2.0 PRUDENCE:**

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

The standard of prudence to be used by investments 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 written procedures and the investment policy and exercising

due diligence shall be relieved of personal responsibility 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.

### **3.0 OBJECTIVE:**

The primary objectives, in order of priority, of the City of Poulsbo investment activities are as follows:

- 3.1 Legality: Funds of the City will be invested in accordance with the Revised Code of Washington (RCW), the BARS manual, these policies and written administrative procedures.
- 3.2 Safety: Investments of the City will 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 other investments.
- 3.3 Liquidity: The City's investments will remain sufficiently liquid to enable the city to meet all operating requirements that might be reasonably anticipated.
- 3.4 Return on Investment: The City's investments will 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 cash flow characteristics.

### **4.0 DELEGATION OF AUTHORITY**

The Finance Director is the investment officer of the City of Poulsbo. This authority is derived from PMC 3.58.010 as established by ordinance 86-05. The Finance Director shall establish written procedures for the operation of the investment program consistent with this investment policy. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Finance Director. The Finance Director shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

Subject to required procurement procedures, the City may engage the support services of outside professionals in regard to its financial program, so long as it can be demonstrated or anticipated that these services produce a net financial advantage or necessary financial protection of the City's resources. External service providers shall be subject to Revised Codes of Washington and the provisions of this Investment Policy.

## **5.0 ETHICS AND CONFLICTS 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 Mayor any material financial interests in financial institutions that conduct business within this jurisdiction and they shall further disclose any large personal financial/investment positions that could be related to the performance of the City's portfolio. Employees and officers shall subordinate their personal investment transactions to those of the City, particularly with regard to the time of purchases and sales.

## **6.0 AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS**

The Finance Director will maintain a list of financial institutions authorized to provide investment services. The selection process for inclusion on this list will be detailed in the written procedures for investments.

In addition, a list will also be maintained of approved security **broker/dealers** selected by credit worthiness who are authorized to provide investment services in the State of Washington. These may include **primary dealers** or regional dealers that qualify under **Securities & Exchange Commission Rule 15C3-1**. Employees of any firm or financial institutions offering securities or investments to the City are expected to be trained in the precautions appropriate to public-sector investments and are expected to familiarize themselves with the City's investment objectives, policies and constraints. These firms and financial institutions are expected to make reasonable efforts to preclude imprudent transactions involving City Funds.

No public deposit shall be made except in a **qualified public depository** as provided in Chapter 39.58 RCW.

All broker/dealers and financial institutions that desire to do business with the City of Poulsbo must supply the Finance Director their most recent financial statements or Consolidated Report of Condition (call report) for review. A current audited financial statement is required to be on file for each financial institution and broker/dealer with whom the City invests.

If an investment advisor is authorized to transact buys and sells on behalf of the City, the advisor's approved dealer list will be provided to the City. Buys and sells may be transacted with any dealers on the advisor's approved list.

## **7.0 AUTHORIZED INVESTMENTS**

The City of Poulsbo is empowered to invest in certain types of securities as detailed in RCW 35A.40050 and RCW 43.84.080. Among the authorized investments are:

- 7.1 U.S. Treasury Obligations (Bills, Notes, Bonds)
- 7.2 Government Sponsored Enterprises (GSEs) – Federal Instrumentality Securities which include the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC), the Federal Home Loan Banks (FHLB), and the Federal Farm Credit Bureau (FFCB). Additional obligations of the U.S. Government, its agencies and instrumentalities, provided that the payment of the principal and interest is either guaranteed by the Federal Government, carries an outright government backing or carries an implicit guarantee.
- 7.3 Nonnegotiable certificates of deposit and other collateralized evidence of deposits with qualified public depositories.
- 7.4 Prime Bankers acceptances purchased on the secondary market with ratings of A1/P1.
- 7.5 Mutual funds and money market funds are inappropriate investments except as authorized in chapter 39.59 RCW and are intended to provide a safe harbor from the Internal Revenue Service's (IRS) arbitrage rules and tax. The money market and mutual fund options in RCW 39.59.030 are allowable investments only for monies subject to the IRS's arbitrage rules. No other monies, unless specifically authorized elsewhere, may be invested in a money market or mutual fund.
- 7.6 State of Washington Local Government Investment Pool
- 7.7 Bonds of the State of Washington and any local government in the State of Washington, which bonds have at the time of investment one of the three highest credit ratings of a nationally recognized rating agency.
- 7.8 Any investments authorized by law for the Treasurer of the State of Washington or any local government of the State of Washington other than a metropolitan municipal corporation but except as provided in RCW 39.58, such investments shall not include certificates of deposits of banks or bank branches not located in the State of Washington.

## **8.0 COLLATERALIZATION**

Collateralization is required on repurchase agreements. In order to anticipate market changes and provide a level of security for all funds, the collateralization level will be (102%) of market value of principal and accrued interest. The City chooses to limit collateral to the following:

- Treasury Obligations (Bills, Notes, Bonds)
- Government Sponsored Enterprises (GSEs) – Federal Instrumentality Securities which

include the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC), the Federal Home Loan Banks (FHLB), and the Federal Farm Credit Bureau (FFCB). Additional obligations of the U.S. Government, its agencies and instrumentalities, provided that the payment of the principal and interest is either guaranteed by the Federal Government, carries an outright government backing or carries an implicit guarantee.

## **9.0 SAFEKEEPING AND CUSTODY**

To protect against potential fraud, embezzlement, or losses caused by collapse of individual securities dealers. Securities purchased by the City shall be held in a segregated account for the City's benefit at a third party trustee as safekeeping agent. The approved investment advisor, investment dealer or bank in which the security is purchased shall issue a confirmation ticket to the City listing the specific instrument, issuer, coupon, maturity, CUSIP number, purchase or sale price, transaction date, and other pertinent information.

The investment advisor, investment dealer or bank which executes the transaction on the City's behalf shall deliver all securities on a delivery versus payment (DVP) method to the designated third party trustee at the direction of the Investment Officer.

Investment officials shall be bonded to protect the City against loss due to possible embezzlement and malfeasance.

## **10.0 DIVERSIFICATION**

The City will diversify its investments by security type and institution and maturity in accordance with the table below.

### **Diversification by security type:**

U.S. Treasury bills, notes & bonds	100%
U.S. Government Sponsored Enterprises	100%
FNMA	50%
FHLMC	50%
FHLB	50%
FFCB	50%
Other GSEs	10%
Certificates of Deposit & Public Deposits	20%
Bankers Acceptance	10%
WA State LGIP	100%
WA State and Local Bonds	10%
Repurchase Agreement	10%
Other Legal Investments	10%



**11.0 MATURITIES**

To the extent possible, the City will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the City will not directly invest in securities maturing more than five (5) years from the date of purchase.

**Maximum Maturity Guidelines:**

Maximum maturity at time of investment	5 years
Maximum weighted average maturity of total portfolio	2 years

Reserve or Capital Improvement Project monies may be invested in securities exceeding five (5) years if the maturity of such investments is made to coincide as nearly as practical with the expected use of the funds.

**12.0 COMPETITIVE TRANSACTIONS**

The Investment Officer will obtain telephone, faxed or emailed quotes before purchasing or selling an investment. The Investment Officer will select the quote which best satisfies the investment objectives of the investment portfolio within the parameters of this policy. The Investment Officer will maintain a written record of each bidding process including the name and prices offered by each participating financial institution.

If the City hires an investment advisor to provide investment management services, the advisor must provide documentation of competitive pricing execution on each transaction the investment advisor will retain documentation and provide upon request.

**13.0 INTERNAL CONTROLS**

Day-to-day procedures concerning investment management and accounting are outside the scope of this policy. The City is subject to annual independent review of its internal controls by the Office of State Auditor. This review will provide internal control by assuring that policies and procedures are being complied with. Such review may also result in recommendations to change operating procedures to improve internal control. The controls shall be designed to prevent loss of public funds due to fraud, error, and misrepresentation by third parties, unanticipated market changes, or imprudent actions by employees or officers of the City. The specific internal controls maintained by the City are contained in normal operating procedures of the Treasury.

**13.1 EXTERNAL CONTROLS**

The City may enter into contracts with third-party investment advisory firms when their services are deemed to be beneficial to the City. The advisor must comply with the investment policy and may have authority to transact investments on behalf of the City. The advisor may only act on a non-discretionary basis. Therefore, the advisor must present investment recommendations and receive approval to execute the recommendation from the Finance Director, or whom the Finance Director designates prior making purchases or sells on behalf of the City.

**14.0 PERFORMANCE STANDARDS**

The City's investment portfolio will be designed to obtain a market average rate of return during budgetary and economic cycles, taking into account the City's investment risk constraints and cash flow needs.

The liquidity weighted average yield of the total portfolio will be compared quarterly to the LGIP average yield.

**15.0 REPORTING**

The Finance Director shall submit a monthly report of investment holdings to the Mayor and will quarterly submit an investment report to the Finance Committee that summarizes recent market conditions, economic developments and anticipated investment conditions.

For reporting purposes the investment portfolio shall be divided into two portfolios - a liquidity portfolio and a core portfolio.

Minimum Reporting Requirements for Total Portfolio Quarterly:

- Book Yield
- Marked to Market Report
- Holdings Report
- Transactions Report
- Weighted Average Maturity or Duration

**16.0 INVESTMENT POLICY ADOPTION AND REVISION CRITERIA**

The City's investment policy shall be adopted by resolution of the City Council. The policy shall be reviewed annually during the budget process. The Finance Committee will review the policy with the Finance Director and recommend to Council any appropriate changes.

## **17.0 GLOSSARY**

**ACCRUED INTEREST:** Interest earned but not yet paid on a security since the latest of the security's issue date or last record date.

**ADJUSTABLE-RATE MORTGAGE (ARM):** A mortgage which features predetermined adjustments of the interest rate at regular intervals. An ARM's interest rate is tied to an index outside the control of the lender.

**AGENCIES:** Federal Agency securities.

**AMORTIZATION:** The reduction of principal (of debt) at regular intervals.

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

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

**BASIS POINT:** A measurement of changes in prices or yields for fixed income securities. One basis point equals 1/100 of 1 percent.

**BEARER SECURITY:** A security the owner of which is not registered on their books of the issuer. A bearer security is payable to the holder.

**BID:** The price at which a buyer is willing to buy a security.

**BOND:** A long-term debt security, (IOU) issued by a government or corporation. Generally pays a stated rate of interest, and returns the face value at maturity.

**BOND ANTICIPATION NOTE:** Short-term interest bearing notes issued in anticipation of bonds to be issued at a later date. The notes are retired from proceeds of the bond issue to which they are related.

**BOND EQUIVALENT YIELD (BEY):** A yield that equates monthly pay mortgage-backed

securities to semi-annual payments bonds.

**BOOK-ENTRY TRANSFER:** A method of transferring securities through computerized entries, which may eliminate the need for physical certificates.

**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.

**CALL OPTION:** The right to purchase a security at a predetermined price on or before a specified future date.

**CASH FLOW BUDGET:** A projection of the cash receipts and disbursements anticipated during a given time period. Typically, this projection covers a year and is broken down into separate projections for each month, week and/or day during the year.

**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.

**COMMERCIAL PAPER:** Corporate promissory notes issued to provide short-term financing, sold at a discount and redeemed at face value. A principal component of money market funds portfolios, because of the high yields.

**CONFIRMATION:** A document used to state and supplement in writing the terms of a transaction, which have previously been agreed to verbally.

**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.

**CURRENT FACE:** Also known as the outstanding loan balance. The current monthly remaining principal of a certificate computed by multiplying the original face of the certificate by the current principal balance factor.

**CUSIP NUMBER (Committee on Uniform Securities Identification Procedures):** An identifying number assigned to a publicly traded security. A nine-digit code is permanently assigned to each issue and is generally printed on the face of the security if it is in physical form.

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

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

**DELIVERY VERSUS PAYMENT:** There are two methods of delivery of securities: delivery versus payment and delivery versus receipt (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.

**DEPOSITORY:** An entity, which accepts securities for deposit. A depository facilitates delivery and transfer between dealers by making account entries reflecting ownership instead of physically moving securities.

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

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

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

**FACE VALUE:** The par value of a security. Face value is not an indication of market value.

**FACTOR:** The proportion of the outstanding principal balance of a security to its original principal balance expressed as a decimal. The *Bond Buyer* publishes the □Monthly Factor Report□ that contains a list of factors for GNMA, FNMA and FHLMN securities.

**FARM CREDIT DISCOUNT NOTES AND BONDS:** Secured joint obligations of Farm Credit Banks that are issued with a minimum face value of \$50,000 with maturities ranging from 5 to 360 days.

**FED BOOK-ENTRY:** An electronic registration, transfer and settlement system for securities on the Federal Reserve System.

**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.

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

**FEDERAL 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 and money.

**FEDERAL RESERVE SYSTEM:** The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington D.C., 12 Regional Banks and about 5,700 commercial banks that are members of the system.

**FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC):** A federal agency that insures bank deposits, currently up to \$100,000 per deposit.

**FEDERAL HOME LOAN BANKS (FHLB):** The institutions that regulate and lend to savings and loan associations. The Federal Home Loan Banks play a role analogous to that played by the Federal Reserve Banks vis-à-vis member commercial banks.

**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 & Urban Development, H.U.D. It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

**FEE:** (1) Commitment fee: a payment to investors or prospective investors, which may or may not be refundable, for the purpose of obtaining a commitment to purchase securities; (2) Standby fee: a non-refundable amount

**FIXED-RATE MORTGAGE:** A mortgage which features level monthly payments that is

determined at the outset of the mortgage and remains constant throughout the life of the mortgage.

**FLAT:** A security trades flat when it is traded with no accrued interest.

**FORWARD TRADE:** A transaction where the settlement will occur on a specified date in the future at a price agreed upon on the trade date.

**GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA OR GINNIE MAE):** Securities 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 FMHM mortgages. The term pass-through is often used to describe Ginnie Maes.

**GNMA Is:** Pass-through mortgage-backed securities on which registered holders receive separate principal and interest payments on each of their certificates. GNMA I securities are single-issuer pools. Investors may expect to receive principal and interest payments on the 15th day of each month.

**GNMA IIs:** Pass-through mortgage-backed securities on which registered holders receive an aggregate principal and interest payment from a central paying agent on all of their GNMA II certificates. Principal and interest payments are disbursed on the 20th day of each month. GNMA II securities are collateralized by multiple-issuer pools or custom pools (one issuer but different interest rates that may vary within one percentage point). Multiple-issuer pools are known as Jumbos. Jumbo pools are generally larger and often contain mortgages that are more geographically diverse than single-issuer pools. Jumbo pool mortgages have interest rates that may vary within one percentage.

**GRADUATED PAYMENT MORTGAGE (GPM):** A mortgage that features negative amortization in which early payments are insufficient to pay

the interest due on the outstanding principal. As a result, the unpaid interest is added to the principal thereby increasing the borrower's balance owed. The payments must graduate or increase over time until they can completely amortize the loan's remaining principal balance by its maturity. The number, frequency and rate of increases are specified in the original contract.

**INTEREST:** Compensation paid or to be paid for the use of money. Interest is generally expressed as an annual percentage rate.

**INTEREST ONLY (I/O):** The interest only portion of a stripped mortgage-backed security. For I/O securities, all of the interest distribution is due to the registered holder based on the current face of the underlying mortgage-backed security.

**INTEREST RATE:** The face coupon rate of a security.

**ISSUE DATE:** The date on which a security is issued or originated.

**ISSUER:** An entity, which issues and is obligated to pay amounts due on securities.

**LIQUIDITY:** A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

**MASTER REPURCHASE AGREEMENT:** A written contract covering all future transactions between the parties to repurchase-reverse repurchase agreements that establish each party's rights in the transactions. A master agreement will often specify, among other things, the right of buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

**MATURITY DATE:** The date on which the principal amount of the security is due and

payable to the registered owner of the security.

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

**MORTGAGE:** A legal instrument that creates a lien upon real estate securing the payment of a specified debt, such as a mortgage note.

**MORTGAGE-BACKED BOND:** A mortgage-backed bond is a general obligation of the issuer, secured by mortgage collateral, where the issuer retains ownership of the mortgages. The bond is secured by the market value of the underlying mortgages. Since the value of the mortgages will decrease over time as a result of principal amortization and prepayments, the market value of the collateral must exceed the value of the bonds issued. Unlike pass-through securities, the cash flow in a mortgage-backed bond is not directly related to the cash flow of the underlying mortgage collateral. Interest on the bond is paid semiannually at a predetermined rate and principal is paid at maturity.

**MORTGAGE-BACKED SECURITIES:** The term mortgage backed securities is a generic term that refers to securities backed by mortgages, including pass-through securities, mortgage-backed bonds, mortgage pay-through securities and CMOs.

**MORTGAGE BANKER:** An entity that originates mortgage loans, sells them to other investors and service the loans.

**MORTGAGE PAY-THROUGH BONDS:** These bonds combine features of pass-through securities and mortgage-backed bonds. A pay-through bond, like a mortgage-backed bond, is a debt obligation of the issuer, secured by mortgage collateral that is owned by the issuer. However, like a pass-through security, the cash flow on a pay-through bond is related to the cash flow in the mortgage collateral. Therefore, the cash flow generated by the mortgage

collateral must be sufficient to cover principal and interest payments on the bonds. Prepayments on the mortgage collateral will be passed on to the bondholders thereby causing fluctuations in the principal payment of the bonds.

**ODD LOT:** A quantity of securities, which is less than the accepted unit of trading.

**OFFER:** The price at which a seller will sell a security.

**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.

**ORIGINAL FACE:** The face value (original principal amount) of a security as of its issue date.

**PAR:** The face amount of a security.

**PAYMENT DATE:** Also known as the payable date. The date that actual principal and interest payments are made to the registered holder of a security. For GNMA Is, the payment date is the 15th day of the second month following the record date. For GNMA II's, the payment date is the 20th day of the month following the record date. For FHLMC PCs, the payment date is the 15th day of the second month following the record date. For FNMA MBSs, the payment date is the 25th day of the month following the record date.

**P&I (PRINCIPAL AND INTEREST):** In the case of mortgage-backed securities and other asset-backed securities, P&I includes regularly scheduled payments as well as prepayments, if any.

**POOL:** A collection of mortgages assembled by an originator or master servicer as the basis for a security. Pools are identified by a number.

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

**PREPAYMENT:** The unscheduled partial or complete payment of the principal amount outstanding on a debt obligation before it is due.

**PRICE:** The dollar amount to be paid for a security expressed as a percentage of its current face value.

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

**PRINCIPAL:** The face amount of a bond, exclusive of accrued interest and payable at maturity.

**PRINCIPAL ONLY (P/O):** The principal only portion of a stripped mortgage-backed security. For P/O securities, all of the principal distribution is due to the registered holder based on the current face of the underlying mortgage-backed security.

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

**PUT OPTION:** The right to sell a security at a predetermined price on or before a specified future date.

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

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

**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 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.

**RATINGS:** Designations used by investors services to give relative indications of credit quality.

**RECORD DATE:** The date for determining who is entitled to payment of principal and interest (and prepayment) on a security. The record date for most mortgage-backed securities is the last calendar day of the month (however, the last day on which they can be presented for transfer is the last business day of the month.) The record date for CMOs and ABSs varies with each issue.

**REGISTERED HOLDER:** The name in which a security is registered as stated on the certificate itself or on the books of the paying agent. All principal and interest payments are made to the registered holder regardless of beneficial

ownership on the record date.

**REVERSE REPURCHASE AGREEMENT (REVERSE REPO):** An agreement of one party to purchase securities at a specified price from a second party and a simultaneous agreement by the first party to resell the securities at a specified price to the second party on demand or at a specified later date.

**SAFEKEEPING:** The storage and protection of customers' securities (i.e., held in the vault) provided as a service by a bank or institution acting as agent for the customer.

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

**SEC RULE 15C3-1:** See uniform net capital rule.

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

**SERVICING FEE:** The amount withheld from the monthly interest payments made by a mortgagor and retained by the mortgage servicer.

**SERVICING:** The duties of the servicer for which a fee is received. Servicing consists of collecting and pooling principal, interest and escrow payments as well as certain operational procedures covering accounting, bookkeeping, insurance, tax records, loan payment follow-up, delinquency loan follow-up, and loan analysis.

**SETTLEMENT DATE:** The date agreed upon by the parties to a transaction for the payment of funds and the delivery of securities.

**TAIL:** The portion of a GNMA pool that is not divisible by \$5,000. For physical GNMA the tail must remain intact. For example, on a GNMA with an original face of \$6,038,921.65 the tail equals \$3,921.65. For book-entry FNMA and FHLMC securities, tails may be split into



multiples of one dollar (\$1).

**TRANSFER AGENT:** A transfer agent is appointed to maintain records of securities owners, to cancel and issue certificates and to address issues arising from lost, destroyed or stolen certificates.

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

**TREASURY BOND:** Long-term U.S. Treasury securities having initial maturities of more than ten years.

**TREASURY NOTES:** Intermediate term coupon bearing U.S. Treasury securities having initial maturities of from one to ten years.

**WEIGHTED AVERAGE COUPON (WAC):** An arithmetic mean of the coupon rate of the underlying mortgages that collateralize a security.

**WEIGHTED AVERAGE MATURITY (WAM):**  
An arithmetic mean of the remaining term of the underlying mortgages that collateralize a security.

**WHOLE LOAN:** An unsecuritized residential or commercial mortgage.

**YIELD:** The annual percentage returns, as computed in accordance with standard industry practices that is earned on a security.

**Z-BOND:** See accrual Bond.

