

CALIFORNIA JOINT POWERS INSURANCE AUTHORITY

STATEMENT OF INVESTMENT POLICY

June 2016

A. INTRODUCTION

The Executive Committee of the California Joint Powers Insurance Authority (the Authority) recognizes its responsibility to wisely direct the investment of the Authority's funds on behalf of the Authority's Members. The Authority's investment assets are essential to its financial strength, its ability to pay claims on behalf of its Members, and its ability to improve service or reduce costs to its Members.

The investment policies and practices of the Authority take into consideration the Authority's particular investment needs including preservation of capital, appropriate levels of liquidity and yield on invested assets. This Statement of Investment Policy (the Policy) is based upon principles of prudent money management and State law. The Authority's investment program will be conducted in accord with State law, however, where the Policy is more restrictive than State law, the Policy shall govern investment practices.

The Policy shall govern the investment of the Authority's funds. The Policy will be used by the Authority's Treasurer, staff, and all third party providers of investment or investment-related services. Its purpose is to direct the prudent investment of assets and to protect the Members' money.

B. INVESTMENT OBJECTIVES

The Authority's investment objectives are to:

- Protect the principal value of the assets entrusted to the Authority—safety of the assets is the primary investment objective;
- Ensure that the Authority has adequate cash to pay claims on behalf of its Members, and the cost of operations, by selecting maturities which anticipate cash needs and avoid forced liquidation;
- Earn a reasonable market rate of return consistent with the primary objective of safety and the need for adequate liquidity;
- Comply with applicable laws governing investment of governmental funds.

C. INVESTMENT PHILOSOPHY

The Authority's investment philosophy is to invest conservatively in order to minimize risk. The fundamental principles of the Authority's conservative philosophy are:

- Diversification of the portfolio by investment type,
- Quality standards for securities issuers,
- Limits on the maximum maturity of investments,
- Purchasing investments with the ability and intent to hold them until maturity.

The Authority will adopt an investment strategy tailored to its specific needs and constraints. The strategy will target a maturity distribution to be reviewed annually upon receipt of the actuarial report.

The Authority's investment strategy will not prohibit the Authority from selling a security prior to its maturity and recording a gain or loss in order to improve the quality, liquidity, or return of the portfolio in response to market conditions or the Authority's needs. However, the Authority's philosophy prohibits speculation, i.e., the purchase of securities with the intent to profit from favorable changes in market prices or market conditions. Leveraging or borrowing money for the purpose of investing is specifically prohibited.

D. PRUDENCE

The Treasurer and the Executive Committee are trustees and therefore fiduciaries subject to the prudent investor standard. Investments shall be made in the context of the Prudent Investor Standard for trustees of local government money which is defined in Government Code Section 53600.3:

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.

E. ETHICS AND CONFLICTS OF INTEREST

Officers and employees involved in the investment process will refrain from personal business activities that could conflict with proper execution of the investment program, or which could impair their ability to make impartial decisions. Employees and investment officials shall disclose to the Chief Executive Officer any material financial interests in financial institutions that conduct business within their jurisdiction, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the Authority.

Authority Officials and employees are prohibited from receiving compensation, directly or indirectly, from broker/dealers, investment advisors, or any other party involved in the investment

program, and from exerting undue influence or pressure against or in concert with any other person involved in the Authority's investment operations, including any method of coercion, confidential financial arrangement, or financial inducement.

F. DELEGATION OF AUTHORITY

The Executive Committee hereby delegates its authority to invest funds of the Authority for a one-year period to the Treasurer, who shall thereafter assume full responsibility for the portfolio until the delegation of authority is revoked or expires. Subject to review, the Executive Committee may renew the delegation of authority each year. The Treasurer may delegate the day-to-day placement of investments to a registered investment advisor, via written agreement approved by the Executive Committee. The investment advisor shall make all investment decisions and transactions in strict accordance with State law and this Policy. The Treasurer shall establish a system of written internal controls to regulate the Authority's investment activities, including the activities of the investment advisor and any subordinate officials acting on behalf of the Authority.

The Treasurer and the delegated 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.

G. AUTHORIZED INVESTMENTS

The Authority is governed by the California Government Code, Sections 53600 et seq. Any percentage limits, credit quality criteria or other limitations listed in this Policy shall apply at time of purchase. Within the context of these limitations, the following investments are authorized:

1. **United States Treasury Issues.** 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.
 - a. The maximum maturity for U.S. Treasury securities is ten years. See additional restrictions for U.S. Treasury issues with maturities longer than five years in the section entitled "Maturities," on page 8.
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, including federal agency mortgage-backed securities.
 - a. A maximum of 30% of the Authority's portfolio may be invested in callable Federal Agency securities. For this paragraph, "portfolio" means the total amortized cost of funds. For purposes of this limitation and for reporting purposes, callable securities that are past their last call date will be classified with other non-callable securities.

- b. A maximum of 20% of the Authority’s portfolio may be invested in federal agency mortgage-backed securities.
 - c. The maximum maturity for federal agency obligations is ten years. See additional restrictions for federal agency obligations with maturities longer than five years in the section entitled “Maturities,” on page 8.
 - d. The Authority may not invest in federal agency instruments issued by the Small Business Administration (SBA) or the Government National Mortgage Association (GNMA).
3. **State of California Municipal Obligations.** Registered treasury notes, warrants or bonds issued by the State of California.
- a. The Authority may invest in municipal obligations rated “AA” for long-term, “A-1” for short-term, their equivalent, or better by a nationally recognized statistical rating organization.
 - b. No more than 2.5% of the Authority’s portfolio may be invested in the securities of any one municipal issuer.
 - c. No municipal investment may have a maturity greater than five years.
 - d. Only general obligation bonds are permitted (no revenue bonds).
 - e. A maximum of 5% of the Authority’s portfolio may be invested in this category. The 5% maximum applies both individually and collectively to all municipal investments, including State of California Municipal Obligations, Other 49 States Municipal Obligations, and California Local Agency Municipal Obligations.
4. **Other 49 States Municipal Obligations.** Registered treasury notes, warrants or bonds issued by any of the other 49 states.
- a. The Authority may invest in municipal obligations rated “AA” for long-term, “A-1” for short-term, their equivalent, or better by a nationally recognized statistical rating organization.
 - b. No more than 2.5% of the Authority’s portfolio may be invested in the securities of any one municipal issuer.
 - c. No municipal investment may have a maturity greater than five years.
 - d. Only general obligation bonds are permitted (no revenue bonds).
 - e. A maximum of 5% of the Authority’s portfolio may be invested in this category. The 5% maximum applies both individually and collectively to all municipal investments, including State of California Municipal Obligations, Other 49 States Municipal Obligations, and California Local Agency Municipal Obligations.
5. **California Local Agency Municipal Obligations.** Bonds, notes, warrants, or other evidences of indebtedness issued by a local government agency within California.
- a. The Authority may invest in municipal obligations rated “AA” for long-term, “A-1” for short-term, their equivalent, or better by a nationally recognized statistical rating organization.
 - b. No more than 2.5% of the Authority’s portfolio may be invested in the securities of any one municipal issuer.
 - c. No municipal investment may have a maturity greater than five years.
 - d. Only general obligation bonds are permitted (no revenue bonds).

- e. A maximum of 5% of the Authority's portfolio may be invested in this category. The 5% maximum applies both individually and collectively to all municipal investments, including State of California Municipal Obligations, Other 49 States Municipal Obligations, and California Local Agency Municipal Obligations.
6. **Medium-term Notes.** Medium-term notes, defined as all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, 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.
- a. The Authority may invest in medium term corporate notes rated "A" or higher, or the equivalent, by a nationally recognized statistical rating organization.
 - b. A maximum of 30% of the Authority's portfolio may be invested in this category.
 - c. No more than 2.5% of the Authority's investment portfolio may be invested in the securities of any one non-government issuer regardless of security type.
7. **Bankers' Acceptances.** Bankers' acceptances, also known as bills of exchange or time drafts that are drawn on and accepted by a commercial bank.
- a. Bankers' acceptances must be issued by a bank that carries a short-term rating of "A-1" or higher, or the equivalent, by a nationally recognized statistical rating organization.
 - b. Bankers' acceptances cannot exceed a maturity of 180 days.
 - c. A maximum of 40% of the Authority's portfolio may be invested in this category.
 - d. No more than 2.5% of the Authority's investment portfolio may be invested in the securities of any one non-government issuer regardless of security type.
8. **Commercial Paper.** Commercial paper 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. The entity that issues the commercial paper shall meet all of the following conditions in either paragraph a. or paragraph b.:
- a. The entity meets the following criteria:
 - i. Is organized and operating in the United States as a general corporation.
 - ii. Has total assets in excess of five hundred million dollars (\$500,000,000).
 - iii. Has debt other than commercial paper, if any, that is rated "A" or higher, or the equivalent, by a nationally recognized statistical rating organization.
 - b. The entity meets the following criteria:
 - i. Is organized within the United States as a special purpose corporation, trust, or limited liability company.
 - ii. Has program wide credit enhancements including, but not limited to, over collateralization, letters of credit, or surety bond.
 - iii. Has commercial paper that is rated "A-1" or higher, or the equivalent, by a nationally recognized statistical rating organization.
 - c. Eligible commercial paper shall have a maximum maturity of 270 days or less and not represent more 10% of the outstanding paper of an issuing corporation.
 - d. A maximum of 25% of the Authority's portfolio may be invested in this category.

- e. No more than 2.5% of the Authority's investment portfolio may be invested in the securities of any one non-government issuer regardless of security type.
9. **Negotiable Certificates of Deposit.** Negotiable certificates of deposit issued by a nationally or state-chartered bank or a state or federal association, or by a federally- or state-licensed branch of a foreign bank.
- a. The Authority may invest in negotiable CDs rated "A" for long-term, "A-1" for short-term, their equivalent, or better by a nationally recognized statistical rating organization.
 - b. The maximum maturity for negotiable certificates of deposit is five years.
 - c. A maximum of 30% of the Authority's portfolio may be invested in this category.
 - d. No more than 2.5% of the Authority's investment portfolio may be invested in the securities of any one non-government issuer regardless of security type.
10. **Money Market Funds.** Shares of beneficial interest issued by diversified management companies that are money market funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1 and following). The company shall have met the criteria in either paragraph a. or b. below:
- a. Attained the highest ranking or the highest letter and numerical rating provided by not less than two nationally recognized statistical rating organizations.
 - b. Retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience managing money market mutual funds with assets under management in excess of five hundred million dollars (\$500,000,000).
 - c. Only funds that invest in U.S. Treasury or Federal Agency obligations may be utilized.
 - d. A maximum of 20% of the Authority's portfolio may be invested in this category.
11. **Repurchase Agreements.** Repurchase Agreements shall be used solely as short-term investments not to exceed 30 days.
- a. The Authority will enter into repurchase agreements only with primary government securities dealers as designated by the Federal Reserve Bank of New York. Repurchase agreements shall be governed by a master repurchase agreement adopted by the Public Securities Association. All securities underlying repurchase agreements shall be delivered to the Authority's custodian bank, or be handled under a properly executed "tri-party" custodial arrangement. Collateral for repurchase agreements is restricted to U.S. Treasury issues or Federal Agency issues.
 - b. The underlying collateral must be at least 102% of the repurchase agreement amount. If the value of securities held as collateral slips below 102% of the value of the cash transferred, then additional cash or acceptable securities must be delivered to the third party custodian. Market value shall be recalculated each time there is a substitution of collateral. For repurchase agreements with terms to maturity of greater than three days, the value of the collateral securities shall be marked to market weekly by the custodian, and, if additional collateral is required, then that collateral must be delivered within two business days. If a collateral

deficiency is not corrected within two days, the collateral securities will be liquidated.

- c. A perfected first security interest in the collateral securities, under the Uniform Commercial Code, shall be created for the benefit of the Authority. Collateral securities shall be held free and clear of any lien and shall be held by an independent third party acting solely as an agent for the Authority, and such third party shall be (i) a Federal Reserve Bank, or (ii) a bank which is a member of the Federal Deposit Insurance Corporation and which has combined capital, surplus, and undivided profits of not less than \$50 million.
12. **Asset-Backed Securities (ABS).** Any mortgage pass-through security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-back certificate, consumer receivable pass-through certificate, or consumer receivable-backed bond
- a. Securities eligible for investment under this subdivision shall be issued by an issuer having an “A” or its equivalent or better for the issuer’s debt by at least two by NRSROs and rated in a rating category of “AA” or its equivalent or better by at least two NRSROs.
 - b. A maximum of 10% of the Authority’s portfolio may be invested in this category.
 - c. ABS may not exceed a maturity of five (5) years.
 - d. No more than 2.5% of the Authority’s investment portfolio may be invested in the securities of any one non-government issuer regardless of security type.
13. **Supranationals.** United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development (IBRD), International Finance Corporation (IFC), or Inter-American Development Bank (IADB).
- a. The Authority may invest in supranational securities rated “AA”, the equivalent, or better by a nationally recognized statistical rating organization.
 - b. Supranational securities may not exceed a maturity of five years.
 - c. Supranational securities must be eligible for purchase and sale within the United States.
 - d. A maximum of 7.5% of the Authority’s portfolio may be invested in this category.
 - e. No more than 2.5% of the Authority’s investment portfolio may be invested in the securities any one issuer in this category.
14. **State of California Local Agency Investment Fund (LAIF).** LAIF is a special fund in the State Treasury that local agencies may use to deposit funds for investment, and which provides daily liquidity.
- a. For due diligence, the Authority shall maintain on file LAIF’s current investment policy and its requirements for participation, including limitations on deposits or withdrawals.
 - b. The Treasurer shall report to the Executive Committee quarterly the percentage amount LAIF has invested in each investment sector.
 - c. The Authority may invest up to the maximum permitted by the State Treasurer.

- d. LAIF investments in instruments prohibited by or not specified in the Authority's policy do not exclude it from the Authority's list of allowable investments, provided that LAIF's reports allow the Treasurer to adequately judge the risk inherent in LAIF's portfolio.

15. California County Investment Pools. County investment pools are investment funds managed by the different California counties whereby local agency deposits are combined with the county's funds and invested by the county on behalf of the depositors. Participation in a county pool requires adoption of an enabling resolution by the Executive Committee.

- a. For any county pool in which the Authority has invested funds, the Authority shall maintain on file the current investment policy and requirements for participation, including limitations on deposits or withdrawals.
- b. The Treasurer shall report to the Executive Committee quarterly the percentage amount the county pool has invested in each investment sector.
- c. No more than \$30 million may be invested in any individual county investment pool.

16. Local Government Investment Pool. Shares of beneficial interest issued by a joint powers authority organized pursuant to Government Code Section 6509.7 that invests in the securities and obligations authorized in subdivisions (a) to (o) of Government Code Section 53601, inclusive. Each share shall represent an equal proportional interest in the underlying pool of securities owned by the joint powers authority. To be eligible under this section, the joint powers authority issuing the shares shall have retained an investment adviser that meets all of the following criteria:

- a. The adviser is registered or exempt from registration with the Securities and Exchange Commission.
- b. The adviser has not less than five years of experience investing in the securities and obligations authorized in subdivisions (a) to (o) Government Code Section 53601, inclusive.
- c. The adviser has assets under management in excess of five hundred million dollars (\$500,000,000).
- d. Only pools that seek to maintain a constant net asset value of \$1.00 per Share are permitted.

17. Demand Deposits, Passbook Savings Accounts and Non-negotiable Certificates of Deposits. Money must be deposited in state or national banks, state or federal savings associations, or state or federal credit unions in the State of California. It may be in inactive deposits, active deposits or interest-bearing active deposits.

- a. The Authority shall only place funds on deposit with financially sound banks in business a minimum of three years and have received a minimum overall satisfactory rating for meeting the credit needs of California Communities in its most recent evaluation, as provided by Government Code Section 53635.2.
 - 1. The Authority requires each financial institution that is used for the deposit of funds submit current financial statements which are evaluated by the Treasurer prior to the deposit of funds.

2. The financial institution must place and maintain on file with the Authority an audited financial statement not more than one year old.
 3. Deposits shall not exceed the shareholders' equity of any depository bank or the net worth of any depository savings and loan association.
- b. Any financial institution accepting Authority funds for deposit must comply with the requirements of Government Code Section 53630 et seq., including collateralization of the Authority's deposits.
1. Collateral is restricted to United States government securities.
 2. The Treasurer or Investment Officer may waive collateral for that portion of a deposit which is insured pursuant to federal law.
 3. As provided by Government Code Section 53649, the Authority shall have a signed contract with each financial institution with Authority's funds on deposit.
- c. Except for operating and imprest funds at Wells Fargo, the amount on deposit in any other single bank may not exceed the amount which is insured pursuant to federal law.
- d. Non-negotiable certificates of deposit are allowable up to insured amounts.
1. Non-negotiable certificates of deposit may not exceed one (1) year in maturity.
 2. A maximum of 10% of the portfolio may be invested in non-negotiable certificates of deposit.

H. TRADING

The Authority or its investment advisor may sell investments prior to maturity, as long as such sales are consistent with the overall objectives of the Authority and the guidelines established by this Policy. A "swap" which improves the portfolio's ability to meet its objectives may be executed even if the transactions result in an accounting loss. Documentation for swaps will be included in the Authority's permanent investment file documents.

I. PROHIBITED INVESTMENTS

The Authority may invest only in the investment types listed in section F. Investments by the Authority in securities permitted by the California Government Code, but not specifically authorized by this Policy are prohibited without the prior approval of the Executive Committee.

In accordance with California Government Code Section 53601.6, the Authority shall not invest any funds in inverse floaters, range notes, mortgage derived interest-only strips, or any security that could result in zero interest accrual if held to maturity.

J. MATURITIES

It is in the best interest of the Authority to maintain a diversified portfolio of investments that will ensure safety, liquidity and an acceptable yield. Maturities shall be selected to match the expected cash needs of the Authority. Where prudent, longer-term purchases may be made to enhance total return.

The duration of the total dollar value of funds invested in accord with this Policy shall not exceed 3.5 years. In addition no investment may have a maturity greater than ten years.

K. RATING CHANGES

The rating requirements specified in this Policy pertain to the rating at the time of purchase. In the event a security held by the Authority is subject to a rating change that brings it below the minimum ratings specified above, the Treasurer shall notify the Executive Committee of the change. The course of action to be followed will be decided on a case-by-case basis, considering such factors as the reason for the rate drop, prognosis for recovery or further rate drops, and the market price of the security.

L. BROKERS/DEALERS

1. If a third party investment advisor is authorized to conduct investment transactions on the Authority's behalf, the investment advisor may use its own list of approved broker/dealers and financial institutions for investment purposes. The investment advisor's approved list must be made available to Authority upon request.
2. For any investment transactions conducted by the Treasurer on behalf of the Authority, the Treasurer shall comply with the following requirements:
 - a. The Treasurer shall maintain a list of at least five authorized broker/dealers and financial institutions that are approved for investment purposes, and it shall be the policy of the Authority to purchase securities only from authorized institutions or firms.
 - b. On a rotating basis among the authorized firms, the Treasurer shall obtain at least two bids and offers, as reasonably comparable as possible, on each investment other than investments in the Local Agency Investment Fund and U.S. Treasury issues. U.S. Treasury issues will be purchased on a rotating basis from qualified firms. Records of bids and offers shall be retained during the period of time the Authority owns the investment. The record shall include an explanation if the lowest offer was not selected.
3. For any investment transactions conducted by the Treasurer, the Authority requires each firm that will be used to be evaluated by the Treasurer prior to any investments. The firms shall submit current financial statements, and annual audited financial statements each year thereafter, which are evaluated by the Treasurer. At a minimum, the authorized firms must meet the following criteria:
 - a. The institution must be financially sound.
 - b. The institution must have been in business at least three years.
 - c. The institution must provide proof of certification from the Financial Industry Regulatory Authority (FINRA).

- d. The institution must show proof of state registration or exemption.
- e. The institution must provide a written acknowledgment of having received and read the Authority's investment policy.

M. SAFEKEEPING OF SECURITIES

All security transactions entered into by the Authority shall be conducted on a delivery-versus-payment (DVP) basis. Securities shall be held by the Authority's designated third party custodian and evidenced by safekeeping receipts. The only exception to the foregoing shall be securities purchases made with: (i) local government investment pools; and (ii) money market mutual funds, since these securities are not deliverable. Securities at safekeeping shall be registered and held in the Authority's name. The Authority shall not purchase securities from, or sell securities to, the financial institution responsible for safekeeping the Authority's securities.

The Authority requires its designated third party custodian to submit current financial statements, and annual audited financial statements each year thereafter, which are evaluated by the Treasurer. The Treasurer will evaluate the institution's financial stability prior to use as a custodian. At a minimum, the institution must have been in business at least three years and must have assets of at least \$50 million and a net worth to liability ratio of 4.0% or greater.

N. REPORTING

1. The Treasurer shall render a monthly report to the Chief Executive Officer, Finance Officers Committee, Executive Committee, and the Board of Directors. The report on investments shall include:
 - a. A list of all investments owned by the Authority
 - b. The type or kind of each investment
 - c. The issuer of each investment
 - d. The purchase date of each investment
 - e. The maturity date of each investment
 - f. The par, amortized cost and market value for each security
 - g. The credit quality, as determined by one or more nationally recognized statistical rating organization, of each investment, as of the report date
 - h. The yield to maturity at cost of each investment
 - i. The average weighted yield at cost of the portfolio
 - j. A list of transactions for the month
 - k. A description of any of the Authority's funds, investments, or programs that are under the management of contracted parties
 - l. The current market value of the investment portfolio, as of the date of the report, and the source of the market value
 - m. A statement as to whether the Authority's investments comply with this Policy, and if not, why not
 - n. A statement denoting the ability of the Authority to meet its expenditure requirements for the next six months

O. BENCHMARK

The investment portfolio shall be designed 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. The Authority will adopt a performance benchmark and review it annually.

P. STATEMENT OF INVESTMENT POLICY

This Policy shall be annually reviewed by the Finance Officers Committee and submitted to the Executive Committee in order to incorporate any changes necessary to ensure consistency and its relevance to current law, and financial and economic trends. The review of this Policy shall be considered at a public meeting. Any changes in this Policy shall also be considered by the Executive Committee at a public meeting.

P. INDEPENDENT EVALUATION

The Authority may have its Investment Policy and investment practices evaluated by an independent evaluator, with expertise in investments and money management, as determined by the Finance Officers Committee or the Executive Committee. The Authority may give direction to the independent evaluator to report on specific issues of interest to the Authority at the time of the evaluation.

APPENDIX A GLOSSARY

BANKERS ACCEPTANCES are short-term credit arrangements to enable businesses to obtain funds to finance commercial transactions. They are time drafts drawn on a bank by an exporter or importer to obtain funds to pay for specific merchandise. By its acceptance, the bank becomes primarily liable for the payment of the draft at maturity. An acceptance is a high-grade negotiable instrument. Acceptances are purchased in various denominations for 30 to 270 days. The interest is calculated on a 360 day discount basis similar to Treasury Bills.

CALIFORNIA LOCAL GOVERNMENT DEBT is bonds, notes, warrants, or other evidences of indebtedness of any local agency within California. California local government debt is a permitted investment under the California Government Code. The Government Code does not specify minimum credit ratings for local government debt in which local agencies may invest. The Authority does not invest in these securities.

CERTIFICATES OF DEPOSIT

Negotiable Certificates of Deposit are large-denomination CDs issued in \$1 million increments. These securities have average trades in the secondary market of \$5 million to \$10 million. They are issued at face value and typically pay interest at maturity, if maturing in less than 12 months. CDs that mature beyond this range pay interest semi-annually. Negotiable CDs are issued by U.S. banks (domestic CDs), U.S. branches of foreign banks (Yankee CDs) and thrifts. There is an active secondary market for negotiable domestic and Yankee CDs. However, the negotiable thrift CD secondary market is limited. Yields on CDs exceed those on U.S. treasuries and agencies of similar maturities. This higher yield compensates the investor for accepting the risk of reduced liquidity and the risk that the issuing bank might fail. State law does not require the collateralization of negotiable CDs.

Non-Negotiable Certificates of Deposit are time deposits with financial institutions that earn interest at a specified rate for a specified term. Liquidation of the CD prior to maturity incurs a penalty. There is no secondary market for those instruments, therefore, they are not liquid. They are classified as public deposits and financial institutions are required to collateralize them. Generally, financial institutions use mortgages to collateralize these deposits.

Non-negotiable CDs of \$250,000 are insured respectively by the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Share Insurance Fund (NCUSIF).

COLLATERAL is securities, evidence of deposits or other property that a borrower pledges to secure repayment of a loan. It also refers to securities pledged by a bank to secure deposits of public monies. In California, repurchase agreements, reverse repurchase agreements, negotiable CDs purchased at a California institution, and public deposits must be collateralized.

COMMERCIAL PAPER is a short term, unsecured, promissory note issued by a corporation to raise working capital. These negotiable instruments may be purchased at a discount

to par value or interest bearing. Eligible commercial paper is issued by corporations organized and operating within the United States and having total assets in excess of \$500 million. This would include firms such as American Express, Bank of America, Wells Fargo Bank, et cetera.

COUNTY POOLED FUNDS are funds deposited with a California County for investment by the County on behalf of the depositors. A number of counties offer pooled fund programs. Pooled fund deposits are combined with the county's funds and invested by the county.

All interest is distributed to those agencies participating on a proportionate share determined by the amounts deposited and the length of time they are invested. Under state law, interest need only be paid quarterly and the county can require 30 days' notice by a local agency before withdrawal of the agency's funds. Some county pools are not as restrictive as state law allows and currently permit unlimited deposits and withdrawals. State law provides that any moneys deposited in the county treasury for investment are not subject to impoundment or seizure by the county.

DELIVERY of securities may be accomplished two ways: delivery vs. payment and delivery vs. receipt (also called free). Delivery vs. payment is delivery of securities with an exchange of money for the securities; this is the method of delivery used by the Authority. Delivery vs. receipt is delivery of securities with an exchange of a signed receipt for the securities.

DEPOSITS

Inactive deposits are certificates of deposit issued in any amount for periods of time as short as fourteen days and as long as several years. Interest must be calculated on a 360-day basis, actual number of days.

Interest-bearing active deposits are money market accounts at a financial institution (i.e., bank, savings and loan, credit union). These accounts are demand accounts (i.e., checking accounts) with restricted transaction activity.

A passbook savings account is similar to an inactive deposit but without a fixed term. The interest rate is much lower than CD's, but the savings account allows flexibility. Funds can be deposited and withdrawn according to daily cash needs.

DURATION is a measure of the sensitivity of a security or portfolio's market value with respect to changes in interest rates. For example, a portfolio with a duration of 2.5 will rise in value by 2.5% for every 100 basis point (1 percent) decline in rates, and fall in value by 2.5% for every 100 basis point increase in rates. Thus, the greater the duration, the greater the price sensitivity or market risk of the portfolio.

EFFECTIVE DURATION refines the traditional measure of duration to incorporate the price sensitivity of securities with imbedded call options, such as callable agencies and mortgage-backed securities.

FEDERAL AGENCY INSTRUMENTS are issued by U.S. Government Agencies or Government Sponsored Enterprises (GSE). Although they were created or sponsored by the U.S. Government, most Agencies and GSEs are not guaranteed by the United States Government. Examples of these securities are notes, bonds, bills and discount notes issued by Fannie Mae (FNMA), Freddie Mac (FHLMC), the Federal Home Loan Bank system (FHLB), and Federal Farm Credit Bank (FFCB). The Agency market is a very large and liquid market, with billions traded every day.

ISSUER means any corporation, governmental unit or financial institution that borrows money through the sale of securities.

LIQUIDITY refers to the ease and speed with which an asset can be converted into cash without loss of value. In the money market, a security is said to be liquid if the spread between the bid and asked price is narrow and reasonably sized trades can be done at those quotes. U.S. Treasury bills are very liquid.

LOCAL AGENCY INVESTMENT FUND (LAIF) is a special fund in the State Treasury that local agencies may use to deposit funds for investment. There is no minimum investment period and the minimum transaction is \$5,000, in multiples of \$1,000 above that, with a maximum of \$50 million for any agency. It offers high liquidity because deposits can be converted to cash in twenty-four hours and no interest is lost. All interest is distributed to those agencies participating on a proportionate share determined by the amounts deposited and the length of time they are deposited. Interest is paid quarterly via direct deposit to the LAIF account. The State keeps an amount for reasonable costs of making the investments, not to exceed one-quarter of one per cent of the earnings.

MATURITY is the date upon which the principal or stated value of an investment becomes due and payable.

MEMBER refers to a governmental entity that is a signatory to the Joint Powers Agreement establishing the California Joint Powers Insurance Authority.

MEDIUM TERM CORPORATE NOTES are debt obligations issued by corporations and banks, usually in the form of unsecured promissory notes. These are negotiable instruments that can be bought and sold in a large and active secondary market. For the purposes of California Government Code, the term "Medium Term" refers to a maximum remaining maturity of five years or less. They can be issued with fixed or floating-rate coupons, and with or without early call features, although the vast majority are fixed-rate and non-callable. Corporate notes have greater risk than Treasuries or Agencies because they rely on the ability of the issuer to make payment of principal and interest. Corporate notes can be rated by one or more Nationally Recognized Statistical Rating Organizations (NRSRO), with ratings of AAA, AA+, AA, AA-, etc. or their equivalent. Frequent issuers of corporate notes are General Electric Capital Corp., Bank of America, J.P. Morgan, AT&T, Wal-Mart and IBM.

MONEY MARKET FUNDS are referred to in the Government Code, Section 53601(1)(2), as "shares of beneficial interest issued by diversified management companies."

Money market funds strive to maintain a stable net asset value (NAV) per share of \$1.00. Money market funds must adhere to Rule 2a-7 of the SEC that regulates the liquidity and credit minimums and sector allocation limitations to protect the investors in money market funds. These funds invest primarily in money market securities with final maturities of 397 days or less to maintain a weighted average maturity of 60 days or less.

NEGOTIABLE is the term used to designate a security, the title to which is transferable by delivery.

PORTFOLIO is the term used to describe the collection or group of securities owned by an investor.

PRINCIPAL describes the original cost of a security. It represents the amount of capital or money that the investor pays for the investment.

REPURCHASE AGREEMENTS are short-term investment transactions. Banks buy temporarily idle funds from a customer by selling him U.S. Government or other securities with a contractual agreement to repurchase the same securities on a future date at an agreed upon interest rate. Repurchase Agreements are typically for one to ten days in maturity. The customer receives interest from the bank. The interest rate reflects both the prevailing demand for Federal Funds and the maturity of the Repo. Repurchase Agreements must be collateralized.

U.S. TREASURY ISSUES are direct obligations of the United States Government. They are highly liquid and are considered the safest investment security. U.S. Treasury issues include:

Treasury Bills are non-interest-bearing discount securities issued by the U.S. Treasury to finance the national debt. Bills are currently issued in one, three, six, and twelve month maturities.

Treasury Notes have original maturities of one to ten years.

Treasury Bonds have original maturities of greater than 10 years.

Treasury Inflation Protected Securities (TIPS) pay principal and interest based on changes in the rate of inflation as measured by the CPI-U index.