Council Meeting
December 18, 2012

Honorable Mayor and Members
Of the Torrance City Council
City Hall
Torrance, California

Members of the Council:

SUBJECT: CITY TREASURER – ADOPT RESOLUTION ESTABLISHING THE 2013 STATEMENT OF INVESTMENT POLICY.

RECOMMENDATION

Recommendation of the City Treasurer that City Council adopt a **RESOLUTION** establishing the Statement of Investment Policy for 2013 and recommendation of City Manager to modify approval of the policy for 3 months with a review by Council of the Investment Committee elements and procedures.

FUNDING

Not Applicable

BACKGROUND AND ANALYSIS

At the Council meeting of February 4, 1992, the City Council adopted Resolution 92-28, establishing the authority of the City Treasurer to invest and reinvest surplus City funds in accordance with certain guidelines.

As specified in the guidelines, prior to submittal of the Statement of Investment Policy to the City Council, the Investment Policy must be reviewed and evaluated for its completeness and relevance by the Investment Advisory Committee. Also, the City Attorney's office reviews Policy for compliance with all governing laws and regulations.

On December 10, 2012, the City Treasurer presented the 2013 Statement of Investment Policy to the Investment Advisory Committee with the following recommended changes:

1) Any reference to Year 2012 was replaced with 2013.
2) Removed section 24 as this regulatory requirement sunset from the California government code.
3) The addition of Appendix C which includes the sections of California government code reference in our Investment Policy.
4) Accept and approve our list of authorized financial institutions.
    a. Annually, financial institutions are encouraged to participate in our broker questionnaire process.

b. Financial institutions are required to be well versed with our investment policy and have extensive experience working with municipalities. Financial institutions are ranked by category and the top six are selected. A "Primary Dealer" is a firm to and from which the New York Federal Reserve directly buys Treasury securities. That is, primary dealers help the Federal Reserve control the money supply by underwriting Treasury securities and placing them with investors. Primary dealers tend to be well-respected and well-known financial institutions. Merrill Lynch and Citigroup are examples of primary `dealers. A secondary dealer is someone that deals outside of the primary market. The Public Depository for the City's funds is selected via the RFP process and other entities are selected because of their community presence and community involvement. No changes were made to our existing authorized financial Institution list as all brokers did resubmit their questionnaire packages and we continue to be satisfied with the services they provide.
c. The custodians are selected based on best pricing practices. "Custodian" shall be defined as a third-party bank trust department that acts as an agent for the City under the terms of a custody agreement executed between both parties.
d. The Trustee is selected as part of the bond issuance process. "Trustee" shall be defined as an entity responsible for managing the financial property of an institution.

The Committee was in concurrence with the recommendation and directed the City Treasurer to bring forth the Policy to the City Council for approval and adoption.

Respectfully submitted,

Dana Cortez
City Treasurer

NOTED:

Eric Tsao
Investment Committee Member

John Fellows
Investment Committee Member

LeRoy J. Jackson
Investment Committee Member

ATTACHEMENTS:
(1) Resolution

City Manager's Note: The City Manager and City Attorney believe it would be advisable to review the original Resolution 92-28 and the establishment of the Advisory Committee with its guidelines. The purpose of the review would be to define the role and responsibility of the Committee with regards to its monthly review of investments and its annual responsibility regarding the investment strategy and report. It is requested that this be assigned to the Finance and Governmental Operations Committee of the Council for its consideration and recommendation.

RESOLUTION NO. 2012-___

A RESOLUTION BY THE TORRANCE CITY COUNCIL ESTABLISHING THE STATEMENT OF INVESTMENT POLICY 2013 IN ACCORDANCE WITH CERTAIN GUIDELINES

WHEREAS, the California State Government Code Sections 53600 (the "Code") et seq. vest the City Council with the authority to invest City Surplus Funds; and

WHEREAS, the code also provides the Council with the authority to delegate its investments duties to the City Treasurer; and

WHEREAS, the City Treasurer and the City Council of the City of Torrance have determined the proper investment portfolio for 2013; and

WHEREAS, the Statement of Investment Policy (Exhibit A) is intended to establish the policies for prudent investments of the City's funds;

NOW, THEREFORE, BE IT RESOLVED THAT THE CITY COUNCIL OF THE CITY OF TORRANCE HEREBY RESOLVES THE FOLLOWING:

1 All monies entrusted to the City Treasurer will be pooled in a diversified portfolio, and the City Treasurer and staff will observe, review and react to changing conditions that affect the Pool;

2. The investment philosophy shall be made in the context of the "prudent investor rule";

3. The objectives of the Policy shall be SAFETY, LIQUIDITY AND RETURN;

4. The City shall have an independent advisory committee consisting of the City Manager, Finance Director, City Attorney, City Treasurer and Deputy City Treasurer or their appointed designee that meets monthly and reviews investment and strategy areas;

5. The authorized investments, and their maximum limits, shall be noted in the attached Statement of Investment Policy;

6. The listing of qualified dealers and institutions shall be clearly outlined in the Policy;

7. The safekeeping of securities, investment controls, discussion of policy review and indemnification of investment officials shall be included in the Policy;

8. The Policy is approved in the form attached as Exhibit A.

Introduced, approved and adopted this 18 day of December 2012.

_____
Mayor Frank Scotto

APPROVED AS TO FORM:
JOHN FELLOWS III, City Attorney

by _____
John Fellows III, City Attorney

ATTEST:

_____
Sue Herbers, CMC
City Clerk

Exhibit A

CITY OF TORRANCE

STATEMENT OF INVESTMENT POLICY

2013

PREPARED BY THE CITY TREASURER'S OFFICE

Dana Cortez
City Treasurer

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1.0 Policy

It is the policy of the:

City of Torrance

(Hereafter referred to collectively as the "City") to predicate their investment policies, procedures, and practices upon the following three principles:

(1) Compliance with all Federal, State and local laws governing the investment of monies under the control of the City Treasurer.
(2) Protection of the principal monies entrusted to the City.
(3) Generate a market rate of return within the parameters of this Statement of Investment Policy.

For the purposes of this policy, "Investment Officers" shall be defined as the City Treasurer and the Deputy City Treasurer.

This policy shall be effective 1 January 2013 through 31 December 2013 unless amended.

2.0 Scope

This policy shall apply to all funds that are under the City Treasurer's control including but not limited to, the general fund; special revenue funds; debt service funds; capital project funds; enterprise funds; and trust and agency funds. These funds are accounted for in the City's Comprehensive Annual Financial Report. The City's Deferred Compensation Plan shall be excluded from the scope of this policy.

Except for cash in certain restricted and special funds, the City will consolidate cash and reserve balances from all funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

3.0 Prudence

Pursuant to California Government Code Section 53600.3, hereto attached as Appendix C.

Investment Officers, as trustees of public monies, shall adhere to the "prudent investor" standard when managing the City's investment portfolios. They shall invest "...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."

Investment Officers who follow the provisions of this policy and who exercise due diligence shall be relieved of personal responsibility for a security's credit risk or market price risk: provided, that they report substantial deviations from expectations to the City Manager and the Investment Advisory Committee in a timely manner, and that they take appropriate action to control adverse developments.

"Substantial deviations" shall be defined as either a decline of 10 percent or more in the market value of a security due to issuer default or a credit risk downgrade; or the sale of a security prior to maturity at 10 percent or more below its acquisition cost.

4.0 Objectives

The City's investment objectives, in order of priority, shall be:

Safety. Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate credit risk and market risk.

Credit Risk, the risk of loss due to the failure of the issuer of the security, shall be mitigated by investing in only the highest quality securities; by diversifying investments; and by pre-qualifying broker-dealers and public depositories; and

Market Risk, the risk of loss due to a decline in bond prices because of rising market interest rates, shall be mitigated by structuring the portfolio so that issues mature concurrently with the City's anticipated cash requirements, thereby eliminating the need to sell securities prematurely on the open market.

Liquidity. An adequate percentage of the portfolio shall be maintained in liquid, short-term securities that can be converted to cash, if necessary, to meet disbursement requirements. Since all cash requirements cannot be anticipated, the portfolio should consist largely of securities with active secondary markets.

Yield. Yield shall be considered only after the basic requirements of safety and liquidity have been met. Whenever possible and in a manner consistent with the objectives of safety and liquidity, a yield higher than the market rate of return shall be sought.

5.0 Delegation of Authority

California Government Code Sections §53607, hereto attached as Appendix C,

authorize the legislative body of a local agency to invest, deposit, and provide for the safekeeping of the local agency's funds or to delegate those responsibilities to the treasurer of the local agency.

Charter Provision Section 630 and subsequent resolution delegates the authority to invest, deposit, and provide for the safekeeping of City public monies to the City Treasurer. The City Treasurer and the Deputy City Treasurer shall have exclusive authority to buy and sell securities on behalf of the City. The Deputy City Treasurer may execute investment transaction on behalf of the City only if the City Treasurer has previously authorized the transactions.

6.0 Investment Procedures

The City Treasurer shall establish written procedures for the operation of the City's investment program that are consistent with the provisions of this policy. The procedures shall include reference to safekeeping, PSA repurchase agreements, banking service contracts, and collateral/depository agreements. 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 under the procedures that the City Treasurer establishes.

7.0 Ethics and Conflicts of Interest

Investment Officers involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Investment Officers shall disclose any material interest in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Investment Officers shall refrain from undertaking personal investment transactions with the same individual with which business is conducted on behalf of the City of Torrance.

8.0 Authorized Financial Institutions, Depositories, and Broker/Dealers

The City Treasurer shall maintain a list of financial institutions and depositories authorized to provide investment services. In addition, a list will be maintained of approved security broker/dealers selected by creditworthiness (e.g., a minimum

capital requirement of $10,000,000 and at least five years of operation). These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) rule 15C3-1 (uniform net capital rule).

All financial institutions and broker/dealers who desire to become qualified for investment transactions must supply the following as appropriate:

8.0.1 Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines.

8.0.2 Proof of National Association of Securities Dealers (NASD) certification (not applicable to Certificate of Deposit counterparties).

8.0.3 Proof of state registration

8.0.4 Completed broker/dealer questionnaire (not applicable to Certificate of Deposit counterparties)

8.0.5 Certification of having read and understood and agreeing to comply with the City of Torrance investment policy.

8.0.6 Evidence of adequate insurance coverage.

The number of primary and regional broker/dealers on the authorized list shall not exceed a combined total of six at any single time. The City shall accept and review new broker/dealer applications only when there is an immediate need to fill a vacancy on the authorized list.

9.0 Authorized and Suitable Investments

The City Treasurer shall be authorized to invest in the following financial instruments pursuant to California Government Code Section 53601 et seq. hereto attached as Appendix C.

The City's investment policy is more conservative than state law.

No.	Type of Investment	% Authorized	Other Restrictions
1.	United States Treasury bills, notes, bonds, or certificates of indebtedness, or those for which the full faith and credit of the United States are pledged for the payment of principal and interest.	100%	Maximum maturity: 5 years
2.	Federal Agency or United States government-sponsored enterprise ("GSE") obligations, participation, or other instruments, including those issued by or fully guaranteed as to principal and interest by Federal Agencies or by GSE.	75%	Maximum maturity: 5 years No more than 30% of the portfolio may be invested in any one issuer (excluding the Proceeds of tax-exempt bonds).
3.	Bonds issued by the local agency, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency or by a department, board, agency, or authority of the local agency.	10%	Maximum maturity: Greater than 5 years as approved by City Council
4.	Banker's Acceptances ("BA") issued by commercial banks.	20%	Rated "A-1 or higher by S&P or "P-1" by Moody's. Maximum maturity: 180 days No more than 5% of the portfolio may be invested in any one BA issuer.
5.	Negotiable Certificates of Deposit ("NCD") issued by a nationally- or state-chartered bank, a savings association, a federal association, or by a state-licensed branch of a foreign bank.	20%	Long-term debt rated "AA-" or higher by S&P or by Moody's. Maximum maturity: 5 years
6.	Time Certificates of Deposit ("TCD") issued by qualified public depositories or a certificate of deposit placement service	10%	TCDs exceeding $ $250,000 must be collateralized. TCDs must be centralized at one location for each bank or S&L.

			Maximum maturity: 1 year If TCD is uncollateralized, than no more than $245,000 may be invested.
7.	Repurchase Agreements ("RP") sold by authorized brokers.	10%	Maximum maturity: 30 days Collateral must be United States Treasury, Federal Agency, or GSE obligations. Zero coupon and stripped coupon instruments are not acceptable as collateral. Collateral must be valued at 102% of cost and adjusted weekly. City's custodian must hold collateral. An authorized broker must file a Public Securities Association (PSA) Master Repurchase Agreement with the City Treasurer.
8.	Commercial Paper ("CP") issued by general corporations organized and operating in the United States with assets exceeding $500 million.	15%	Rated "A-1" by S&P or "P-1" by Moody's. Maximum maturity: 270 days No more than 10% of the outstanding CP of any one issuer may be purchased.
9.	Medium-Term Notes issued by corporations organized and operating in the United States, or by depository institutions operating in the United States and licensed by the United States or by any state.	20%	Rated "AA-"or higher by S&P and by Moody's. No more than 5% of the portfolio may be invested in any one issuer.

10.	State of California Local Agency Investment Fund ("LAIF") that is Managed by the State Treasurer's Office.	See note	$50 million limit per account with LAIF, except for bond trustee accounts (no limit).

10.0 Prohibited Investments

Investment Officers shall not invest public monies in financial instruments that are not authorized under this policy.

Prohibited investments shall include, but shall not be limited to, equity securities, bond mutual funds, reverse repurchase agreements, and derivative contracts (forwards, futures, and options). Securities with high price volatility or limited marketability and common stocks and share of beneficial interest.

Investment Officers shall not engage in securities lending, short selling, or other hedging strategies.

LAIF shall be exempt from the prohibitions on derivative contracts, derivative securities, reverse repurchase agreements, securities lending, short selling, and other hedging strategies.

11.0 Investment Pools/Money Market Mutual Funds

A thorough investigation of the pool/fund is required prior to investing, and on a continual basis. All State or County Personnel that manage an investment pool or Investment Advisors that offer money market mutual funds must supply the following as appropriate:

11.0.1 A description of eligible investment securities, and a written statement of investment policy and objectives.

11.0.2 A description of interest calculations and how it is distributed, and how gains and losses are treated.

11.0.3 A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced and the program audited.

11.0.4 A description of who may invest in the program, how often, what size deposit and withdrawal are allowed.

11.0.5 A schedule for receiving statements and portfolio listings.

11.0.6 Verification on whether or not reserves or retained earnings are utilized by the pool/fund.

11.0.7 A fee schedule, and when and how it is assessed.

11.0.8 An eligibility of the pool/fund for bond proceeds and whether it will accept such proceeds.

12.0 Collateralization

Investment Officers shall ensure that all demand deposits and all non-negotiable certificates of deposit that exceed $250,000 shall be fully collateralized with securities authorized under state law and under this Investment Policy. Collateral may be waived for the first $250,000 since this will be insured by the Federal Deposit Insurance Corporation. Any amount on deposit over $250,000 plus accrued interest, however, shall be collateralized with United States Treasury or federal agency securities at a constant margin ratio of 110 percent or with mortgage-backed collateral at a constant margin ratio of 150 percent.

Collateralized investments and demand deposits may require substitution of collateral. The City Treasurer must approve all requests from financial institutions for substitution of collateral that involve interchanging classes of security.

An independent third party with which the City has a current custodial agreement shall always hold the collateral. The independent third party shall provide the City Treasurer with a safekeeping receipt that he shall retain.

13.0 Safekeeping and Custody

Investment Officers shall conduct all security transactions on a delivery-versus payment ("DVP") or on a receipt-versus-payment ("RVP") basis. A third-party bank trust department ("Custodian") that acts as an agent for the City under the terms of a custody agreement executed between both parties shall hold the securities.

The only exception to the foregoing shall be securities purchases made

with: Local government investment pools.

Money Market mutual funds.

No securities broker or investment advisor shall have access to City monies, accounts, or investments. Any transfer of monies to or through a securities broker must have the City Treasurer's prior written approval. If the City Treasurer is unavailable, then the Deputy City Treasurer must authorize the transfer, in writing.

The City shall require Broker Trade Confirmations for all trades. Investment Officers shall review these confirmations immediately upon receipt, for conformity with the terms of the City's Trade Sheets.

14.0 Diversification

Investment Officers shall diversify the City's investment portfolios by security type and by issuer, except for bond reserve monies; bond escrow monies, and any other monies that the City Council determines.

15.0 Maximum Maturities

Investment Officers shall not invest in securities with maturities exceeding five years. The City Council, however, may approve longer maturities for the investment of bond reserve, bond escrow, and other funds if the maturities of such investments are expected to coincide with the expected use of the funds.

16.0 Portfolio Re-Balancing

If portfolio percentage constraints are violated due to a temporary imbalance in the portfolio, then Investment Officers shall hold the affected securities to maturity in order to avoid capital losses.

If no capital losses would be realized upon sale, however, than Investment Officers shall consider rebalancing the portfolio after evaluating the expected length of time that it will be imbalance.

Portfolio percentage limits are in place in order to ensure diversification of the City investment portfolio; a small temporary imbalance will not significantly impair that strategy.

17.0 Credit Downgrading

This policy sets forth minimum credit risk criteria for each type of security. This credit risk criteria applies to the initial purchase of a security; it does not automatically force the sale of a security if its credit risk ratings fall below policy limits.

If a security is downgraded below the minimum credit risk criteria specified in this policy, then Investment Officers shall evaluate the downgrade on a case-by case basis in order to determine whether the security should be held or sold.

The City Treasurer shall inform the Investment Advisory Committee at its next monthly meeting of the credit downgrade and of the Investment Officers decision to hold or sell the downgraded security. Investment Officers shall review the credit standing of all securities in the City's investment portfolio annually, at a minimum.

18.0 Bond Proceeds

The City Treasurer shall segregate the gross proceeds of tax-exempt bonds from the City general pool and shall keep them in a separate pool. They shall be invested pursuant to the instructions in the respective bond indentures of trust. If the bond indenture authorizes investments that conflict with this policy, then such investments shall be made in accordance with the bond indenture. All securities shall be held in third-party safekeeping with the bond trustee ("Trustee") and all DVP and RVP rules shall apply. The Trustee shall be represented on the authorized list (see page 15).

Investment Officers shall use competitive offerings, whenever practical, for all investment transactions that involve the gross proceeds of tax-exempt bonds. The City shall obtain a minimum of three competitive offers. Any exceptions to this policy shall be documented and shall be reported to the Investment Advisory Committee at its next monthly meeting.

The City is required under the "U.S. Tax Reform Act of 1986" to perform annual arbitrage calculations and to rebate excess earnings to the United States Treasury from the investment of the gross proceeds of tax-exempt bonds that were sold after the effective date of that law. The City Treasurer may contract with qualified outside financial consultants to provide the necessary technical expertise that is required to comply with this law.

19.0 Internal Controls

The City Treasurer shall ensure that all investment transactions comply with the City's policy, and shall establish internal controls that are designed to prevent losses due to fraud, negligence, and third-party misrepresentation.

Internal controls deemed most important shall include: avoidance of collusion; separations of duties and administrative controls; separating transaction authority from accounting and record keeping; custodial safekeeping; clear delegation of authority; management approval and review of investment transactions; specific limitations regarding securities losses and remedial action; written confirmation of telephone transactions; documentation of investment transactions and strategies; and monitoring of results.

The City Treasurer shall establish a process of independent review by an external audit firm of the City's investment program every three years. The

external auditor shall review the program's management in terms of compliance with the internal controls that are specified in the City's Treasury Policies and Procedures Manual.

An Investment Advisory Committee consisting of City officials shall be responsible for reviewing the City investment reports, transactions, policies, procedures, and strategies, on a monthly basis. The City Manager; City Finance Director; City Attorney; City Treasurer; and Deputy City Treasurer; or their designees shall sit on this committee.

20.0 Performance Standards

The investment portfolio shall be designed with the objective of obtaining a rate of return throughout budgetary and economic cycles, commensurate with investment risk constraints and cash flow needs.

21.0 Market Yield (Benchmark)

The City's investment portfolio, shall be passively managed with portfolio securities being held to maturity. On selected occasions, however, the City's portfolio may be actively managed for purposes of improving portfolio risk structure, liquidity, or yield in response to market conditions or to meet City requirements.

The City shall adopt a benchmark that approximates the composition and weighted-average maturity of the City portfolio, in order to measure whether or not the City's portfolio yields are matching or surpassing the market yield.

22.0 Reporting

The City Treasurer shall provide the Investment Advisory Committee and the City Council with a monthly investment report within 45 days of each month-end or at the next scheduled City Council meeting following an Investment Committee meeting.

Pursuant to Government Account Standards Board ("GASB") Statement Number 40, as amended March 2003, the monthly investment report shall:

22.0.1 Organize individual securities by investment type (e.g., U.S. Treasuries, corporate bonds, commercial paper, etc.). Dissimilar investments (e.g., U.S. Treasury bills and Treasury strips) should not be aggregated.

22.0.2 List credit risk ratings for each security, money market fund, or investment pool from at least two nationally recognized statistical rating organizations. If the security, money market fund, or investment pool has no rating, then it shall be shown as "unrated".

22.0.3 Disclose the amount of individual securities and corresponding issuers if they exceed five percent of net plan assets, except for securities

guaranteed by the U.S. Government, money market funds, and external investment pool.

22.0.4 Use the specific identification method to reflect interest-rate risk by investment type and amount.

This report shall include a complete portfolio inventory with details on issue, par value, book value, coupon/rate, original settlement date of purchase, final maturity date, CUSIP number, average weighted yield, average days to

maturity, and market value (including source of market valuation). The report will include a statement on compliance or noncompliance with the City's Investment Policy and a statement on whether there are or are not sufficient funds to meet the City's anticipated cash requirements for the next six months.

23.0 Investment Policy Adoption

The City Treasurer shall submit a Statement of Investment Policy to the Investment Advisory Committee and the City Council annually for their review and adoption.

24.0 Regulatory Submission

Appendix A: List of Authorized Financial Institutions

The City Treasurer's Office is authorized to transact investment and depository business with the following financial institutions. Investment and depository transactions with firms other than those appearing on this list are prohibited.

PRIMARY DEALERS
Morgan Stanley & Company, Inc.
Citigroup Global Market, Inc.

SECONDARY DEALERS

Wedbush Morgan Securities
Higgins Capital Management, Inc.
Great Pacific Securities
Vining Sparks

CORPORATE BOND - ISSUER
Toyota Motor Credit – Corporate Partner Direct Issues of Short-Term Paper

PUBLIC DEPOSITORIES
Bank of America
City National Bank

CUSTODIAN
Union Bank of California

TRUSTEE
Bank of New York Mellon

Appendix B: Glossary

AGENCIES. Federal agency and instrumentality securities.

ASKED. The price at which securities are offered. -

BANKER'S ACCEPTANCE ("BA"). A draft, bill, or exchange accepted by a bank or a trust company. Both the issuer and the accepting institution guarantee payment of the bill.

BID. The price offered by a buyer of securities (when one sells securities, one asks for a bid). See "Offer".

BROKER. A broker brings buyers and sellers together so that he can earn a commission.

CERTIFICATE OF DEPOSIT ("CD"). A time deposit with a specific maturity, as evidenced by a certificate. Large-denomination CDs 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.

COMPREHENSIVE ANNUAL FINANCIAL REPORT ("CAFR"). The official annual report for the City of Torrance. It included combined statements for each individual fund and account group, which prepared in conformity with GAAP. It also includes supporting schedules that are necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed statistical section.

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, which evidences interest due on a payment date.

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: (1) delivery versus payment (DVP); and (2) delivery versus receipt (DVR). DVP is delivery of securities with an exchange of money for the securities. DVR is delivery of securities with an exchanged of a signed receipt for the securities.

DERIVATIVES. (1) Financial instruments that are linked to, or derived from, the movement of one or more underlying indexes or securities, and may include a

leveraging factor; or (2) financial contracts based upon a notional amount whose value is derived from an underlying index or security (e.g., interest rates, foreign exchange rates, equities, or commodities).

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

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

DIVERSIFICATION. Dividing investment funds among a variety of securities that offer independent returns.

FEDERAL CREDIT AGENCIES. Agencies of the Federal Government that were established to supply credit to various classes of institutions and individuals (e.g., S&Ls, small business firms, students, farmers, farm cooperative, and exporters).

FEDERAL DEPOSIT INSURANCE CORPORATION ("FDIC"). A federal agency that insures bank deposits, currently up to $ 250,000.00 per deposit.

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 HOME LOAN BANKS ("FHLB"). Government-sponsored wholesale banks (currently 12 regional banks) which lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit unions, and insurance companies. The mission of the FHLBs is to liquefy the housing-related assets of its member, who must purchase stock in their District Bank.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (`FNMA"). FNMA, like GNMA, was charted under the Federal National Mortgage Association Act of 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. The corporation's purchases 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 assures and guarantees that all security holders will receive timely payment of principal and interest.

FEDERAL OPEN MARKET COMMITTEE ("FOMC"). The FOMC consist of seven members of the Federal Reserve Board and five of the 12 Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while- the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of government securities in the open market, as a means of influencing the volume of bank credit and money.

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.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATIONS ("GNMA" or "Ginnie Mae"). Securities that influence the volume of bank credit that is guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. The full faith and credit of the U.S. Government protect a security holder. Ginnie Mae securities are backed by the FHA, VA, or FMHM mortgages. The term "pass-through" is often used to describe Ginnie Maes.

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.

LOCAL AGENCY INVESTMENT FUND ("LAIF"). Monies from local governmental units may be remitted to the California State Treasurer for deposit in this special fund for the purpose of investment.

MARKET VALUE. The price at which a security is trading and could presumably be purchased or sold.

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

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

MONEY MARKET. The market in which sort-term debt instruments (e.g., bills, commercial paper, and banker's acceptances) are issued and traded.

OFFER. The price asked by a seller of securities (when one buys securities, one asks for an offer). See "Asked" and "Bid".

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.

PORTFOLIO. A collection of securities that an investor holds.

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

PRUDENT INVESTOR RULE. An investment standard. A fiduciary, such as a trustee, may invest in a security if it is one that would be bought by a prudent investor acting in like capacity, who is seeking reasonable income and preservation of capital.

QUALIFIED PUBLIC DEPOSITORIES. A financial institution that: (1) does not claim exemption from the payment of any sales, compensating use, or ad valorem taxes under the laws of this state; (2) has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability; and (3) has been approved by the Public Deposit Protections Commission to hold public deposits.

RATE OF RETURN. The yield obtainable on a security based on its purchase price or it current market price.

REPURCHASE AGREEMENT ("RP" OR "REPO"). A holder of securities sells them to an investor with an agreement to repurchase the securities 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 (increasing bank reserves).

SAFEKEEPING. A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

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

SECURITIES AND EXCHANGE COMMISSION. An agency created by Congress to administer securities legislation for the purpose of protecting investors in

securities transactions.

SEC RULE 15c3-1. See "Uniform Net Capital Rule".

STRUCTURED NOTES. Notes issued by instrumentality's (e.g., FHLB, FNMA, SLMA) and by corporations, that have imbedded options (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns) in their debt structure, The market performance of structured notes is affected by fluctuating interest rates; the volatility of imbedded options; and shifts in the yield curve.

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

TREASURY BONDS. Long-term, coupon-bearing U.S. Treasury securities that are issued as direct obligations of the U.S. Government, and having initial maturities of more than 10 years.

TREASURY NOTES. Medium-term, coupon-bearing U.S. Treasury securities that are issued as direct obligations of the U.S. Government, and having initial maturities of two to 10 years.

UNIFORM NET CAPITAL RULE. SEC requirement that member firms, as well as non-member broker-dealers in securities, maintain a maximum ratio of indebtedness-toliquid capital of 15 to one. Also called net capital rule and net capita ratio. Indebtedness covers all money that is owed to a firm, including margin loans and commitments to purchase securities (one reason that new public issues are spread among members of underwriting syndicates). Liquid capital includes cash and assets easily converted to cash.

YIELD. The rate of annual income return on an investment, expressed as a percentage. (a) INCOME YIELD is obtained by dividing the current dollar income by the current market price for the security. (b) NET YIELD OR YIELD TO MATURITY is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.

Appendix C: California Government Code Section Provision

California Government Code Section 53600.3,

Except as provided in subdivision (a) of Section 27000.3, all governing bodies of local agencies or persons authorized to make investment decisions on behalf of those local agencies investing public funds pursuant to this chapter 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 agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law.

California Government Code Sections §53607

The authority of the legislative body to invest or to reinvest funds of a local agency, or to sell or exchange securities so purchased, may be delegated for a one-year period by the legislative body to the treasurer of the local agency, who shall thereafter assume full responsibility for those transactions until the delegation of authority is revoked or expires, and shall make a monthly report of those transactions to the legislative body. Subject to review, the legislative body may renew the delegation of authority pursuant to this section each year.

and §53608 The legislative body of a local agency may deposit for safekeeping with a federal or state association (as defined by Section 5102 of the Financial Code), a trust company or a state or national bank located within this state or with the Federal Reserve Bank of San Francisco or any branch thereof within this state, or with any Federal Reserve bank or with any state or national bank located in any city designated as a reserve city by the Board of Governors of the Federal Reserve System, the bonds, notes, bills, debentures, obligations, certificates of indebtedness, warrants, or other evidences of indebtedness in which the money of the local agency is invested pursuant to this article or pursuant to other legislative authority. The local agency shall take from such financial institution a receipt for securities so deposited. The authority of the legislative body to deposit for safekeeping may be delegated by the legislative body to the treasurer of the local agency; the treasurer shall not be responsible for securities delivered to and receipted for by a financial institution until they are withdrawn from the financial institution by the treasurer.

Government Code Section 53601 et seq.

This section shall apply to a local agency that is a city, a district, or other local agency that does not pool money in deposits or investments with other local agencies, other than local agencies that have the same governing body. However, Section 53635 shall apply to all local agencies that pool money in deposits or investments with other local agencies that have separate governing bodies. The legislative body of a local agency having moneys in a sinking fund or moneys in its treasury not required for the immediate needs of the local agency may invest any portion of the moneys that it deems wise or expedient in those investments set forth below. A local agency purchasing or obtaining any securities prescribed in this section, in a negotiable, bearer, registered, or nonregistered format, shall require delivery of the securities to the local agency, including those purchased for the agency by financial advisers, consultants, or managers using the agency's funds, by book entry, physical delivery, or by third-party custodial agreement. The transfer of securities to the counterparty bank's customer book entry account may be used for book entry delivery.

For purposes of this section, "counterparty" means the other party to the transaction. A counterparty bank's trust department or separate safekeeping department may be used for the physical delivery of the security if the security is held in the name of the local agency. Where this section specifies a percentage limitation for a particular category of investment, that percentage is applicable only at the date of purchase. Where this section does not specify a limitation on the term or remaining maturity at the time of the investment, no investment shall be made in any security, other than a security underlying a repurchase or reverse repurchase agreement or securities lending agreement authorized by this section, that at the time of the investment has a term remaining to maturity in excess of five years, unless the legislative body has granted express authority to make that investment either specifically or as a part of an investment program approved by the legislative body no less than three months prior to the investment:

(a) Bonds issued by the local agency, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency or by a department, board, agency, or authority of the local agency.

(b) 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.

(c) Registered state warrants or treasury notes or bonds of this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency, or authority of the state.

(d) Registered treasury notes or bonds of any of the other 49 states in addition to California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the other 49 states, in addition to California.

(e) Bonds, notes, warrants, or other evidences of indebtedness of a local agency within this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency,

or authority of the local agency.

(f) 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.

(g) Bankers' acceptances otherwise known as bills of exchange or time drafts that are drawn on and accepted by a commercial bank. Purchases of bankers' acceptances shall not exceed 180 days' maturity or 40 percent of the agency's moneys that may be invested pursuant to this section. However, no more than 30 percent of the agency's moneys may be invested in the bankers' acceptances of any one commercial bank pursuant to this section.

This subdivision does not preclude a municipal utility district from investing moneys in its treasury in a manner authorized by the Municipal Utility District Act (Division 6 (commencing with Section 11501) of the Public Utilities Code).

(h) 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 (NRSRO). The entity that issues the commercial paper shall meet all of the following conditions in either paragraph (1) or (2):

(1) The entity meets the following criteria:

(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 an NRSRO.

(2) The entity meets the following criteria:

(A) Is organized within the United States as a special purpose corporation, trust, or limited liability company.

(B) Has program wide credit enhancements including, but not limited
to, overcollateralization, letters of credit, or a surety bond.

(C) Has commercial paper that is rated "A-1" or higher, or the equivalent, by an NRSRO.

Eligible commercial paper shall have a maximum maturity of 270 days or less. Local agencies, other than counties or a city and county, may invest no more than 25 percent of their moneys in eligible commercial paper. Local agencies, other than counties or a city and county, may purchase no more than 10 percent of the outstanding commercial paper of any single issuer. Counties or a city and county may invest in commercial paper pursuant to the concentration limits in subdivision (a) of Section 53635.

(i) Negotiable certificates of deposit issued by a nationally or state-chartered bank, a savings association or a federal association (as defined by Section 5102 of the Financial Code), a state or federal credit union, or by a federally licensed or state-licensed branch of a foreign bank. Purchases of negotiable certificates of deposit shall not exceed 30 percent of the agency's moneys that may be invested pursuant to this section. For purposes of this section, negotiable certificates of deposit do not come within Article 2 (commencing with Section 53630), except that the amount so invested

shall be subject to the limitations of Section 53638. The legislative body of a local agency and the treasurer or other official of the local agency having legal custody of the moneys are prohibited from investing local agency funds, or funds in the custody of the local agency, in negotiable certificates of deposit issued by a state or federal credit union if a member of the legislative body of the local agency, or a person with investment decision making authority in the administrative office manager's office, budget office, auditor-controller's office, or treasurer's office of the local agency also serves on the board of directors, or any committee appointed by the board of directors, or the credit committee or the supervisory committee of the state or federal credit union issuing the negotiable certificates of deposit.

(j) (1) Investments in repurchase agreements or reverse repurchase agreements or securities lending agreements of securities authorized by this section, as long as the agreements are subject to this subdivision, including the delivery requirements specified in this section.

(2) Investments in repurchase agreements may be made, on an investment authorized in this section, when the term of the agreement does not exceed one year. The market value of securities that underlie a repurchase agreement shall be valued at 102 percent or greater of the funds borrowed against those securities and the value shall be adjusted no less than quarterly. Since the market value of the underlying securities is subject to daily market fluctuations, the investments in repurchase agreements shall be in compliance if the value of the underlying securities is brought back up to 102 percent no later than the next business day.

(3) Reverse repurchase agreements or securities lending agreements may be utilized only when all of the following conditions are met:

(A) The security to be sold using a reverse repurchase agreement or securities lending agreement has been owned and fully paid for by the local agency for a minimum of 30 days prior to sale.

(B) The total of all reverse repurchase agreements and securities lending agreements on investments owned by the local agency does not exceed 20 percent of the base value of the portfolio.

(C) The agreement does not exceed a term of 92 days, unless the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity date of the same security.

(D) Funds obtained or funds within the pool of an equivalent amount to that obtained from selling a security to a counterparty using a reverse repurchase agreement or securities lending agreement shall not be used to purchase another security with a maturity longer than 92 days from the initial settlement date of the reverse repurchase agreement or securities lending agreement, unless the reverse repurchase agreement or securities lending agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity date of the same security.

(4) (A) Investments in reverse repurchase agreements, securities lending agreements, or similar investments in which the local agency

sells securities prior to purchase with a simultaneous agreement to repurchase the security may be made only upon prior approval of the governing body of the local agency and shall be made only with primary dealers of the Federal Reserve Bank of New York or with a nationally or state-chartered bank that has or has had a significant banking relationship with a local agency.

(B) For purposes of this chapter, "significant banking relationship" means any of the following activities of a bank:

(i) Involvement in the creation, sale, purchase, or retirement of a local agency's bonds, warrants, notes, or other evidence of indebtedness.

(ii) Financing of a local agency's activities.

(iii) Acceptance of a local agency's securities or funds as deposits.

(5) (A) "Repurchase agreement" means a purchase of securities by the local agency pursuant to an agreement by which the counterparty seller will repurchase the securities on or before a specified date and for a specified amount and the counterparty will deliver the underlying securities to the local agency by book entry, physical delivery, or by third-party custodial agreement. The transfer of underlying securities to the counterparty bank's customer book-entry account may be used for book-entry delivery.

(B) "Securities," for purposes of repurchase under this subdivision, means securities of the same issuer, description, issue date, and maturity.

(C) "Reverse repurchase agreement" means a sale of securities by the local agency pursuant to an agreement by which the local agency will repurchase the securities on or before a specified date and includes other comparable agreements.

(D) "Securities lending agreement" means an agreement under which a local agency agrees to transfer securities to a borrower who, in turn, agrees to provide collateral to the local agency. During the term of the agreement, both the securities and the collateral are held by a third party. At the conclusion of the agreement, the securities are transferred back to the local agency in return for the collateral.

(E) For purposes of this section, the base value of the local agency's pool portfolio shall be that dollar amount obtained by totaling all cash balances placed in the pool by all pool participants, excluding any amounts obtained through selling securities by way of reverse repurchase agreements, securities lending agreements, or other similar borrowing methods.

(F) For purposes of this section, the spread is the difference between the cost of funds obtained using the reverse repurchase agreement and the earnings obtained on the reinvestment of the funds.

(k) 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. Notes eligible for investment under this subdivision shall be rated "A" or better by an NRSRO. Purchases of medium-term notes shall not include other instruments authorized by this section and may not exceed 30 percent of the agency's moneys that may be invested pursuant to this section.

(l) (1) Shares of beneficial interest issued by diversified management companies that invest in the securities and obligations as authorized by subdivisions (a) to (k), inclusive, and subdivisions (m) to (o), inclusive, and that comply with the investment restrictions of this article and Article 2 (commencing with Section 53630). However, notwithstanding these restrictions, a counterparty to a reverse repurchase agreement or securities lending agreement is not required to be a primary dealer of the Federal Reserve Bank of New York if the company's board of directors finds that the counterparty presents a minimal risk of default, and the value of the securities underlying a repurchase agreement or securities lending agreement may be 100 percent of the sales price if the securities are marked to market daily.

(2) 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 et seq.).

(3) If investment is in shares issued pursuant to paragraph (1), the company shall have met either of the following criteria:

(A) Attained the highest ranking or the highest letter and numerical rating provided by not less than two NRSROs.

(B) 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 subdivisions (a) to (k), inclusive, and subdivisions (m) to (o), inclusive, and with assets under management in excess of five hundred million dollars ($500,000,000).

(4) If investment is in shares issued pursuant to paragraph (2), the company shall have met either of the following criteria:

(A) Attained the highest ranking or the highest letter and numerical rating provided by not less than two NRSROs.

(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).

(5) The purchase price of shares of beneficial interest purchased pursuant to this subdivision shall not include commission that the companies may charge and shall not exceed 20 percent of the agency's moneys that may be invested pursuant to this section. However, no more than 10 percent of the agency's funds may be invested in shares of beneficial interest of any one mutual fund pursuant to paragraph (1).

(m) Moneys held by a trustee or fiscal agent and pledged to the payment or security of bonds or other indebtedness, or obligations under a lease, installment sale, or other agreement of a local agency, or certificates of participation in those bonds, indebtedness, or lease installment sale, or other agreements, may be invested in accordance with the statutory provisions governing the issuance of those bonds, indebtedness, or lease installment sale, or other agreement, or to the extent not inconsistent therewith or if there are no specific statutory provisions, in accordance with the ordinance, resolution, indenture, or agreement of the local agency providing for the issuance.

(n) Notes, bonds, or other obligations that are at all times

secured by a valid first priority security interest in securities of the types listed by Section 53651 as eligible securities for the purpose of securing local agency deposits having a market value at least equal to that required by Section 53652 for the purpose of securing local agency deposits. The securities serving as collateral shall be placed by delivery or book entry into the custody of a trust company or the trust department of a bank that is not affiliated with the issuer of the secured obligation, and the security interest shall be perfected in accordance with the requirements of the Uniform Commercial Code or federal regulations applicable to the types of securities in which the security interest is granted.

(o) A mortgage pass through security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable pass through certificate, or consumer receivable-backed bond of a maximum of five years' maturity. Securities eligible for investment under this subdivision shall be issued by an issuer having an "A" or higher rating for the issuer's debt as provided by an NRSRO and rated in a rating category of "AA" or its equivalent or better by an NRSRO. Purchase of securities authorized by this subdivision may not exceed 20 percent of the agency's surplus moneys that may be invested pursuant to this section.

(p) Shares of beneficial interest issued by a joint powers authority organized pursuant to Section 6509.7 that invests in the securities and obligations authorized in subdivisions (a) to (o), 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:

(1) The adviser is registered or exempt from registration with the Securities and Exchange Commission.

(2) The adviser has not less than five years of experience investing in the securities and obligations authorized in subdivisions (a) to (o), inclusive.

(3) The adviser has assets under management in excess of five hundred million dollars ($500,000,000).