



***INVESTMENT POLICY***

**CITY OF OTHELLO**  
**INVESTMENT POLICY**

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It is the policy of the City of Othello to invest public funds in a manner which will provide maximum security with the highest investment return while meeting the daily cash flow demands of the City of Othello and conforming to all state and local statutes governing the investment of public funds.

**1. Scope**

This investment policy applies to all financial assets of the City of Othello. These funds are accounted for in the City of Othello's **Annual Financial Report** and includes the following funds: General Fund, Special Revenue Funds, Capital Project Funds, Enterprise Funds, Trust and Agency Funds, and any new fund created by the legislative body, unless specifically exempted.

**1.1 Pooling of Funds**

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

**2. Objective**

The primary objectives, in priority order, of the City of Othello's investment activities shall be safety, liquidity and return on investment.

**Safety:** Safety of the principal is the foremost objective of the investment program. Investments of the City of Othello shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To obtain this objective, diversification is required in order that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio. Credit risk and interest rate risk will also be considered.

**Credit Risk:** The City of Othello will minimize credit risk, the risk of loss due to the financial failure of the security issuer or backer, by:

- Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisers with which the City will do business.
- Diversifying the investment portfolio so that potential losses on individual securities will be minimized.
- Actively monitoring the investment portfolio holdings for ratings changes, changing economic/market conditions, etc.

**Interest Rate Risk:** The City of Othello will minimize the risk that the market value of securities in the portfolio will fall due to changes in general interest rates, by:

- Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity.
- Structuring the investment portfolio for laddered maturities.

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**Liquidity:** The City of Othello's investment portfolio will remain sufficiently liquid to enable the City of Othello to meet all operating requirements that might be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands (static liquidity). Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity).

**Return on Investment:** The City of Othello's investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the City of Othello's investment risk constraints and the cash flow characteristics of the portfolio. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The majority of the portfolio is limited to highly rated/low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall not be sold prior to maturity with the following exceptions:

- A security with declining credit may be sold early to minimize loss of principal.
- A security swap would improve the quality, yield, or target duration in the portfolio.
- Liquidity needs of the portfolio require that the security be sold.

### **3. Standards of Care**

#### **3.1. Prudence**

The standard of prudence to be used by investment officials shall be the "**prudent person**" standard and shall be applied in the context of managing the overall portfolio. Investment officers acting in accordance with written procedures and the investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments.

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

#### **3.2. Ethics and Conflicts of Interest**

Officers and employees involved in the investment process shall refrain from personal business activity that may conflict with the proper execution of the investment program, or may impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the Finance Officer any material financial interests in financial institutions that conduct business within this jurisdiction, and they shall further disclose any personal financial/investment positions that could be related to the performance of the City of Othello's portfolio. Employees and officers shall subordinate their personal investment transactions to those of the City of Othello, particularly with regard to the timing of purchases and sales.

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**3.3. Delegation of Authority**

Authority to manage the City of Othello's investment program is derived from the following: Othello Municipal Code Chapter 2.11 Finance Officer, Section 2.11.030 Scope of Authority. Management responsibility for the investment program is hereby delegated to the Finance Officer, who shall establish written procedures for the operation of the investment program consistent with this investment policy.

Procedures should include reference to: safekeeping, repurchase agreements, wire transfer agreements, custody agreements, and investment related banking services contracts. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Finance Officer. The Finance Officer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

**4. Safekeeping and Custody**

**4.1. Authorized Financial Dealers and Institutions**

The Finance Officer will maintain a list of financial institutions authorized to provide investment services. In addition, a list will also be maintained of approved security broker/dealers selected by credit worthiness. These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule). No public deposits shall be made except in qualified public depositories as provided in RCW Chapter 39.58.

All brokers/dealers and financial institutions that desire to do business with the City of Othello must supply the Finance Officer with the following:

- Annual audited financial statements and quarterly financial statements.
- Proof of National Association of Securities Dealers (NASD) certification.
- Certification of having read the City's investment policy and agree to comply with the City's investment policy.
- Proof of state registration.
- Completed broker/dealer questionnaire.

The Finance Officer will conduct an annual review of the financial condition and registration of qualified bidders. A current audited financial statement is required to be on file for each financial institution and broker/dealer with whom the City of Othello invests. Investment purchases from any institution or broker/dealer, which does not satisfy the criteria established herein, must be approved in advance by the City Council

**4.2. Internal Controls**

The Finance Officer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft, or misuse. Accordingly, the Finance Officer shall establish an annual process of independent review by the State Auditor's Office or an external auditor, to assure compliance with policies and procedures. The internal controls shall address the following points:

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- Control of collusion.
- Separation of transaction authority from accounting and record keeping.
- Custodial safekeeping.
- Avoidance of physical delivery of securities whenever possible and address control requirements for physical delivery where necessary.
- Clear delegation of authority to subordinate staff members.
- Written confirmation of transactions for investments and wire transfers.
- Development of a wire transfer agreement with the lead bank and third-party custodian and implementation of the appropriate safeguards described in the GFOA Recommended Practice on "Electronic Transactions for State and Local Governments."
- Compliance and oversight with investment parameters including diversification and maximum maturities.

**4.3. Safekeeping and Custody**

All security transactions, including collateral for repurchase agreements, entered into by the City of Othello shall be conducted on a **delivery-versus-payment (DVP)** basis. Securities purchased by the entity will be delivered against payment and held in a custodial safekeeping account. The Treasurer will designate a third party custodian and safekeeping receipts will evidence all transactions.

**5. Authorized and Suitable Investments**

**5.1. Investment Types**

The City of Othello is empowered to invest in the following types of securities as described by RCW: 35.39.030, 39.59.020, 39.59.030, 43.84.080, and 43.250.040. These securities include:

- Investment deposits with qualified public depositories as defined in RCW Chapter 39.58
  - Certificates of Deposits.
  - Money Market Accounts (Municipal Investment Account, MIA).
- Washington State Local Government Investment Pool (LGIP).
- Any of the qualifying investments or securities as described in Appendix I

**5.2. Repurchase Agreements**

The City of Othello will not use Repurchase Agreements as investments.

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**6. Investment Parameters**

**6.1. Diversification**

The City of Othello will diversify its investments by security type and institution. The diversification can be with any of the allowable investments in Appendix I.

Diversification will include the following limits:

<u>Security Type</u>	<u>Portfolio Maximum with One Financial Institution</u>	<u>Portfolio Maximum</u>
Bankers Acceptance (BA)	10%	20%
Commercial Paper	10%	20%
Federal Agency Securities	35%	75%
Local Government		
Investment Pool	100%	100%
US Treasuries	100%	90%
Certificates of Deposits (CD)	35%	90%
Municipal Investors Account (US Bank)	100%	100%
State of Washington Bonds	10%	25%
Local Government Bonds	10%	25%

**6.2. Maximum Maturities**

To the extent possible, the City of Othello will attempt to match its investments with anticipated cash flow requirements. The weighted average maturity for the investment portfolio will not exceed two and one half (2 ½) years. The maximum maturity of investments other than investments for reserve funds will not exceed three (3) years. Reserve funds may be invested in securities with a maximum maturity of five (5) years if the maturity of such investments are made to coincide as nearly as practical with the expected use of the funds.

Because of inherent difficulties in accurately forecasting cash flow requirements, a portion of the portfolio will be continuously invested in the State of Washington's LGIP and/or US Bank's Municipal Investment Account to ensure that appropriate liquidity is maintained to meet ongoing obligations.

**6.3. Portfolio Management Diversification**

Should the City of Othello decide to contract the services of a Portfolio Manager, the manager will diversify the portfolio in accordance with the qualifying investments as described in Appendix I.

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**7. Reporting**

**7.1 Methods**

The Finance Officer shall provide City Council monthly reports. These reports shall provide an accurate and meaningful representation of the investment portfolio, its performance versus the established benchmark, and proof of compliance with the investment policy. Monthly reports will include:

- A listing of individual securities held at the end of the reporting period.
- Average life and final maturity of all investments listed.
- Coupon, discount or earnings rate.
- Par value, amortized book value and market value.
- Percentage of the portfolio in each investment category.

The report will be provided to the Mayor, all City Council Members and the City Administrator.

**7.2. Performance Standards**

The investment portfolio will be designed to obtain an average rate of return during budgetary and economic cycles, consistent with the investment objectives and cash flow needs. The City of Othello investment portfolio will be designed toward conservative and passive investments. The performance shall consider the City’s investment risk constraints and cash flow needs. Maturity of investment shall be kept relatively shorter in periods of rising interest rates and relatively longer in periods of declining interest rates. Given this investment strategy, the City will use as investment yield benchmarks, the Federal Fund rate and the Merrill Lynch 1-3 Year Government Index. The benchmarks will be the weighted-average of the follow:

<u><b>Portfolio Component</b></u>	<u><b>Benchmark</b></u>
LGIP or Other Money Market Funds	Federal Fund Rate
Certificate of Deposit or Other Securities	Merrill Lynch 1 – 3 Year Government Index

**8. Policy Considerations**

**8.1. Investment Policy Adoption**

The City of Othello’s investment policy shall be adopted by resolution of the City's Council. The policy shall be reviewed on an annual basis by the approving authority and the same authority must approve any modifications.

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**APPENDIX I  
ELIGIBLE INVESTMENTS**

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**ELIGIBLE INVESTMENTS FOR PUBLIC FUNDS**  
**IN THE STATE OF WASHINGTON**

**RCW 39.59.020:**

- Bonds of the State of Washington and any local government in the State of Washington, which bonds have at the time of investment one of the three highest credit ratings of a nationally recognized rating agency.
- General obligation bonds of a state other than the State of Washington and general obligation bonds of a local government of a state other than the State of Washington, which bonds have at the time of investment one of the three highest credit ratings of a nationally recognized rating agency.
- Any investments authorized by law for the Treasurer of the State of Washington or any local government of the State of Washington other than a metropolitan municipal corporation but except as provided in chapter [39.58 RCW](#), such investments shall not include certificates of deposit of banks or bank branches not located in the State of Washington.

**RCW 35.39.030**

- Utility revenue bonds or warrants of any city or town in the State of Washington.
- Bonds or warrants of a local improvement district, which are within the protection of the local improvement guaranty fund law.
- In addition to any other investment authority granted by law, the State of Washington and local governments in the State of Washington are authorized to invest their funds and money in their custody or possession, eligible for investment and **subject to the arbitrage provisions of section 148 of the federal internal revenue code** or similar provision concerning the investment of state and local money and funds, in:
  - (1) Shares of mutual funds with portfolios consisting of only United States government bonds or United States government guaranteed bonds issued by federal agencies with average maturities less than four years, or bonds described in [RCW 39.59.020](#) (1) or (2), except that bonds otherwise described in [RCW 39.59.020](#) (1) or (2) shall have one of the four highest credit ratings of a nationally recognized rating agency;
  - (2) Shares of money market funds with portfolios consisting of only bonds of states and local governments or other issuers authorized by law for investment by local governments, which bonds have at the time of investment one of the two highest credit ratings of a nationally recognized rating agency; or,
  - (3) Shares of money market funds with portfolios consisting of securities otherwise authorized by law for investment by local governments.

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**RCW 43.84.080:**

- Treasury Bills
- Treasury Bonds
- Federal Home Loan Bank Bonds and/or Discount Notes
- Federal National Mortgage Association Bonds and/or Discount Notes
- Federal Farm Credit Banks Consolidated System-Wide Bonds and/or Discount Notes
- Federal Home Loan Mortgage Corporation Bonds and/or Discount Notes
- Government National Mortgage Association Bonds
- Student Loan Marketing Association Bonds and/or Discount Notes
- Small Business Administration Bonds
- Export-Import Bank Bonds
- Maritime Administration Bonds
- Obligations of any other government sponsored corporation whose obligations are or may become eligible as collateral for advances to member banks as determined by the board of governors of the Federal Reserve System.
- Bankers' acceptances purchased on the secondary market.
- Commercial paper: provided that the Treasurer shall adhere to the investment policies and procedures adopted by the State Investment Board.
- State, county, municipal, or school district bonds, or in warrants of taxing districts of the state. Such bonds and warrants shall be only those found to be within the limit of indebtedness prescribed by law for the taxing district issuing them and to be general obligations.
- Motor vehicle fund warrants when authorized by agreement between the State Treasurer and the department of transportation requiring repayment of invested funds from any moneys in the motor vehicle fund available for state highway construction.

**RCW 43.250.040**

- If authorized by statute, local ordinance, or resolution, a local government official or financial officer may place funds into the public funds investment account for investment and reinvestment by the state treasurer in those securities and investments set forth in [RCW 43.84.080](#) and [RCW 39.58](#).

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**TEXT OF RCW'S PERTAINING TO**  
**ELIGIBLE INVESTMENTS FOR PUBLIC FUNDS**

**RCW 39.59.020 Authorized Investments - Bonds, Warrants, and Other Investments**

In addition to any other investment authority granted by law and notwithstanding any provision of law to the contrary, the State of Washington, and local governments in the State of Washington are authorized to invest their funds and money in their custody or possession, eligible for investment, in:

- (1) Bonds of the State of Washington and any local government in the State of Washington, which bonds have at the time of investment one of the three highest credit ratings of a nationally recognized rating agency;
- (2) General obligation bonds of a state other than the State of Washington and general obligation bonds of a local government of a state other than the State of Washington, which bonds have at the time of investment one of the three highest credit ratings of a nationally recognized rating agency;
- (3) Subject to compliance with [RCW 39.56.030](#), registered warrants of a local government in the same county as the government making the investment; or
- (4) Any investment authorized by law for the Treasurer of the State of Washington or any local government of the State of Washington other than a metropolitan municipal corporation but except as provided in Chapter [39.58 RCW](#), such investments shall not include certificates of deposit of banks or bank branches not located in the State of Washington.

**RCW 39.59.030 Authorized Investments - Mutual Funds and Money Market Funds**

In addition to any other investment authority granted by law, the State of Washington and local governments in the State of Washington are authorized to invest their funds and money in their custody or possession, eligible for investment and subject to the arbitrage provisions of Section 148 of the federal internal revenue code or similar provisions concerning the investment of state and local money and funds in:

- (1) Shares of mutual funds with portfolios consisting of only United States Government bonds or United States Government guaranteed bonds issued by federal agencies with average maturities less than four years, or bonds described in [RCW 39.59.020](#) (1) or (2), except that bonds otherwise described in [RCW 39.59.020](#) (1) or (2) shall have one of the four highest credit ratings of a nationally recognized rating agency;
- (2) Shares of money market funds with portfolios consisting of only bonds of states and local governments or other issuers authorized by law for investment by local governments, which bonds have at the time of investment one of the two highest credit ratings of a nationally recognized rating agency; or
- (3) Shares of money market funds with portfolios consisting of securities otherwise authorized by law for investment by local governments.

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**RCW 43.84.080 Investment of Current State Funds**

Wherever there is in any fund or in cash balances in the state treasury more than sufficient to meet the current expenditures properly payable there from, the State treasurer may invest or reinvest such portion of such funds or balances as the State treasurer deems expedient in the following defined securities or classes of investments:

- (1) Certificates, notes, or bonds of the United States or any other obligations of the United States or its agencies or of any corporation wholly owned by the government of the United States;
- (2) In state, county, municipal, or school district bonds, or in warrants of taxing districts of the State. Such bonds and warrants shall be only those found to be within the limit of indebtedness prescribed by law for the taxing district issuing them and to be general obligations. The State treasurer may purchase such bonds or warrants directly from the taxing district or in the open market at such prices and upon such terms as it may determine, and may sell them at such times as it deems advisable;
- (3) In motor vehicle fund warrants when authorized by agreement between the State treasurer and the department of transportation requiring repayment of invested funds from any moneys in the motor vehicle fund available for state highway construction;
- (4) In federal home loan bank notes and bonds, federal land bank bonds and federal national mortgage association notes, debentures, and guaranteed certificates of participation, or the obligations of any other government sponsored corporation whose obligations are or may become eligible as collateral for advances to member banks as determined by the board of governors of the federal reserve system;
- (5) Bankers' acceptances purchased on the secondary market;
- (6) Negotiable certificates of deposit of any national or state commercial or mutual savings bank or savings and loan association doing business in the United States: Provided, That the treasurer shall adhere to the investment policies and procedures adopted by the State investment board;
- (7) Commercial Paper: Provided, that the treasurer shall adhere to the investment policies and procedures adopted by the State investment board.

**RCW 43.250.040 Authority of official to place funds in the public funds investment accounts--Investment of funds by state treasurer--Degree of judgment and care required.**

If authorized by statute, local ordinance, or resolution, a local government official or financial officer may place funds into the public funds investment account for investment and reinvestment by the state treasurer in those securities and investments set forth in [RCW 43.84.080](#) and chapter [39.58 RCW](#). The state treasurer shall invest the funds in such manner as to effectively maximize the yield to the investment pool. In investing and reinvesting moneys in the public funds investment account and in acquiring, retaining, managing, and disposing of investments of the investment pool, there shall be exercised the judgment and care under the circumstances then prevailing which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of the funds considering the probable income as well as the probable safety of the capital.

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**COMMON INVESTMENT VEHICLES**

▪ **Bankers' Acceptance**

A bankers' acceptance (BA) is a unique credit instrument used to finance both domestic and international self-liquidating transactions. By definition, a bankers' acceptance is a time draft, that is, an order to pay a specified amount of money to the acceptance holder on a specified date. BA's are drawn on and accepted by a bank that, accepting the draft, assumes responsibility to make payment on the draft at maturity. From the standpoint of security, a bankers' acceptance is an irrevocable primary obligation of the accepting bank, and a contingent obligation of the drawer and of any endorsers whose names appear upon it. The bank is protected by its customer's agreement to provide good funds by the time the acceptance matures and by the pledge of documents such as invoices, bills of lading, independent warehouse or terminal receipts, trust receipts, and other papers evidencing ownership and insurance of the goods financed. Since its inception 75 years ago, the bankers' acceptance has come through the trials of war and economic depression with no known principal loss to investors. Courts have held that the letter of credit agreement from inception to conclusion is based on the principle that the accepting bank holds the agreement not for its own benefit or the benefit of its general creditors, but in trust for the holder of the acceptance.

Foreign acceptances are U.S. dollar denominated acceptances backed by the credit of foreign banks or agencies domiciled in the United States. Foreign BA's have the same characteristics as domestics. There has been no principal loss to investors in foreign BA's.

An example of a bankers' acceptance creation would be as follows:

Consider a Seattle car dealer who wishes to finance the importation of Japanese cars on an acceptance basis. The American importer, after negotiating with the exporter in Japan, arranges for his American commercial bank to issue an irrevocable letter of credit in favor of the exporter. The letter of credit specifies the details of the shipment and states that the Japanese exporter may draw a time draft for a certain amount on the American bank. The Japanese exporter, in conformity with the terms of the letter of credit, draws a draft on the American bank, receiving immediate payment. The exporter's Japanese bank then forwards the draft to the United States for presentation to the bank that issued the letter of credit. This bank stamps the draft "accepted", thus incurring an obligation to pay the draft at maturity. An acceptance has been created.

The new acceptance is discounted for the Japanese bank by the accepting bank and the proceeds credited to the account of the Japanese bank. The accepting bank, in turn, may either sell the acceptance or hold it in its own portfolio. The importer is obligated to deposit the proceeds of the car sales at the accepting bank in time to honor the acceptance. At maturity, its owner presents the acceptance for payment and the transaction is completed.

Acceptances generally have maturities of 180 days or less (with 90 days being the most typical). They are quoted, bought, and sold on a discount basis.

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▪ **Commercial Paper**

Commercial paper (CP) is a short-term debt obligation, where there is a promise to repay a fixed amount on a certain future date. Banks, corporations, and other borrowers issue CP.

CP is issued with maturities ranging from overnight to 270 days. Though some CP is interest bearing, most are quoted, bought, and sold on a discount basis.

RCW 39.59.020(4) authorizes local governments to invest in “Any investments authorized by law for the treasurer of the state of Washington ...”. RCW 43.84.080(7) authorizes the state treasurer to invest in commercial paper, but only to the extent consistent with the policy of the State Investment Board (SIB). The CP policy guidelines, adopted by the SIB on 2/18/99, for entities with funds under management of less than ten billion dollars, are as follows:

- (1) Commercial paper must be rated with the highest short-term credit rating of any two Nationally Recognized Statistical Rating Organizations (NRSROs), at the time of purchase. If the commercial paper is rated by more than two NRSROs, it must have the highest rating from all of the organizations.
- (2) Commercial paper holdings may not have maturities exceeding 180 days.
- (3) Any commercial paper purchased with a maturity longer than 100 days must also have an underlying long-term credit rating at the time of purchase in one of the two highest rating categories of an NRSRO.
- (4) The percentage of commercial paper may not exceed 25 percent of the total assets of the portfolio.
- (5) The percentage of commercial paper that can be purchased from any single issuer is five percent of the total assets of the portfolio.
- (6) Commercial paper must be purchased in the secondary market and not directly from the issuers.
- (7) Portfolio managers will routinely monitor the ratings of the issuers of the commercial paper they are purchasing. Appropriate personnel will be notified of any credit rating downgrades of issuers of any commercial paper in their portfolios.

▪ **Federal Agency Securities**

From time to time, Congress becomes concerned about the volume of credit that is available to various sections of the economy and the terms at which that credit is available. Its usual response is to set up a federal agency to provide credit to that sector.

Those agencies borrowing in the open market do so primarily by issuing notes and bonds. These securities bear interest, and they are issued and redeemed at face value. Instead of using the auction technique for issuing their securities, federal agencies look to the market to determine the best yield at which they can sell a new issue, put that yield on the issue, and then sell it through a syndicate of dealers. Some agencies also sell short-term discount paper that resembles a Treasury bill.

Normally, agencies yield slightly more than the Treasury securities of the same maturity. There are several reasons for this. Agency issues are smaller than Treasury issues and are, therefore, somewhat less liquid. Also, while all agency issues have de facto backing from the federal government (it is inconceivable that the government would let one of them default on its

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obligations), the securities of only a few agencies are explicitly backed by the full faith and credit of the U.S. Government. Thus, some investors view some agency securities as carrying a small but perceptible credit risk. A third disadvantage of some agency issues is that interest income from them is not exempt from state taxation. Agencies are generally traded by the same dealers who trade governments and in much the same way.

The most commonly traded agencies are:

- **Federal Home Loan Banks**

The Federal Home Loan Bank System was organized under the Federal Home Loan Bank Act and opened for business in October 1932. The twelve District Banks comprising the system are distributed geographically around the country similarly to the Federal Reserve Banks and operate as a credit reserve system for the thrift industry to stabilize the flow of mortgage credit to the public. Their member institutions wholly own the District Banks but operate under the supervision of the Federal Home Loan Bank Board, an independent federal agency. The Bank Board issues all federal charters for savings and loan associations and mutual savings banks. Membership for thrift institutions chartered by the Banks' Board is mandatory. At the end of 1983, membership consisted of over 3,400 financial institutions. Debt is issued as consolidated obligations of the twelve Federal Home Loan Banks. Although the U.S. Government does not guarantee system debt, the banks do operate under federal charter and government supervision.

Consolidated bonds are issued only in book entry form for a minimum of \$10,000 with multiples of \$5,000 thereafter. Bond financings are scheduled once a month and the system enters the market if funds are needed. Bonds are for longer term funding requirements with maturities generally ranging from one year to ten years. Consolidated obligations issued on a discount basis to mature in one year or less are designated consolidated discount notes. The buyer at the time of purchase may select maturities, within the 30-360 day range, subject to the general limitations prescribed by the system. They are issued in book-entry form only and are available in denominations of \$100,000, \$150,000, and \$1,000,000.

- **Federal Home Loan Mortgage Corporation (Freddie Mac)**

The Federal Home Loan Mortgage Corporation (FHLMC) was created in July 1970 through enactment of Title III of the Emergency Home Finance Act of 1970. The organization's purpose is to promote the development of a nation-wide secondary market in conventional residential mortgages. To accomplish this, the FHLMC buys residential mortgages and then resells them via the sale of mortgage related instruments. The Federal Home Loan Bank System directs the FHLMC operations. The FHLMC may purchase mortgages only from financial institutions that have their deposits or accounts insured by agencies of the federal government. It purchases only conventional residential mortgages and FHA/VA mortgages, and then sells its interest in the mortgages it purchases through mortgage-backed, pass-through securities. Specifically, the FHLMC sells two types of pass-through securities: mortgage participation certificates (PC's) and guaranteed mortgage certificates (GMC's). Each PC represents an undivided interest in a pool of conventional residential mortgages underwritten and previously purchased by the FHLMC. Each month the certificate holder receives a prorated share of the principal and interest payments made on the underlying pool. The FHLMC guarantees timely payment of interest on PC's and the full return of principal to the investor. While PC's technically

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have a maturity at issue of 30 years, their average weighted life is assumed to be 12 years or less.

Guaranteed mortgage certificates also represent an undivided interest in conventional residential mortgages underwritten and previously purchased by the FHLMC. These certificates pay interest semiannually and return principal once a year in guaranteed maximum amounts. The final payment date on GMC's is 30 years from the date of issue, but the expected average weighted life of these securities is around 10 years.

Both PC's and GMC's are issued in registered form in initial principal amounts of \$100,000, \$500,000, and \$1,000,000.

▪ **Government National Mortgage Association (Ginnie Mae)**

The 1968 partition of the Federal National Mortgage Association spawned the Government National Mortgage Association. Ginnie Mae is a wholly government-owned corporation within the Department of Housing and Urban Development. It took over the special assistance and the management and liquidating functions that had formerly been lodged in FNMA. These functions involve activities that could not be profitably carried out by a private firm. Ginnie Mae's mission is also to make real estate investment more attractive to institutional investors which it has done by designing and issuing, partly in conjunction with private financial institutions, mortgage-backed securities for which an active secondary market has developed. Under the pass-through approach, private mortgage lenders assemble pools of mortgages acquired through Ginnie Mae auctions or from other sources and then sell certificates backed by these mortgages to investors. These securities are referred to as pass-through securities because payment of interest and principal on mortgages in the pool is passed on to the certificate holders after deduction of fees for servicing and guarantee. Pass-through certificates have stated maturities equal to those of the underlying mortgages. However, actual maturities tend to be much shorter because of prepayments, the average life on single-family mortgages being approximately 12 years. On pass-through securities, principal and interest are paid monthly to the investor. Because payments are made monthly and because the amount passed through varies from month to month due to mortgage prepayment, pass-through are issued in registered form only. They have minimum denominations of \$25,000. They carry Ginnie Mae's guarantee of timely payment of both principal and interest and, in addition, are backed by the full faith and credit of the U.S. Government.

▪ **Federal Farm Credit Banks Consolidated System-wide Bonds**

The Farm Credit System is a cooperatively owned nationwide system of banks and associations that provides mortgage loans, short and intermediate-term credit and related services to farmers, ranchers, producers, or harvesters of aquatic products, rural homeowners, and agricultural and rural cooperatives. The Farm Credit System is organized geographically into 12 Farm Credit Districts. In each district, there is a Federal Land Bank, a Federal Intermediate Credit Bank, and a Bank for Cooperatives. In addition, there is a Central Bank for Cooperatives in Denver, Colorado, which participates with district banks in larger loans. Responsibility for supervising the Farm Credit System in the public's best interest is the Farm Credit Administration, which is an independent agency of the U.S. Government. Each of the 37 Farm Credit Banks is audited and examined at least once each year by Farm Credit Administration examiners. Federal Farm Credit Banks Consolidated System-wide Bonds are secured joint and

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several obligations of the 37 Farm Credit Banks. Bonds are issued each month with six and nine-month maturities. Longer-term bonds are issued approximately eight times a year. They are issued in book-entry form, in multiples of \$1,000 for maturities of over 13 months and of \$5,000 for shorter maturities. System-wide bonds sold to the public are secured by collateral consisting of notes or other obligations of borrowers, obligations of the United States or any agency thereof, or other readily marketable securities approved by the Farm Credit Administration, or cash, in an aggregate value equal to the bonds outstanding. The system also issues discount notes with maturities ranging from 7 to 270 days.

▪ **Federal National Mortgage Association (FNMA)**

The Federal National Mortgage Association is a government-chartered corporation owned entirely by private stockholders. It is subject to regulation by the Secretary of Housing and Urban Development. Originally chartered in February 1938, it was partitioned in 1968 into two corporations: Federal National Mortgage Association and Government National Mortgage Association. FNMA was authorized to render supplementary assistance to the secondary market for federally guaranteed or insured mortgages. However, under the Emergency Home Finance Act of 1970, FNMA is also empowered, with the approval of the Secretary of Housing and Urban Development, to purchase, service, lend on the security of, sell, and otherwise deal in mortgages not federally insured or guaranteed.

Mortgages and loans insured by the Federal Housing Administration, or guaranteed by the Administrator of Veterans Affairs, or insured by the Farmers Home Administration are purchased by FNMA from an approved list of mortgage sellers, including mortgage companies, and from any federal agency authorized to sell such mortgages or loans. Purchases of mortgages by FNMA are financed by the sale of debentures and short-term notes to private investors. FNMA also issues short-term discount notes with maturities ranging from 30 to 360 days. Discount notes are issued in denominations of \$5,000, \$10,000, \$25,000, \$100,000, \$500,000, and \$1,000,000. The minimum order is \$50,000.

▪ **Student Loan Marketing Association (Sallie Mae)**

The Student Loan Marketing Association is a stockholder owned corporation established by the Higher Education Act of 1965. Sallie Mae has broad statutory authority to provide liquidity for banks, savings and loans, educational institutions, state agencies, and other lenders engaged in the Federal Guaranteed Student Loan Program and the Health Education Assistance Loan Program in a manner which will increase the amount of funds available for lending and to otherwise support the credit needs of students. Loans originated under the GSLP and HEAL are either insured directly by the U.S. or guaranteed by state or nonprofit private agencies and reinsured by the U.S.

The federal government has oversight responsibilities with respect to certain aspects of Sallie Mae's activities. The President of the United States designates One third of Sallie Mae's 21-member board of directors and its 12 chairman. Sallie Mae is permitted to conduct business without regard to any qualification or similar statute in any state of the United States. Sallie Mae finances its market activities primarily from the sale of its debt securities. The Higher Education Act permits the Secretary of Education to guarantee Sallie Mae obligations, regardless of maturity, issued prior to September 30, 1984. From 1974 through 1982, Sallie Mae financed its activities principally through the issuance to

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the Federal Financing Bank of such obligations. In May 1981, Sallie Mae began to finance its operation in part through the issuance of non-guaranteed discount notes. These notes are unsecured debt obligations having a maturity of no longer than one year and are issued on a daily basis in minimum denominations of \$100,000 and multiples of \$50,000 above that amount. In 1982, they began to offer, on a public basis, non-guaranteed floating rate notes with maturities generally of three years or longer. Interest on these notes is generally adjusted on the basis of the bond equivalent yield of the 91-day Treasury Bill rate. Sallie Mae also offers to the public, from time to time, long-term fixed rate securities. In February 1984, Sallie Mae also began issuing short-term floating rate notes, at a spread to the bond equivalent yield on the 91-day Treasury Bill. The rates are offered monthly.

The Internal Revenue Service has ruled that Sallie Mae is an instrumentality of the United State for the purposes of the IRS code. As a result of this, domestic building and loan associations and mutual savings banks are permitted to include Sallie Mae obligations among those assets defined as "stock or obligations of a corporation which is an instrumentality of the United States".

▪ **Small Business Administration (SBA)**

The Small Business Administration was created in 1953 and derives its present authority from the Small Business Act of 1958 as amended and various other laws. SBA provides financial, procurement, and management assistance to small business concerns and also assists victims of natural and other disasters. SBA aid to small business firms includes both direct loans and guaranteed loans. As part of its financial assistance functions, SBA makes loans to small business investment companies (SBIC's), which are privately owned, SBA licensed and regulated companies that supply venture capital and long-term financing to small firms. Under a guaranty authority, which became law on December 22, 1971, SBA may (when authorized in appropriate acts) guarantee the timely payment of all principal and interest as scheduled on SBIC debentures. The SBA guaranty is secured by the full faith and credit of the United States. Currently, all such sales of debentures are being made to the Federal Financing Bank, which is subject to the general supervision and direction of the United States Treasury. When a lender makes a SBA loan, SBA guarantees 90 percent of the loan. The guaranteed portion of SBA loans can be sold by lenders to brokers/dealers or directly to investors via SBA forms 1084 or 1086 (secondary participation guaranty agreements), the latter to utilize the services of the fiscal and transfer agent. The overwhelming proportion of SBA guaranteed loans sold into the secondary market are regular business loans. Only the entire guaranteed portion can be sold. Although it is legally permissible that there might be multiple owners of this guaranteed interest, there can be but one registered holder (SBA form 1086) or holder (SBA form 1084) entitled to ownership benefits of the guaranteed interest. Under the fiscal and transfer agent or older 1084 systems below, however, the owner may be an individual, joint tenant, tenants in common, or tenants by the entirety. Borrower payments of principal and interest are apportioned between the lender and investor according to their respective ownership interests and the servicing fee of the lender. SBA's secondary market operations changed materially in 1979, when nationwide implementation of the Fiscal and Transfer Agent program commenced. A registered, negotiable instrument identified as the guaranteed interest certificate is the only documentation evidencing ownership, which the secondary investor need retain. SBA's

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fiscal and transfer agent issues these certificates and serves as the central registry of certificate ownership. All subsequent transfers are made between the seller and buyer without review or approval by SBA, but with the involvement of the fiscal and transfer agent. The transfer agents issuing a new certificate to the owner affect trades. The fiscal and transfer agent is the custodian of loan documentation, bills lenders for monthly payments, and receives borrowers' monthly payments from lenders. In turn, the fiscal and transfer agent provides one aggregate payment to the registered holder, regardless of the number of certificates owned, along with an accounting of the transaction. When a lender decides to sell the guaranteed portion of a fully disbursed SBA loan - and only the entire guaranteed portion can be sold - a sale is negotiated with a broker/dealer or directly with an investor. Secondary market sales to investors electing the services of the fiscal and transfer agent must be accomplished on SBA form 1086, a tripartite secondary participation guaranty and certification agreement. A loan document package (to consist of the 1086, copies of the note, and commitment letter identifying the settlement date, along with a transcript of account) is then forwarded to the SBA servicing district office; SBA executes the 1086 after a satisfactory in-house review. Wire transfer of funds permits settlement and certificate issuance to the investor by the fiscal and transfer agent. The lender remains responsible for servicing the loan.

An optimal method of sale is the use of the old SBA form 1084, secondary participation guaranty agreement. This method of sale does not utilize the services of the fiscal and transfer agent; thus, the benefits of the certificate system do not flow to the investor. The lender and broker/investor first execute a tri-party agreement, SBA form 1084, containing the lender's annual servicing fee. SBA must satisfactorily complete an in-house review before execution of form 1084 at the time of initial sale. The fully executed original of the 1084 and a copy of the borrower's note evidence the investor's ownership. Under both the 1084 and 1086 sale process, a holder of the guaranteed interest must have no interest in the borrower in the note, or in the collateral hypothecated to the loan. All subsequent transfers are arranged between the seller and buyer. Resale of the guaranteed interest by the investor holding a SBA form 1084 includes drafting a transfer instrument and providing written notice to the lender and SBA by copy of the executed assignment document. The transferee must not be the borrower or an associate of the borrower or lender.

There is one caveat that the public funds investor should be aware of in dealing with SBA's. In the event of either default by the borrower or repayment by the borrower, the investor will receive the par value of the SBA. Thus, if the security were purchased at a premium, the investor would face a principal loss on the investment.

▪ **Local Government Investment Pool**

The LGIP is comparable to a Rule 2a-7 money market fund recognized by the Securities and Exchange Commission (17CFR.270.2a-7). Rule 2a-7 funds are limited to high quality obligations with limited maximum and average maturities, the effect of which is to minimize both market and credit risk.

The objectives of the State Treasurer's investment practices for the LGIP, in priority order, will be: safety, liquidity, and return on investment. To provide for the safety and liquidity of funds deposited in the LGIP, the state treasurer and designated investment officers shall:

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- Adhere to all restrictions on the investment of funds established by law and by this policy;
- Limit the purchase of investments in securities so that the average maturity of the portfolio does not exceed 90 days;
- Limit the purchase of investments to securities that have a maximum maturity of 397 days, except securities used as collateral in repurchase agreements;
- Limit the purchase of investments in securities other than those issued by the U.S. government or its agencies; and,
- Prepare regular reports of portfolio activity.

Within the restrictions necessary to ensure the safety and liquidity of funds, the investment portfolio of the LGIP will be structured to attain a market rate of return throughout budgetary and economic cycles.

- **U.S. Treasury Securities**

US Treasury securities are direct debt obligations of the Federal government and are exempt from state and local income tax. Treasuries are guaranteed by the full faith and credit of the U.S. government.

Treasury bills (T-bills or bills) are discount securities that mature in one year or less. The price of a bill is always quoted as a discount rate from par. The discount rate of bills represents the size of the price reduction for a 360-day period. For example, a bill that matures in 360 days and is sold at a discount rate of 6%, is priced at 94. This means a bill with a face value of \$10,000 would be sold at \$9,400 and pay the investor \$10,000 at maturity. Bills are completely identified by their maturity date, since they have no coupon (e.g. the 10/14/1999 bill).

The Treasury issues 3-month, 6-month, and 1-year bills on a regular schedule. Auctions for 3- and 6-month bills occur every Monday, with settlement each Thursday. Year bill auctions occur every fourth Tuesday, with settlement on Thursday. In addition to this regular schedule, the Treasury can also issue *Cash Management Bills* (CMBs) to meet its short-term borrowing needs.

Treasury notes and bonds are coupon securities. Notes are issued with maturities of 1 to 10 years, while bonds are issued with maturities up to 30 years. Notes and bonds are otherwise identical; for this reason, both will now be referred to as bonds.

The Treasury pays the investor total annual interest equal to the coupon rate. In addition, the bond is traded by its price, which is quoted as a percentage of face value. For example, a dollar price of 99 on \$10mm face amount of bonds is worth \$9,900,000.

The Treasury auctions notes and bonds less frequently than it auctions bills since they don't need to refinance cash raised through long-term issues as frequently as cash raised through short-term issues. Currently, the 2-year note is auctioned monthly. The 5-year and 10-year notes and the 30-year bond are auctioned quarterly in February, May, August, and November.

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**IMPORTANT GUIDELINES**

**Important Elements of Custodial Agreements:**

1. Agreement should be between the municipal treasurer and custodial third party.
2. Agreement specifies that the custodial third party will act as trustee solely on behalf, and at the direction of the municipal treasurer for the safekeeping of securities purchased by the municipal treasurer and carry out other duties as specified and agreed to between the parties in the agreement (disposition of money coming to the custodian for the benefit of the municipal treasurer, money entrusted to the custodian by the municipal treasurer for the payment of securities, audit requests, account statements, etc.).
3. The responsibilities of the custodial third party and the municipal treasurer in the event of default by the seller.
4. Means of compensation to custodial third party.
5. Terms by which the agreement may be altered or terminated.

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**APPENDIX II**  
**GLOSSARY OF CASH MANAGEMENT TERMS**

The following is a glossary of key investing terms, many of which appear in the City's Investment Policy.

**Accrued Interest** - The accumulated interest due on a bond as of the last interest payment made by the issuer.

**Agency** - A debt security issued by a federal or federally sponsored agency. Federal agencies are backed by the full faith and credit of the U.S. Government. Federally sponsored agencies (FSAs) are backed by each particular agency with a market perception that there is an implicit government guarantee. An example of federal agency is the Government National Mortgage Association (GNMA). An example of a FSA is the Federal National Mortgage Association (FNMA).

**Amortization** - The systematic reduction of the amount owed on a debt issue through periodic payments of principal.

**Average Life** - The average length of time that an issue of serial bonds and/or term bonds with a mandatory sinking fund feature is expected to be outstanding.

**Basis Point** - A unit of measurement used in the valuation of fixed-income securities equal to 1/100 of 1 percent of yield, e.g., "1/4" of 1 percent is equal to 25 basis points.

**Bid** - The indicated price at which a buyer is willing to purchase a security or commodity.

**Book Value** - The value at which a security is carried on the inventory lists or other financial records of an investor. The book value may differ significantly from the security's current value in the market.

**Callable Bond** - A bond issue in which all or part of its outstanding principal amount may be redeemed before maturity by the issuer under specified conditions.

**Call Price** - The price at which an issuer may redeem a bond prior to maturity. The price is usually at a slight premium to the bond's original issue price to compensate the holder for loss of income and ownership.

**Call Risk** - The risk to a bondholder that a bond may be redeemed prior to maturity.

**Cash Sale/Purchase** - A transaction, which calls for delivery and payment of securities on the same day that the transaction is initiated.

**Collateralization** - Process by which a borrower pledges securities, property, or other deposits for the purpose of securing the repayment of a loan and/or security.

**Commercial Paper** - An unsecured short-term promissory note issued by corporations, with maturities ranging from 2 to 270 days.

**Convexity** - A measure of a bond's price sensitivity to changing interest rates. A high convexity indicates greater sensitivity of a bond's price to interest rate changes.

**Coupon Rate** - The annual rate of interest received by an investor from the issuer of certain types of fixed-income securities. Also known as the "interest rate."

**Credit Quality** - The measurement of the financial strength of a bond issuer. This measurement helps an investor to understand an issuer's ability to make timely interest payments and repay the

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loan principal upon maturity. Generally, the higher the credit quality of a bond issuer, the lower the interest rate paid by the issuer because the risk of default is lower. Credit quality ratings are provided by nationally recognized rating agencies.

**Credit Risk** - The risk to an investor that an issuer will default in the payment of interest and/or principal on a security.

**Current Yield (Current Return)** - A yield calculation determined by dividing the annual interest received on a security by the current market price of that security.

**Delivery Versus Payment (DVP)** - A type of securities transaction in which the purchaser pays for the securities when they are delivered either to the purchaser or his/her custodian.

**Derivative Security** - Financial instrument created from, or whose value depends upon, one or more underlying assets or indexes of asset values.

**Discount** - The amount by which the par value of a security exceeds the price paid for the security.

**Diversification** - A process of investing assets among a range of security types by sector, maturity, and quality rating.

**Duration** - A measure of the timing of the cash flows, such as the interest payments and the principal repayment, to be received from a given fixed-income security. This calculation is based on three variables: term to maturity, coupon rate, and yield to maturity. The duration of a security is a useful indicator of its price volatility for given changes in interest rates.

**Fair Value** - The amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

**Federal Funds (Fed Funds)** - Funds placed in Federal Reserve banks by depository institutions in excess of current reserve requirements. These depository institutions may lend fed funds to each other overnight or on a longer basis. They may also transfer funds among each other on a same-day basis through the Federal Reserve banking system. Fed funds are considered to be immediately available funds.

**Federal Funds Rate** - Interest rate charged by one institution lending federal funds to the other.

**Government Securities** - An obligation of the U.S. government, backed by the full faith and credit of the government. These securities are regarded as the highest quality of investment securities available in the U.S. securities market. See "Treasury Bills, Notes, and Bonds."

**Interest Rate** - See "Coupon Rate."

**Interest Rate Risk** - The risk associated with declines or rises in interest rates, which cause an investment in a fixed-income security to increase or decrease in value.

**Internal Controls** - An internal control structure designed to ensure that the assets of the entity are protected from loss, theft, or misuse. The internal control structure is designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that 1) the cost of a control should not exceed the benefits likely to be derived and 2) the valuation of costs and benefits requires estimates and judgments by management. Internal controls should address the following points:

1. **Control of collusion** - Collusion is a situation where two or more employees are working in conjunction to defraud their employer.

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2. **Separation of transaction authority from accounting and record keeping** -By separating the person who authorizes or performs the transaction from the people who record or otherwise account for the transaction, a separation of duties is achieved.
3. **Custodial safekeeping** - Securities purchased from any bank or dealer including appropriate collateral (as defined by state law) shall be placed with an independent third party for custodial safekeeping.
4. **Avoidance of physical delivery securities** - Book-entry securities are much easier to transfer and account for since actual delivery of a document never takes place. Delivered securities must be properly safeguarded against loss or destruction. The potential for fraud and loss increases with physically delivered securities.
5. **Clear delegation of authority to subordinate staff members** - Subordinate staff members must have a clear understanding of their authority and responsibilities to avoid improper actions. Clear delegation of authority also preserves the internal control structure that is contingent on the various staff positions and their respective responsibilities.
6. **Written confirmation of transactions for investments and wire transfers** -Due to the potential for error and improprieties arising from telephone and electronic transactions, all transactions should be supported by written communications and approved by the appropriate person. Written communications may be via fax if on letterhead and if the safekeeping institution has a list of authorized signatures.
7. **Development of a wire transfer agreement with the lead bank and third-party custodian** - The designated official should ensure that an agreement will be entered into and will address the following points: controls, security provisions, and responsibilities of each party making and receiving wire transfers.

**Inverted Yield Curve** - A chart formation that illustrates long-term securities having lower yields than short-term securities. This configuration usually occurs during periods of high inflation coupled with low levels of confidence in the economy and a restrictive monetary policy.

**Investment Company Act of 1940**- Federal legislation that sets the standards by which investment companies, such as mutual funds, are regulated in the areas of advertising, promotion, performance reporting requirements, and securities valuations.

**Investment Policy** - A concise and clear statement of the objectives and parameters formulated by an investor or investment manager for a portfolio of investment securities.

**Investment-grade Obligations** - An investment instrument suitable for purchase by institutional investors under the prudent person rule. Investment-grade is restricted to those obligations rated BBB or higher by a rating agency.

**Liquidity** - An asset that can be converted easily and quickly into cash.

**Local Government Investment Pool (LGIP)** - An investment by local governments in which their money is pooled as a method for managing local funds.

**Mark-to-Market** - The process whereby the book value or collateral value of a security is adjusted to reflect its current market value.

**Market Risk** - The risk that the value of a security will rise or decline as a result of changes in market conditions.

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**Market Value** - Current market price of a security.

**Maturity** - The date on which payment of a financial obligation is due. The final stated maturity is the date on which the issuer must retire a bond and pay the face value to the bondholder. See ‘Weighted Average Maturity.’”

**Money Market Mutual Fund** - Mutual funds that invest solely in money market instruments (short-term debt instruments, such as Treasury bills, commercial paper, bankers’ acceptances, repos and federal funds).

**Mutual Fund** - An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments. Mutual funds are regulated by the Investment Company Act of 1940 and must abide by the following Securities and Exchange Commission (SEC) disclosure guidelines:

1. Report standardized performance calculations.
2. Disseminate timely and accurate information regarding the fund’s holdings, performance, management and general investment policy.
3. Have the fund’s investment policies and activities supervised by a board of trustees, which are independent of the adviser, administrator or other vendor of the fund.
4. Maintain the daily liquidity of the fund’s shares.
5. Value their portfolios on a daily basis.
6. Have all individuals who sells SEC-registered products licensed with a self-regulating organization (SRO) such as the National Association of Securities Dealers (NASD).
7. Have an investment policy governed by a prospectus, which is updated and filed by the SEC annually.

**Mutual Fund Statistical Services** - Companies that track and rate mutual funds, e.g., IBC/Donoghue, Lipper Analytical Services, and Morningstar.

**National Association of Securities Dealers (NASD)** - A self-regulatory organization (SRO) of brokers and dealers in the over-the-counter securities business. Its regulatory mandate includes authority over firms that distribute mutual fund shares as well as other securities.

**Net Asset Value** - The market value of one share of an investment company, such as a mutual fund. This figure is calculated by totaling a fund’s assets which includes securities, cash, and any accrued earnings, subtracting this from the fund’s liabilities and dividing this total by the number of shares outstanding. This is calculated once a day based on the closing price for each security in the fund’s portfolio. (See below.)  $[(\text{Total assets}) - (\text{Liabilities})]/(\text{Number of shares outstanding})$

**No Load Fund** - A mutual fund, which does not levy a sales charge on the purchase of its shares.

**Nominal Yield** - The stated rate of interest that a bond pays its current owner, based on par value of the security. It is also known as the “coupon,” “coupon rate,” or “interest rate.”

**Offer** - An indicated price at which market participants are willing to sell a security or commodity. Also referred to as the “Ask price.”

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**Par** - Face value or principal value of a bond, typically \$1,000 per bond. **Positive Yield Curve** - A chart formation that illustrates short-term securities having lower yields than long-term securities.

**Premium** - The amount by which the price paid for a security exceeds the security's par value.

**Prime Rate** - A preferred interest rate charged by commercial banks to their most creditworthy customers. Many interest rates are keyed to this rate.

**Principal** - The face value or par value of a debt instrument. Also may refer to the amount of capital invested in a given security.

**Prospectus** - A legal document that must be provided to any prospective purchaser of a new securities offering registered with the SEC. This can include information on the issuer, the issuer's business, the proposed use of proceeds, the experience of the issuer's management, and certain certified financial statements.

**Prudent Person Rule** - An investment standard that outlines the fiduciary responsibilities of public funds investors relating to investment practices.

**Regular Way Delivery** - Securities settlement that calls for delivery and payment on the third business day following the trade date (T+3); payment on a T+1 basis is currently under consideration. Mutual funds are settled on a same day basis; government securities are settled on the next business day.

**Reinvestment Risk** - The risk that a fixed-income investor will be unable to reinvest income proceeds from a security holding at the same rate of return currently generated by that holding.

**Repurchase Agreement (repo or RP)** - An agreement of one party to sell securities at a specified price to a second party and a simultaneous agreement of the first party to repurchase the securities at a specified price or at a specified later date.

**Reverse Repurchase Agreement (Reverse Repo)** - An agreement of one party to purchase securities at a specified price from a second party and a simultaneous agreement by the first party to resell the securities at a specified price to the second party on demand or at a specified date.

**Rule 2a-7 of the Investment Company Act** - Applies to all money market mutual funds and mandates such funds to maintain certain standards, including a 13-month maturity limit and a 90-day average maturity on investments, to help maintain a constant net asset value of one dollar (\$1.00).

**Safekeeping** - Holding of assets (e.g., securities) by a financial institution. **Serial Bond** - A bond issue, usually of a municipality, with various maturity dates scheduled at regular intervals until the entire issue is retired.

**Sinking Fund** - Money accumulated on a regular basis in a separate custodial account that is used to redeem debt securities or preferred stock issues.

**Swap** - Trading one asset for another.

**Term Bond** - Bonds comprising a large part or all of a particular issue, which come due in a single maturity. The issuer usually agrees to make periodic payments into a sinking fund for mandatory redemption of term bonds before maturity.

**Total Return** - The sum of all investment income plus changes in the capital value of the portfolio. For mutual funds, return on an investment is composed of share price appreciation plus

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any realized dividends or capital gains. This is calculated by taking the following components during a certain time period. (Price Appreciation) + (Dividends paid) + (Capital gains) = Total Return

**Treasury Bills** - Short-term U.S. Government non-interest bearing debt securities with maturities of no longer than one year and issued in minimum denominations of \$10,000. Auctions of three- and six-month bills are weekly, while auctions of one-year bills are monthly. The yields on these bills are monitored closely in the money markets for signs of interest rate trends.

**Treasury Notes** - Intermediate U.S. Government debt securities with maturities of one to 10 years and issued in denominations ranging from \$1,000 to \$1 million or more.

**Treasury Bonds** - Long-term U.S. Government debt securities with maturities of ten years or longer and issued in minimum denominations of \$1,000. Currently, the longest outstanding maturity for such securities is 30 years.

**Uniform Net Capital Rule** - SEC Rule 15C3-1 outlining capital requirements for broker/dealers.

**Volatility** - A degree of fluctuation in the price and valuation of securities.

**“Volatility Risk” Rating** - A rating system to clearly indicate the level of volatility and other non-credit risks associated with securities and certain bond funds. The ratings for bond funds range from those that have extremely low sensitivity to changing market conditions and offer the greatest stability of the returns (“aaa” by S&P; “V-i” by Fitch) to those that are highly sensitive with currently identifiable market volatility risk (“ccc-” by S&P, “V-IO” by Fitch).

**Weighted Average Maturity (WAM)** - The average maturity of all the securities that comprise a portfolio. According to SEC rule 2a-7, the WAM for SEC registered money market mutual funds may not exceed 90 days and no one security may have a maturity that exceeds 397 days.

**When Issued (WI)** - A conditional transaction in which an authorized new security has not been issued. All “when issued” transactions are settled when the actual security is issued.

**Yield** - The current rate of return on an investment security generally expressed as a percentage of the security’s current price.

**Yield-to-call (YTC)** - The rate of return an investor earns from a bond assuming the bond is redeemed (called) prior to its nominal maturity date.

**Yield Curve** - A graphic representation that depicts the relationship at a given point in time between yields and maturity for bonds that are identical in every way except maturity. A normal yield curve may be alternatively referred to as a positive yield curve.

**Yield-to-maturity** - The rate of return yielded by a debt security held to maturity when both rising interest rates and relatively longer in periods of declining interest rates.

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**APPENDIX III  
BROKER/DEALER QUESTIONNAIRE**

**CRITERIA FOR SELECTING FINANCIAL INSTITUTIONS AND SECURITIES  
DEALERS TO PROVIDE SERVICES**

**AUTHORITY**

This criteria and selection process is established pursuant to Section 4.1 of the City of Othello's Investment Policy of January 2003.

**CRITERIA**

1. An institution/dealer must be an established business in the investment services field with at least a five-year operating history.
2. The institution/dealer must provide services routinely to public entities in the Pacific Northwest.
3. The institution/dealer must be knowledgeable of Washington government investments statutes and the City of Othello's Investment Policy.
4. The institution/dealer must furnish:
  - a. Disclosure statement of involvement in any civil or criminal litigation or investigation regarding its business practices during the past five years;
  - b. "Conflict of Interest" statement prohibiting employees serving the City to provide personal investment services to City investment staff;
  - c. Copy of license and professional credentials of institution/dealer and most recent audited financial statements;
  - d. List of public entities with which it has done business over the past five years;
  - e. Volume of transactions and types of securities involved for the most recent fiscal year for the five largest municipal clients;
  - f. A profile of all representatives serving the City including their employment history and CRD number.
5. The institution/dealer must agree not to intentionally offer or suggest investments contrary to the City's Investment Policy.
6. The institution/dealer must agree the decision of the Finance Officer on the eligibility or removal from approved list is final.

**PROCEDURE FOR APPLICATION AND SELECTION TO PROVIDE SERVICES**

1. Institution/dealer submits documents verifying Items 1, 2 and 3; materials under Item 4; and statement agreeing to Items 5 and 6 of the criteria.
2. The Finance Officer reviews the submission for completeness and determines if the institution/dealer meets the selection criteria.
3. The Finance Officer will review the submissions and select six to eight institutions/dealers determined to best meet the needs of the City as authorized providers of investment services to the City.
4. The Finance Officer reserves the right to withdraw approval for cause, as determined by the Finance Officer, at anytime.

**CITY OF OTHELLO**  
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**APPENDIX VI**  
**PROCEDURES FOR INVESTING**

1. To purchase investment with funds in Treasurer's account.

- A. Determine funds available to invest by deducting the dollar amount of the outstanding checks from the balance in the checking/sweep account. Take into consideration that you may have an investment maturity coming in for the day. Also take into consideration whether payroll, accounts payable or an advance check are being issued for the day. These will increase or decrease the balance in the Treasurer's account. There are available funds which are located in the US Bank Municipal Investment Account (MIA) or Local Government Investment Pool (LGIP). You have the option of transferring funds from these accounts into the Treasurer's account to cover the cost of an investment.
- B. After determining the dollar amount of the funds available to invest, determine a maturity date for the investment. This will be determined by the amount of time the City wishes to hold the investment. Take into consideration any future cash flow requirements when determining the maturity date.
- C. After determining the dollar amount and the maturity date for the investment, then determine whether to contact the investment bankers/brokers or portfolio managers the City is currently working with, invest in the MIA, or LGIP.

2. To Purchase Investments Through Bankers/Brokers or Portfolio Manager

- A. Discuss with the banker/brokers or manager the availability of specific investment types as outlined in the city's Investment Policy. They will give information on those investment types and interest rates for the same. Record this information on the Treasurers Investment Record (TIR)(see form following). Gather all the information from the investment bankers/brokers or portfolio manager on the TIR, review this information and choose the investment which best fits your investment needs. Call the investment banker/broker or portfolio manager handling that investment and state that the City is willing to purchase the investment.
- B. On the TIR, record the purchase price, interest rate, the type of investment and the maturity date of the investment. Then wire-out the amount of the purchase price of the investment to the bank/broker or portfolio manager the investment was purchased. (See Procedure for Wire Transfer section)
- C. Fill out Investment Purchase Record (see form following) as well as Cash Receipt Book with investment information and forward to Deputy Finance Officer for processing (Investment Purchase). This process will post the investment check out on the General Ledger records. When finished processing, the Deputy Finance Officer will return this form, along with the file list printouts from the processing of this form. Maintain paperwork in working file, to be included with any other investment paperwork for the month. Record the investment on the Allocation Spreadsheet for Other Investments. Journalized transactions will be filed with other monthly journals.

**CITY OF OTHELLO**  
**INVESTMENT POLICY**

- D. For all investment purchases and sales, make a copy of the TIR for the working file. Place the TIR, along with any paperwork from the banker/broker through whom the City purchased the investment, in the Outstanding Investments file by maturity date. Place the information for the investment onto the Monthly Investment Report. This report will go to City Council at the end of every month.

3. To receive funds into Treasurer's account from investment maturity.

- A. Each banker/broker or portfolio manager the City deals with to purchase investments should have the City's bank account information and wire instructions on file. Upon having an investment mature, they can then wire the maturity amount to City's bank account. Follow the outstanding investments to know when an investment is maturing. On the day the investment matures, Call the banker/broker holding this investment and confirm with them the maturity date and the principal and interest due. The total investment due will appear on the Daily Bank Report as a deposit.
- B. Pull the TIR for the maturing investment from your Outstanding Investment file. Determine the allocation of the principal and interest.
- C. Fill out Investment Sale Record (see form following) as well as Cash Receipt Book with deposit information and forward to Deputy Finance Officer for processing (Investment Sales). This process will post the investment check on the General Ledger records. When finished processing, the Deputy Finance Officer will return this form, along with the file list printouts from the processing of this form. Update the Investment Allocation spreadsheet for the Other Accounts. Maintain paperwork in working file, to be included with any other investment paperwork for the month. Journalized transactions will be filed with other monthly journals.

4. To transfer funds from Treasurer's account to the LGIP. (Deposit)

- A. A call must be made to the LGIP by 9 A.M. in order to make a transaction for that day. Inform the LGIP representative the city you are from and the dollar amount you wish to deposit. (See Procedures for Wire Transfer to make actual transfer for deposit) This process can also be completed online through the Treasury Management System (TM\$) with the State Treasury Department.
- B. On the TIR, record the dollar amount deposited into the LGIP. You will then have to wire-out the amount of the deposit to the LGIP. (See Procedures for Wire Transfer section)
- C. Fill out Investment Purchase Record (see form following) as well as Cash Receipt Book with deposit information and forward to Deputy Finance Officer for processing (Investment Purchases). This process will post the investment check on the General Ledger records. When finished processing, the Deputy Finance Officer will return this form, along with the file list printouts from the processing of this form. Update the Investment Allocation spreadsheet for the LGIP Account. Maintain paperwork in working file, to be included with any other investment paperwork for the month. Journalized transactions will be filed with other monthly journals.

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5. To transfer funds from Treasurer's account to the MIA. (Deposit)

- A. Write a check made out to the City's MIA Account from the Treasurer's Account, fill out deposit form for the MIA Account and deposit with daily deposit
- B. On the TIR, record the dollar amount deposited into the MIA.
- C. Fill out Investment Purchase Record (see form following) as well as Cash Receipt Book with deposit information and forward to Deputy Finance Officer for processing (Investment Purchases). This process will post the investment check on the General Ledger records. When finished processing, the Deputy Finance Officer will return this form, along with the file list printouts from the processing of this form. Update the Investment Allocation spreadsheet for the MIA Account. Maintain paperwork in working file, to be included with any other investment paperwork for the month. Journalized transactions will be filed with other monthly journals.

6. To transfer funds from the LGIP to Treasurer's account. (Withdrawal)

- A. This process will move funds from the LGIP to the Treasurer's account. Determine the dollar amount needed to withdraw from the LGIP account and to deposit into Treasurer's account to cover any outstanding checks, checks to be issued or investments to purchase. Once the dollar amount has been determined, you must call the LGIP by 9 A.M. in order to make a transaction for that day. Give the LGIP representative information related to the City and the amount to be transferred (See Procedures for Wire Transfer to make actual transfer for withdrawal). This process can also be completed online through the Treasury Management System (TM\$) with the State Treasury Department.
- B. On the TIR, record dollar amount withdrawn from the LGIP. Update the Investment Allocation spreadsheet for the LGIP Account.
- C. Fill out Investment Sale Record (see form following) as well as Cash Receipt Book with deposit information and forward to Deputy Finance Officer for processing (Investment Sales). This process will post the investment check on the General Ledger records. When finished processing, the Deputy Finance Officer will return this form, along with the file list printouts from the processing of this form. Update the Investment Allocation spreadsheet for the LGIP Account. Maintain paperwork in working file, to be included with any other investment paperwork for the month. Journalized transactions will be filed with other monthly journals.

7. To transfer funds from the MIA Account to Treasurer's account. (Withdrawal)

- A. This process will move funds from the MIA account to the Treasurer's account. Determine the dollar amount needed to withdraw from the LGIP account and to deposit into Treasurer's account to cover any outstanding checks, checks to be issued or investments to purchase. Once the dollar amount has been determined, call US Bank. This can be done anytime before 3:00 pm in order to make a transaction for that day. Follow the US Bank transfer procedures.

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- B. On the TIR, record dollar amount withdrawn from the MIA. Update the Investment Allocation spreadsheet for the MIA Account.
- C. Fill out Investment Sale Record (see form following) as well as Cash Receipt Book with deposit information and forward to Deputy Finance Officer for processing (Investment Sales). This process will post the investment check on the General Ledger records. When finished processing, the Deputy Finance Officer will return this form, along with the file list printouts from the processing of this form. Maintain paperwork in working file, to be included with any other investment paperwork for the month. Journalized transactions will be filed with other monthly journals.

**Procedures for Wire Transfers or Electronic Funds Transfers (EFT)**

A wire transfer or EFT is the movement of funds into or out of the Treasurer's account to or from other banks, government entities, private business or citizens. The City utilizes outgoing wire transfers to purchase investments and to make debt service payments on bond issues or other outstanding types of loans. The city receives various types of payments via wire transfer, to include investment maturities, and State revenue distributions.

Wire transfers will show as credits (incoming) or debits (outgoing) on your daily bank report. Make sure these amounts are correct. If any discrepancies exist, contact the bank to correct the situation.

- 1. To transfer funds from Treasurer's account to banker/broker or portfolio manager for investment purchase.
  - A. To initiate wire transfers; use the current banking vendor's wire transfer system. The transfer will show up on the Daily Bank Report as a credit transaction.
- 2. To transfer funds from Treasurer's account to LGIP. (Deposit)
  - A. To initiate wire transfers, use the current banking vendor's wire transfer system. The transfer will show up on the Daily Bank Report as a debit transaction.
- 3. To transfer funds from the LGIP to Treasurer's account. (Withdrawal)
  - A. Call the LGIP with your withdrawal request (1-800-331-3284), or do the transaction request online through the TR\$. (See LGIP Transfer Instructions) The LGIP should already have on hand your wire instructions for making this transaction. The transfer will show up on the Daily Bank Report as a credit transaction.
- 4. To transfer funds from the MIA to Treasurer's account. (Withdrawal)
  - A. Call US Bank (1-800-872-2657) and follow the instructions. (See MIA Transfer Instructions) The transfer will show up on the Daily Bank Report as a credit transaction.

**CITY OF OTHELLO**  
**INVESTMENT POLICY**

**TREASURER'S INVESTMENT RECORD**

PURCHASE DATE: \_\_\_\_\_ MATURITY DATE: \_\_\_\_\_

PRINCIPAL AMOUNT: \_\_\_\_\_

**Instrument:** CD \_\_\_\_ BA \_\_\_\_ T-Note \_\_\_\_ T-Bill \_\_\_\_ LGIP \_\_\_\_ MIA \_\_\_\_ Other \_\_\_\_

FINANCIAL INSTITUTION: \_\_\_\_\_

FINANCIAL INSTITUTION: \_\_\_\_\_

CONTACT NAME: \_\_\_\_\_

CONTACT NAME: \_\_\_\_\_

INTEREST RATE: \_\_\_\_\_

INTEREST RATE: \_\_\_\_\_

MATURITY VALUE: \_\_\_\_\_

MATURITY VALUE: \_\_\_\_\_

INTEREST AMOUNT: \_\_\_\_\_

INTEREST AMOUNT: \_\_\_\_\_

FINANCIAL INSTITUTION: \_\_\_\_\_

FINANCIAL INSTITUTION: \_\_\_\_\_

CONTACT NAME: \_\_\_\_\_

CONTACT NAME: \_\_\_\_\_

INTEREST RATE: \_\_\_\_\_

INTEREST RATE: \_\_\_\_\_

MATURITY VALUE: \_\_\_\_\_

MATURITY VALUE: \_\_\_\_\_

INTEREST AMOUNT: \_\_\_\_\_

INTEREST AMOUNT: \_\_\_\_\_

<b>REMARKS</b>
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**CITY OF OTHELLO**  
**INVESTMENT POLICY**  
**INVESTMENT PURCHASE RECORD**

TO: Deputy Finance Officer

FROM: Finance Officer

SIGNED: \_\_\_\_\_

DATE	VENDOR #	INVESTMENT TYPE	AMOUNT	FUND	BARS NO.

CASH RECEIPT #: \_\_\_\_\_

POSTED DATE: \_\_\_\_\_

**INVESTMENT SALE RECORD**

TO: Deputy Finance Officer

FROM: Finance Officer

SIGNED: \_\_\_\_\_

DATE	VENDOR #	INVESTMENT TYPE	AMOUNT	FUND	BARS NO.

CASH RECEIPT #: \_\_\_\_\_

POSTED DATE: \_\_\_\_\_