

Cash Management  
Policy Board

ANNUAL REPORT

To the Governor and  
General Assembly



Fiscal Year 2016  
*July 1, 2015 – June 30, 2016*

## LETTER FROM THE CHAIR

*John V. Flynn, Jr., Ph.D.*

The Cash Management Policy Board has spent the past year reviewing significant changes in how Delaware's money is safeguarded. From analyzing the volatility of monthly cash flows to managing intra-day bank risk, the Board continues to explore the means to improve upon its mandate: to keep Delaware's financial resources secure and liquid while earning a reasonable return. This year's annual report highlights a few of the key initiatives that the Board completed during the past year and outlines our goals for next year.



This year's key accomplishments in its oversight of Delaware's banking services focused on higher security and greater efficiency. As the financial markets have become ever more connected, the State must be attuned to the risk of contagion in the banking network and choose partners and establish safe-keeping arrangements that ensure Delaware's access to funding under any scenario. Strides were made during the year to seek partners for core services who will improve on current operational risks and strengthen collateral arrangements. As the Board gets to work in FY17, the consummation of such arrangements will be front and center to ensure that Delaware's network is secure and its funds are fully and properly protected.

In terms of the investment portfolio, the Board continues to take a long view, focusing on capital preservation. As the credit markets have gradually improved since the Great Recession, the Board has worked with investment managers to adjust investment guidelines to best accommodate a slow and steadily rising rate environment. In addition, the Board is undertaking a lengthy evaluation of the State's operating cash needs in order to ascertain the excess liquidity in the portfolio. While security will always be paramount, the Board is taking a hard look at the means to restructure the portfolio to use excess funds to earn a higher return. The next year will see the culmination of that analysis in what may be the first major restructuring of the portfolio in over a generation.

As the world of banking and investments continues to change, the Board is working to ensure Delaware is ready. For more than 30 years, the Board has provided the insight and guidance from a collective body of government and industry leaders. We look forward to serving you this coming fiscal year, and continuing to be proactive leaders in the field of public finance.

Sincerely,

[JOHN]

## **OVERVIEW OF THE BOARD'S WORK IN FY16**

- Engagement of three new investment managers (July 2015) to manage both the Land and Water and Parks Endowment Funds.
- Created an Investment Guideline Review Working Group to reorganize and make technical corrections to the Statement of Investment Objectives and Guidelines with the goal of producing a more concise and user friendly document for all users.
- Engagement of a new Investment Consultant (January 2106), NEPC, through the State's competitive bid process to provide expertise in the oversight and evaluation of the public fund investments under the Board's purview.
- Began the competitive bid process for custody holding services for the State's public funds investment accounts.
- Initiated the competitive bid process for both Merchant Services (credit card processing) and Direct Deposit of payroll and pension funds.
- Initiated a study of collateralization methods used by other states and various options available with current banking vendors to best safeguard public funds.
- Commenced work with NEPC to analyze the seasonality of liquidity needs for the state and the optimization of invested funds to meet both anticipated and unanticipated needs.

## **OVERVIEW OF THE BOARD'S GOALS FOR FY17**

- Completion of Liquidity Analysis with NEPC and the optimal re-allocation of invested public funds between liquidity and reserve managers.
- Engagement of an outside banking consultant to analyze the State's current banking architecture and determine the optimal mix of banks to meet cash management needs.
- Completion of procurement and contract negotiation processes for merchant banking and direct deposit banking services, including the development of vendor management practices to monitor provision of these services.
- Completion of procurement and contract negotiation process for custody services.
- Identification and centralization of bank accounts held by state organizations "outside" of the state accounting system.
- Implementation of new operational procedures to minimize intra-day collateralization risk with the State's largest cash management banks.
- Engagement of outside special counsel to assist in contract negotiations with banking and investment vendors and other special projects on behalf of the Board.

## **INVESTMENT PERFORMANCE RESULTS FOR FISCAL YEAR 2016**

### Total Liquidity Portfolio Results

As of June 30, 2016 the market value of the Liquidity Portfolio was \$922,376,736. The Liquidity Pool generated a Fiscal Year 2016 return of 0.80%, which outperformed its Custom Index return by 0.04%. Contribution to the above benchmark return was due to two of the four actively managed accounts exceeding the benchmark, while a third actively managed strategy performed in line with the benchmark. An overweight to high quality corporate, structured credit securities, and CD's performed well during the year. In addition, allocating away from treasury and agency securities was beneficial to the portfolio, as the credit spread between corporate securities and comparable treasuries narrowed over the course of the fiscal year.

### Total Reserve and Operating Portfolio Results

As of June 30, 2016 the market value of the Reserve and Operating Portfolio was \$920,863,513. The Reserve and Operating Portfolio generated a Fiscal Year 2016 return of 2.29%, which outperformed its Custom Index return by 0.23%. Contribution to the above benchmark return was due to four actively managed accounts exceeding the benchmark, while the remaining actively managed account narrowly underperformed the index. Overweight positions, relative to the Custom Index, in corporate and structured securities were beneficial to the portfolio as credit spreads narrowed during the year. Longer duration positioning also positively affected the portfolio's results, as interest rates declined year-over-year.

### Total Land and Water Endowment Fund Results

As of June 30, 2016 the market value of the Land and Water Endowment Fund Portfolio was \$62,183,455. The Land and Water Endowment Fund generated a Fiscal Year 2016 return of -1.49%, which underperformed its Custom Index return by 2.41%. Contribution to the below benchmark return during Fiscal Year 2016 was due to two of the three actively managed strategies underperforming the benchmark. Contributing to the below benchmark results was an above benchmark allocation to non-US equity markets, which trailed the US equity market, along with subpar stock selection in several of the larger equity markets. Overweighting to non-US positions also subtracted value as the US dollar appreciated relative to developed international markets.

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**Fiscal Year ending June 30, 2016**

	Market Value(\$)					
	Ending June 30, 2016	% of Portfolio	1 Yr(%)	3 Yrs(%)	5 Yrs(%)	10 Yrs(%)
Delaware Total Consolidation	1,905,423,704	100	1.46	1.05	0.86	1.88
Total Liquidity	922,376,736	48.41	0.8	0.56	0.54	1.62
Liquidity Custom Index			0.76	0.5	0.44	1.72
Over/Under			0.04	0.06	0.1	-0.1
Insight Investment	229,364,881	12.04	0.76	0.49	--	--
PFM Asset Management	232,046,442	12.18	0.86	0.66	--	--
Wells Capital Inv. Liquidity	230,611,290	12.1	0.75	0.54	0.5	1.55
Wilmington Liquidity	230,354,123	12.09	0.85	0.54	0.57	1.87
Total Reserve & Operating	920,863,513	48.33	2.29	1.53	1.25	2.52
Reserve Custom Index			2.06	1.47	1.31	2.87
Over/Under			0.23	0.06	-0.06	-0.35
Chandler Asset Management	115,339,603	6.05	2.57	1.81	--	--
Federated Investors	162,610,848	8.53	2.64	1.66	--	--
JPM Intermediate	246,283,015	12.93	2.26	1.54	--	--
Morgan Stanley	173,714,721	9.12	2.23	1.48	--	--
Schroder Intermediate	165,520,050	8.69	2.02	1.39	1.21	2.42
Total Land & Water Endowment	62,183,455	3.26	-1.49	--	--	--
L&W Endowment Custom Index			0.92	5.96	5.71	--
Over/Under			-2.41			
SEI Funds	20,203,771	1.06	1.03	--	--	--
MSIFT Global Strategist	19,460,774	1.02	-2.7	--	--	--
JP Morgan Diversified	19,512,506	1.02	-2.45	--	--	--
Cash Account	3,006,404	0.16	0.17	--	--	--

Source: NEPC

Notes: Net of Fees. Results for periods longer than one year are annualized  
Performance history through 12/2015 is from BNY Mellon. NEPC Performance start date is January 2016. Fiscal Year end is June 30.  
Liquidity Custom Index is comprised of 25% BofA Merrill Lynch 1-3 year Govt/Corporate A+ or Better/ 75% 6 Month Treasury Bill.  
Reserve Custom Index is comprised of 75% BofA Merrill Lynch 1-5 year Govt/Corporate A+ or Better/ 25% 6 Month Treasury Bill.  
L&W Endowment Custom Index is comprised of 60% MSCI World Index/40% Barclays Capital Aggregate.

## OVERVIEW OF THE CASH MANAGEMENT POLICY BOARD

**Creation of the Board.** The Cash Management Policy Board was created by the General Assembly as a provision of Title 29, Section 2716 of the Delaware Code when it was signed into law on July 13, 1981. In accordance with the code, the Board is required to submit an annual report to the governor and General Assembly that reviews the State’s cash management practices and performance.

**Mission.** The Board exists to create policies and provide oversight for the investment of all money belonging to the State or on deposit from its political subdivisions, except money deposited in any state pension fund or the State Deferred Compensation Program, and to determine the terms, conditions and other matters relating to those investments, including the designation of permissible investments.

**Responsibility.** In carrying out its function to designate permissible investments, the members of the Board are required to exercise the same level of prudence, discretion and intelligence as they would in the management of their own affairs with due regard to the probable income and level of risk from investments belonging to the State.

**Authority.** The Board is authorized to adopt rules and regulations for the general administration of its duties, and to enter into agreements or contract for the services of private and public consultants, research, or other services, and facilities whenever deemed necessary by the Board.

**Composition of the Board.** The Board is comprised of nine members, four of whom are government officials serving “ex officio” and five of whom are financial experts from the private sector appointed by the Governor and approved by the Senate. At the end of FY 2016, the Board was comprised of these members:

### *Appointed members*

Mr. John V. Flynn, Jr. (chairman)  
Managing Director, Healthcare Resource Solutions

Mr. David F. Marvin  
Partner, Marvin & Palmer Associates, Inc.

Mr. Warren C. Engle  
Retired, Senior Vice President, PNC Bank

Mr. Mike Karia  
Treasurer, MK Consulting, Inc.

Ms. Lynda A. Messick  
Consultant – Bank Governance Advisors

### *Ex Officio members*

Mr. Thomas J. Cook  
Secretary of Finance

Mr. Jeffery W. Bullock  
Secretary of State

Mr. Kenneth A. Simpler  
State Treasurer

Mr. Michael L. Morton  
Controller General