MINUTES FROM MEETING OF CASH MANAGEMENT POLICY BOARD
BUENA VISTA CONFERENCE CENTER
MARCH 28, 2014

A meeting of the Cash Management Policy Board (the "Board") was held on Friday, March 28, 2014 at 10:00 am at the Buena Vista Conference Center, 661 South DuPont Highway, New Castle, DE 19720.

Board Members in Attendance:	Honorable Chip Flowers, State Treasurer (via phone) Honorable Tom Cook, Secretary of Finance Honorable Jeff Bullock, Secretary of State (via phone) Honorable Michael Morton, Controller General Mr. John Flynn (via phone) Mr. Warren Engle (via phone) Mr. Mike Karia Mr. David Marvin
Others in Attendance:	Deputy Attorney General Ed Black Mr. Steve McVay, Treasury (via phone) Mr. Jeff Hoover, Treasury (via phone) Ms. Kelly Callahan, Treasury Mr. Chip Kurtzman, Credit Suisse Securities (USA) (via phone) Mr. Jamie Johnstone, Department of Finance

Mr. Flynn called the meeting to order at 10:07 am.

Minutes

There was conversation concerning the November 2013 minutes and whether minutes should include more detail concerning discussions on various topics. Mr. Flynn asked members to provide opinions about the detail level of the minutes to Kelly Callahan.

Approval of the November 2013 minutes was delayed until the anticipated June 2014 meeting.

Joint Sunset Committee ("JSC") Update

Secretary Cook provided a draft of a new response to the Joint Sunset Committee. This draft included the Treasury's original response on behalf of its office with additions or dissenting opinions from those completing on behalf of the Board. Mr. Flynn solicited comments on the draft from the members of the Board excluding the Treasurer.

Treasurer Flowers questioned, as a point of clarification, whether the Board wanted to reflect the areas where the responses were in alignment or whether it was the intent of the Board to maintain separate responses. Secretary Cook says he tried to reflect where the responses were consistent. Treasurer Flowers commented that the Treasury's response was completed prior to the passage of SB 151 and certain responses may need to be updated. Mr. Flynn remarked that understanding that, Mr. Flynn, Secretary Bullock, Secretary Cook and Treasurer Flowers would all be represented at the JSC and have the chance to clarify points at that time. Treasurer Flowers requested time to change the Treasury's responses where necessary as a result of SB 151. Secretary Cook cited a deadline of that day and said he would make modifications based on Treasurer Flowers' March 27 email and then submit. Secretary Cook went on to state that he received no responses from the Board concerning the draft he distributed to the Board.

Mr. Flynn made a motion to accept the questionnaire as presented to be sent to the JSC. Secretary Cook noted that he would modify Sections 2C and 2F of the response with necessary corrections as requested by the Treasurer and would submit. The motion carried without objection.

Annual Report

Mr. Flynn asked if members reviewed the annual report sent by the Treasury to the Board. Secretary Bullock stated that the report only focused more on the cash management section of the Treasury than the Board, but he had no issue as this was the traditional format of the report. Treasurer Flowers confirmed that this was the format used for many years and Secretary Bullock expressed that he understood such as the authors of the report (members of the Treasury team) had remained the same for a number of years.

Secretary Bullock made a motion that the annual report be adopted and sent to the requested parties. Mr. Karia seconded the motion and without objection, the motion carried.

Request from Department of Natural Resources and Environmental Control ("DNREC")

Mr. Flynn commented that he felt the Board approved in concept the changes Secretary O'Mara presented and the request to separate the Land & Water Fund from the guidelines, but that he thought Secretary O'Mara was going to come before the Investment Subcommittee with the recommendations. He questioned if anyone knew the status of this request. Treasurer Flowers commented that Secretary O'Mara and team met with Schroders and sent an email to Mr. Flynn asking how they should address with the Investment Subcommittee. They did not receive a response. Mr. Flynn expressed his desire to proceed as the Board traditionally does with policy changes and for Secretary O'Mara to present changes to the investment subcommittee. If the subcommittee chooses, it can make a recommendation to the entire Board to accept or not.

Secretary Bullock commented that he had seen a draft of the proposed changes and asked if they had not been seen by the Investment Subcommittee. Treasurer Flowers said that he knew Secretary O'Mara met with Schroders, but did not believe he met with Mr. Marvin's subcommittee. Secretary Bullock expressed his desire to move this process along as DNREC made the request last year. Mr. Flynn said someone would need to reach out to the Investment Subcommittee. Secretary Cook then requested a clarification of the process. He asked if the Investment Subcommittee would meet, hear the changes and make recommendation to the Board for the next meeting. This was confirmed.

Administrative Procedures Act ("APA")

Mr. Black asked to be recognized and wishes to express clarification that his opinions were not in conflict with the letter the Board received from the Attorney General's Office via Mr. Elio Batista in December 2011. He stated that the issue is not whether the APA applies to the Board necessarily and gave the history of the timing of the APA relative to the creation of the Board. The adoption that made all Boards subject to the APA left questions concerning the definition of a regulation and the applicability of such rules to certain Boards. The opinion by Mr. Batista remains the opinion of the Attorney General's Office. This means the catch-all includes the Board and makes it subject to Subchapters 1 and 2 and Judicial Review. It does not answer the question of specific interest concerning whether a new guideline or amendment to existing guidelines constitute "regulations" according to the APA and if the APA process is required.

Mr. Flynn commented that he did not care if the Board was exempt or not, but asked for the Attorney General's Office to clarify if changes in duration, etc. are covered or not. He further asked that if it is covered for duration or quality changes, that the Attorney General's Office draft a position that the Board has emergency power – whatever it is, whether it be signed by the Treasurer, Chair or member of the Board to approve.

Mr. Black commented that there was already a provision for adopting emergency regulations and then go through the process after the fact, but he would confirm applicability to the Board. Mr. Flynn asked for clarification that if there is an emergency provision, who would have to sign off on it and what was a reasonable path forward.

Mr. Bullock commented that this discussion on applicability of the APA has gone on too long. He mentioned that he felt as a practical issue that the Board could be faced with this at the next meeting if DNREC's proposal was recommended by the Investment Subcommittee.

Secretary Cook asked for some clarification on what Mr. Black was asking the Attorney General's Office to opine. Mr. Black stated that it was to clarify whether duration or quality changes count as regulations such that they apply to the full APA process. Secretary Cook asked if part of the APA, that there be clarification for emergency situations and who would sign. Treasurer Flowers expressed the belief that under existing law if the Treasury faced an emergency situation, it could take action and present action for consent or rejection at the next Board meeting. Mr. Black asked for permission to confer with Mr. Peter Jamison on the issue and Treasurer Flowers agreed.

Secretary Cook expressed concerns that Treasury could act in emergency without other signatures. Treasurer Flowers expressed concerns about obtaining necessary signatures in the midst of a crisis when time was of the essence. More discussion ensued about electronic means to obtain the signatures and whether this can work. Mr. Black will examine all available aspects.

Collateralization

Mr. Flynn stated that the Cash Management Policy Board Investment Policy guidelines deal with collateralization in Section 5, but that Treasurer Flowers wrote in his letter to the Board that Section 5 is not adequate. Mr. Flynn commented that the investment managers do not hold funds as they are held by a custodian bank and since managers don't have possession of state funds, why is collateralization needed.

Treasurer Flowers informed the Board that money invested is indeed held at a custodian bank. However, the state has exposure on all money held as cash in banks including about $60-70M in bank accounts. Unclaimed property has about $200+M exposed. There are also significant sums of money in Treasury accounts waiting to be put at the custodian bank or waiting to be paid out that are not required to be collateralized. The Treasurer further commented that collateralization does not cost the state money because the banks agree that such funds have to be collateralized.

Mr. Flynn opened the floor for comments. Mr. Karia asked for clarification that the money was not that in investment accounts, but in bank accounts. Mr. Marvin had no objection nor did Mr. Karia who expressed that collateralizing these funds was a good idea. Mr. Engle said he had no issue as periodic cash flows can be significant and there was a concern with them not being collateralized. He suggested an annual review with banks the state does business with to ensure they are operating properly. Treasurer Flowers suggested a future call with Mr. Engle and the Treasury team to discuss further.

Mr. Bullock asked if the Board needed a motion to accept the Treasurer's recommendation. Upon confirmation, he made such motion. Mr. Engle seconded the motion. Hearing no objection, the motion carried.

Credit Suisse Report

Mr. Flynn acknowledged receipt of Credit Suisse's letter to the Board and asked Mr. Kurtzman to provide his report. Mr. Flynn inquired of the status of compliance with the Board's requested allocation percentages and Mr. Kurtzman questioned whether this was in regards to the 50/50 liquidity versus reserve allocation. Treasurer Flowers noted that the portfolio was in alignment with the Board's requested 50/50 +/- 5% allocation standard under existing law that passed February 14, 2014. The

Treasury was waiting for the Board's guidance on how to reposition amongst the various managers to achieve an equal allocation to each manager in the respective immediate and liquidity mandates.

Mr. Flynn questioned whether the portfolio was in alignment with the 50/50 standard based on the reports Mr. McVay sent to the Board. Mr. Kurtzman walked through the reports sent and directed the Board to the appropriate page which reflected a 53/47 allocation which is in alignment with the 50/50 +/- 5% standard. Mr. Marvin questioned when this standard was achieved and Mr. Kurtzman confirmed that the portfolio reached that number in January. Treasurer Flowers confirmed that the portfolio moved back into that direction upon passage of the new legislation. Mr. Kurtzman confirmed that the portfolio has been in alignment since and is adjusted as cash comes in and out.

Mr. Marvin asked for a rough estimate on how much money it cost the state being out of compliance. Treasurer Flowers took issue with the use of "out of compliance" since the law had just passed February 14, 2014 and stated that the state probably made more money over the last three years under the Treasury's allocation strategy. Mr. Marvin stated that with the move of the 10 year bond rate, there had to be a loss of money. Treasurer Flowers said that the Treasury will take into account the entire measurement period and not a particular timeframe that benefits the Board or the Treasury. Mr. Kurtzman clarified that the portfolio duration is under 1.5 years and that the 10 year bond rate change was not representative of the portfolio.

Mr. Kurtzman continued with his report. The portfolio increased 48 basis points ("BP") year to date ("YTD") (based on first two months). Secretary Cook asked for clarification that YTD was calendar year. Mr. Kurtzman confirmed this and went on to present more results. The reserves have done well and were up 81 BP YTD versus a benchmark of 50 BP. The liquidity accounts were up 6 BP versus a benchmark of 10 BP. In the first two months of the year, the longer portion of the portfolio performed better against the benchmark. Mr. Marvin stated that these numbers were all from January because the 10 year bond rallied from 300 to 260 BP. Mr. Kurtzman clarified that this was not correct and that the portfolio was up 10 BP in February.

Mr. Kurtzman provided Credit Suisse's market outlook for the coming year. Mr. Marvin questioned what the data had to do with how the managers of the portfolio were positioned. Mr. Kurtzman clarified that the managers are positioned short, thus the portfolio is more liquid, because of how the benchmarks are created. Mr. Marvin continued to challenge this assertion and Mr. Kurtzman continued with the presentation.

Mr. Kurtzman went on to review some recommendations from Credit Suisse concerning the portfolio which were sent in a previous letter to the Board. The first recommendation was to have monthly calls with the managers to share with them when it's time to be cautious because of very low break-even levels and to avoid taking too much risk as rates increase as is predicted over the next year. Another recommendation included forecast model flow forecasting. Treasurer Flowers noted the difficulty with staying within the 50/50 +/- 5% mandate because of cash flows. He stated the preference for taking money from the liquidity accounts rather than the reserves because of the difficulty posed on reserve managers to properly manage the accounts if funds were constantly being taken from the accounts. Mr. Marvin questioned why money was being taken from the reserve accounts. Mr. Kurtzman clarified that it was a necessity to stay within the 50/50 mandate. Mr. Marvin questioned why the liquidity might be on the high side and Mr. Kurtzman explained that this had to do with money coming into the accounts. Mr. Engle asked for confirmation that cash was not included in the 50/50 mandate. Treasurer Flowers confirmed that the Board had not decided to factor cash in the allocation percentages.

Mr. Kurtzman continued with some additional recommendations including the addition of senior secured loans as they are traded off LIBOR and would serve as a defense against inflation. As interest rates rise, the rates of the loans would go up thus neutralizing the portfolio against rising rates. Credit Suisse believes this would be a smart addition to the Board's permissible investment list in the Board's guidelines.

Mr. Marvin commented that he assumed someone would call and request the Investment Subcommittee get together to review as this was his preferred method to propose new recommendations and not before the Board as a whole.

Mr. Kurtzman also noted some additional recommendations. He discussed some situations where the managers wanted to sell investments that were "legacy positions." They are unable to do so because they would have book losses posing an issue per the guidelines which consider book over market. Mr. Marvin agreed that the guidelines state book versus market and this may need to be changed at the next meeting. Mr. Flynn stated that he was surprised this issue was coming up again as a note was sent to the managers 7 years ago telling them to look at market over book. He agreed that this should be in the Board's guidelines so it does not come up again.

Mr. Kurtzman also discussed the changes proposed by DNREC in the land and water funds. The policy would have to change to allow the investment in securities. The history of the funds shows an ability to handle more risk in accordance with the goals of the funds. There was a recommendation that the Board look at more than one proposal before handing over a portfolio of over $70M. The money is currently in Schroders, but it should be considered if the funds should be divided by manager based on expertise if the changes are permitted. This could be discussed at the Investment Subcommittee meeting to hear the request from DNREC. Treasurer Flowers noted that the managers were selected in the latest Request for Proposals based on the Board's guidelines at the time. The managers were not evaluated on performance or management of equities as they are not permitted under the current guidelines. The Treasurer understood Secretary Bullock's request to move the process to approve the DNREC request quickly, but expressed concern that it is unclear if the managers are qualified in this area as they were not vetted from an equity performance perspective. Mr. Kurtzman expressed his concern as well as the Board's guidelines don't allow for anything other than fixed income.

Mr. Flynn inquired as to whether the question to get into compliance with the Board's allocation standards had been addressed. Treasurer Flowers indicated that the Treasury has no position on how the Board wants to move money from the various managers or accounts. He posed two questions to the Board: (i) Does the Board still want to go to even distribution amongst managers irrespective of the portfolio's performance? (ii) If so, tell the Treasury how the Board wants this done. Treasurer Flowers stated that the Treasury deferred the decision to the Board on how to move the money.

Mr. Marvin indicated that no scientific studies were necessary and that the money should be divided evenly amongst the managers. In the liquidity category, each of the 4 managers should get 12.5% of the portfolio to achieve the 50% liquidity mandate (4 x 12.5% = 50%). Mr. Marvin expressed his desire for equal allocation as he said that no one knows future performance and the division of anything of other than equal means a choice is made as to who is better. He stated his desire to take from the above average percentage accounts and redistribute to the accounts below the average allocation. Secretary Cook asked since there was a new slate of managers in April what the methodology was of distributing money at that point.

Treasurer Flowers noted that the Board and the Treasury disagreed in allocation as the new managers were implemented. The Treasury cited 3 criteria in determining allocation amongst managers: (i) Performance – those who made more got more; (ii) Diversification – looked at expertise of the managers; and (iii) Resources of Managers. The legislation made it clear on February 14 that the Board makes the call and as a result, some securities will have to be moved. Treasurer Flowers said it was not as simple as dividing by 4 as Mr. Marvin implied since there are transfer costs and some managers do not have expertise in these securities and may want to sell. Treasurer Flowers confirmed though that he will execute as the Board desires.

Mr. Flynn questioned why with monthly cash flows money could not be reallocated from the managers above the allocation percentage to those below the percentage. He recommended moving the cash. Treasurer Flowers noted that there is not that much cash and the cash coming in is used to pay the state's bills. Some shifting would have to take place in order to align with the mandate immediately. Mr. McVay commented that cash could be used, but it would take 2-3 months for that amount to become available. Mr. Engle inquired as to whether this change was required to allocate equally amongst the managers and not the 50/50 mandate. The Treasurer confirmed that as of February 14, the portfolio has been in alignment with the 50/50 mandate. The reallocation could potentially be achieved via cash flows, but this process could take 90 days or more. Mr. Morton asked if the Board could give wiggle room until the next meeting in June and see the progress at that time. Mr. Flynn made a motion that the Board ask the Treasury and Credit Suisse to move towards meeting the current policy set by the Board using cash in and out and the maturity of investments in the institutions above the allocation levels and report the progress of this at the June meeting. Mr. Karia seconded the motion and without objection, the motion carried.

Banking Committee Report

There was no banking committee report.

New Business

Mr. Flynn indicated his intention to hold a meeting in the first week of June before the summer rush and asked the Treasury to contact the managers to see their availability.

Return to Allocation Motion

Mr. Hoover asked for clarification as to whether the most recently passed motion applied to both the reserve and liquidity accounts. Mr. Flynn stated that it would just apply to liquidity. He commented that since the reserve managers were not as "seasoned," it did not make sense to do equal allocation. Mr. Flynn requested that when the Board meets in June, the Treasury provides information as to the allocation amounts given to each reserve manager, the reason behind that allocation and a report on the safety and security of the managers.

Return to New Business

Mr. Flynn said he would pick a day in the middle of the first week of June for the meeting. Secretary Cook requested a morning meeting and Treasurer Flowers said the Treasury would check with the managers.

Public Comment

There was no public comment.

Return to New Business

Secretary Cook requested an Investment Subcommittee meeting prior to the June Board meeting to address the DNREC request. Secretary Bullock stated his objective to bring this issue as an item of business in June. Secretary Cook requested clarification on the role of Credit Suisse to the Board and Treasurer Flowers suggested that this would be answered in detail in upcoming discussions. Both Secretary Cook and Treasurer Flowers discussed the positive nature of the day's meeting and a desire to continue this in the future.

There was a motion by Mr. Karia to adjourn the meeting. Treasurer Flowers seconded the motion and without objection, the meeting adjourned at 11:33 am.