

MINUTES FROM MEETING OF CASH MANAGEMENT POLICY BOARD
BUENA VISTA CONFERENCE CENTER
JUNE 5, 2014

A meeting of the Cash Management Policy Board (the “Board”) was held on Thursday, June 5, 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
Mr. Warren Engle
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)

Mr. Flynn called the meeting to order at 10:05 am.

Minutes

There was conversation concerning the minutes from the two previous meetings and which format was preferred. Mr. Flynn noted that he preferred the format used for the March 28, 2014 minutes.

Secretary Bullock made a motion to approve the November 19, 2013 minutes. Treasurer Flowers seconded the motion, and without objection, the minutes were approved. Secretary Bullock then made a motion to approve the March 28, 2014 minutes. The motion was seconded by Mr. Karia, and without objection, the minutes were approved.

Investment Subcommittee Report

Mr. Marvin provided an update on the subcommittee meeting held on May 21. Representatives from the Department of Natural Resources and Environmental Control (“DNREC”) were present. It appears that Mr. Marvin’s impression of DNREC’s request was different from the intention of the committee and members of the department concerning the change in guidelines. Mr. Marvin proposed that DNREC remove the Land & Water fund (“L&W Fund”) from the Board’s control. Secretary Cook gave a brief history of a bill currently in the General Assembly that would remove those funds from control of the Board and place with the Delaware Community Foundation. As the Secretary explained, such an act would require legislation and there are concerns over removing the control of state funds from state oversight. Secretary Cook then inquired if there was not the capability to set aside the L&W Fund and place different parameters around it.

Mr. Marvin said this could be done, but he felt it was better if DNREC removed the L&W Fund. Secretary Bullock said that was a fair opinion, but that was for the Legislature to decide. He then inquired about the presentation Schroders was to present at the subcommittee meeting. Mr. Marvin said they did not hear the presentation because DNREC wanted permission to leave and he thought that was best. Secretary Bullock further commented how this was an item for the Legislature to decide and asked if there was any action on the Schroders recommendations. Mr. Marvin explained that there was not. Secretary Bullock expressed his disappointment in that and his understanding that the subcommittee was to review the proposal. More discussion ensued about the legality of the proposed legislation and how to handle the L&W Fund. Mr. Marvin retained his recommendation that the L&W Fund leave and Mr. Flynn placed Mr. Karia in charge of reviewing the proposal from Schroders to change the guidelines for the L&W Fund.

Mr. Karia provided two changes to the guidelines recommended by the subcommittee for Board review. The changes are as follows:

Page number 3: Section II, Point number 3

To add 2nd paragraph after current first paragraph:

In case of such purchases, the Board expects an investment manager to ignore the book gains and losses and sell the security. An investment manager will inform the Delaware State Treasury about these transactions immediately.

Page number 3: Section number II, Point number 4

To add 2nd paragraph after current first paragraph:

In such downgrade of currently held investments, the Board expects an investment manager to sell the securities without any consideration to the book gains and losses. An investment manager will inform the Delaware State Treasury about these transactions immediately.

Mr. Karia made a motion to approve the changes. Treasurer Flowers requested the friendly amendment of inserting “Delaware State” prior to Treasury (change reflected above) and Mr. Engle seconded the motion with the additional language inserted. Without objection, the motion carried.

Deputy Attorney General’s Report

Mr. Flynn inquired with Mr. Black about the items the Board asked the Attorney General’s Office to review. Mr. Black explained that when the investment guidelines for the Board were set, they were not subject to the Administrative Procedures Act (“APA”). That has changed. That being the case, it was Mr. Black’s opinion that changes to the guidelines have to go through the APA. Mr. Flynn asked if changes to duration were included, etc. Mr. Black explained that there are corrections to regulations that exist which can be adopted as final changes without public hearing. There is a “facts and circumstances test” to determine which changes fit this category and the list of potential changes is relatively small. Mr. Black said the problem is the law of unintended consequences.

According to Mr. Black, if the Board gets to a position where it needs to change a final regulation, the Board will have to publish the entire set of guidelines as a regulation. The changes and the guidelines could then be adopted as final format. The regulations would have to be published in a particular format that the regulator, Mr. Hayes, prefers. If there is a major change, it would require a public hearing. The Board would also need to leave a window open of 14 days for written comment. The second way to do this would be to publish the regulations and ask for written comment only. The third option is if it is a technical exercise only, the Board can adopt as a final regulation, but it would have to be open for a period of time.

Treasurer Flowers thanked Mr. Black for his review and commented that the application of the APA to the Board Mr. Black described was as he had stated in the past. He questioned whether the most recent change recommended by the investment subcommittee and proposed earlier in this meeting would be categorized as a technical change. He then inquired as to whether a change in a different type of investment security (change to "A" securities, for example) would be considered a substantive change. Treasurer Flowers further questioned if the Board could include the change to "A" in the first publishing and then go forward with the other changes per the APA process after this initial posting. Mr. Black stated that the Treasurer was correct on all matters.

Treasurer Flowers then made a motion that the Board move to publish the existing investment policy guidelines subject to the changes proposed by the Board at the current meeting and proposed by the Board in 2012 to move to "A" securities and permit additional countries where securities are based. After the motion, there were questions on the status of the other recommended changes such as the "A" securities and country permission. Those changes have not been adopted. Mr. Black clarified that if there is an emergency, the Board can adopt a limited process. Treasurer Flowers inquired as to how long the process would take for the changes to be implemented. Mr. Black clarified that it was about a 60 day process at the earliest, not including a public hearing. This timeframe would include allowance for written comments. He then outlined a potential timeframe for the process in detail. Upon conclusion of the discussion, Mr. Karia seconded the motion made by Treasurer Flowers and without objection, the motion carried.

Further discussion ensued about clarifying the definition of an emergency under the procedure. Mr. Black explained there are no definitive definitions of an emergency. Again, it is really a facts and circumstances test. As statute stands, either the Treasurer or Chair can call a meeting at any time. If Board deems an emergency meeting is necessary, the Board can meet telephonically and not face to face. The Board would have to determine an emergency according to Mr. Black, which would be determined by a majority indicating such. Further discussion ensued. Treasurer Flowers clarified that every agency has a statute that lets certain procedures commence in an emergency. Practically, anything affecting the portfolio is rarely an emergency he stated. Such an emergency with the portfolio would be a rare issue such as a Bank losing its charter and the money needing to be moved immediately. Treasurer Flowers went on to state that there is a provision in the statute that requires him to move the money operationally, but he could not figure any scenario that impacts the Board process as the item would have to come back to the Board within 30-60 days anyway. Mr. Black stated this is the definition of a facts and circumstances emergency and that the Treasurer obviously has such power or there would be no reason for the office.

Mr. Black requested copies of the contracts with investment managers to distribute to Board members. The Treasury will provide the contracts to Mr. Black for distribution. Mr. Engle inquired as to whether the Board was responsible for details of contracts since he did not personally assist in their creation. Mr. Black responded that the Board would not be responsible for details, but needed to know the details.

Credit Suisse Report

Mr. Kurtzman provided the report on the investment managers and performance. Currently, portfolio distribution among the liquidity managers is basically equal. Mr. Marvin inquired why the reserve was so different with JPMorgan Chase and Company ("JPMorgan"). Mr. Kurtzman explained that JPMorgan holds the state's Rainy Day Fund while Schroders holds the L&W Fund. Mr. Flynn inquired if more money was going to the Rainy Day Fund and Secretary Cook described how this number is determined. Secretary Cook inquired as to whether there were any losses incurred by bringing the portfolio to equal alignment among managers. Mr. Kurtzman explained that there was not as this was achieved through maturities. Mr. Kurtzman said that the unaudited numbers for May were good (up 16 basis points) bringing the year to date increase to 79 basis points. The liquidity category is up 2 basis points to 18 basis points year to date.

Banking Committee Report

Mr. Engle explained that there was a Request for Proposals (“RFP”) for over-the-counter items. Two banks responded to the RFP and one was the incumbent. On an average day, about \$49 is deposited at Citizens Bank by state agencies over-the-counter. Mr. McVay explained that the two respondents were Citizens Bank and M&T Bank. Overall, the committee was pleased with Citizens Bank’s offer, their prior service to the state and their fee proposal. The RFP committee voted unanimously to recommend Citizens Bank. Mr. Engle made a motion to approve Citizens Bank as the over-the-counter depository agency for the State and Secretary Cook seconded the motion. Without objection, the motion carried. Mr. McVay noted that the contract would likely be for three years with a one-year extension option. There was discussion as to who would be involved with the contract creation and Mr. Black said that would be left to the Treasury with advice from its counsel. Mr. McVay noted that as approved at the April 2013 meeting, the Treasury would prepare for the next banking services RFP likely to be distributed in August.

Mr. Marvin and Mr. Bullock both requested a shift in the agenda to allow for discussion on items not related to the investment managers’ performance reviews as they needed to depart at a specific time. Mr. Flynn complied.

Joint Sunset Committee (“JSC”) Update

Secretary Cook provided a status update on the Board’s review before the JSC. Two bills were established as a result of the process. The first is HB 365 which Secretary Cook stated lets the Board enter into agreements with consultants (requests that Treasurer’s consultant be available to the Board), sets the minimum number of meetings per year at four, clarifies the powers and duties of the Board, and moves administrative and budgetary support of the Board to the Department of Finance (“Finance”). Mr. Morton said those recommendations in HB 365 were voted out of committee the day prior (June 4) and would likely be debated on the House floor the following week. Mr. Flynn asked for an explanation on the staffing recommendation and how this would affect Mr. McVay, Mr. Hoover, etc. Secretary Cook explained that the bill would not affect day-to-day operations at the Treasury and would shift such responsibilities as minutes, posting of public meetings, etc. to Finance. Mr. Flynn inquired as to whether contracts would be Finance’s responsibility and Mr. Morton clarified they would not be as day-to-day functions would remain at Treasury.

Mr. Flynn then asked for further clarification with regards to contracting with the consultant. Secretary Cook said the legislation says the Board has to approve and can ask questions. Mr. Marvin asked if that means the Board hired Credit Suisse or if Credit Suisse works for the Treasury or all. Secretary Cook said the message the JSC was sending was that the state hired the consultant and not only Treasury, but the Board should have access. Secretary Bullock said this point was a little less than clear, but essentially Secretary Cook was correct that the JSC wanted one consultant and not one for Treasury and one for the Board. Mr. Engle asked if the legislation passed if the Board had to vote on Credit Suisse and Secretary Cook said there would be a subsequent vote. Treasurer Flowers noted two points of clarification. The first was that the Board initially disagreed about hiring an investment advisor and that was fine. There were two issues now involved. Credit Suisse does certain operational activities for the Treasury and that would not change. The Treasurer noted this was just like many Cabinet secretaries who have consultants for their departments. Treasurer Flowers clarified that the JSC was reviewing the Board and not the Treasury. Operationally, the Treasury would be keeping its own advisor. That portion of the Credit Suisse contract that applies to advising the Board is what could change. Mr. Marvin asked if he and Mr. Karia wanted to hear fifteen minutes from Credit Suisse about the market or something the Board authorized and wanted a report (such as asset-backed securities, etc.), do they have the ability to call up Credit Suisse and ask them to come. Mr. Marvin said that was what he wanted as opposed to the Board and the Treasury having different consultants. Treasurer Flowers stated that as the legislation currently stands, the Board has to make a decision to use Credit Suisse for their own consultant or if they want someone else. The Treasury would be open to the Board using Credit Suisse and is sure they would be

open to it as well. The legislation the Treasurer clarifies shifts the decision to the Board to decide to RFP the process or use Credit Suisse. Secretary Cook asked if Treasurer Flowers knew how the contract for Credit Suisse was funded and the Treasurer noted that all Treasury contracts come from the Appropriated Special Funds (“ASF”) line if it deals with investments. This never came from General Fund (“GF”) money as it is operational. Mr. Flynn inquired as to the definition of ASF which was explained.

Secretary Cook stated that there was one other piece of legislation as a result of the JFC recommendations. It is HB 381 which requires annual financial disclosure for appointed Board members just as the other Board members are already required to do. Mr. Flynn inquired as to whether this requirement was specific to the Board or all financial boards. Secretary Cook noted that the legislation adds line item G to the list of Boards that must disclose. He noted that there were questions as to the difference between the Board and DEFAC, etc., but the JSC recommended this. Mr. Engle then asked for clarification if it was this board only and Secretary Cook noted it also applies to the Public Integrity Commission. The difference he stated is that they get a salary.

Investment Manager Reports

The representatives from each manager that provided performance reports at the meeting are noted. For detailed copies of the numbers contained in their report, copies of the performance packets are available.

Cutwater – Mr. Jason Cilente

PFM Asset Management – Mr. Steve Faber, Mr. Jeff Rao

Wells Fargo – Ms. Janette Dziadon, Mr. Jeff Lang, Mr. Rick Welsh, Mr. Travis Dugan (via phone)

Wilmington Trust – Mr. Dominick D’Eramo, Ms. Rosemary Hoffman

Conclusion

Mr. Flynn asked Mr. Kurtzman to complete a few requests as part of Credit Suisse’s proposed new role to the Board. First, Mr. Flynn said he was personally confused with the benchmarks and how they originated. In the past he said, the Board lined up all four managers against each other and Mr. Flynn did not see this being done. Mr. Marvin said this process came from years ago when they didn’t establish benchmarks and let the managers compete against each other. Mr. Marvin said people can always outperform a benchmark. Since no one knows long-term policy he commented, there should be a discussion on what would be an appropriate benchmark, if any. Mr. Kurtzman clarified that a performance by entity comparison is included on the Treasury’s web site and distributed to members of the Board monthly as has been practice. Mr. Flynn acknowledged he had not reviewed this in the recent past. Mr. Kurtzman then clarified how the benchmarks are determined and why certain managers may have outperformed others based on their positions.

New Business

There was no new business.

Public Comment

There was no public comment.

There was a motion by Secretary Bullock to adjourn the meeting. Mr. Flynn then adjourned the meeting at 11:55 am.