NEPC, LLC

To: Delaware Cash Management Policy Board

From: John Krimmel and Kevin Leonard

Date: April 25, 2019

Subject: Supranational Institution Investments

Background

During recent discussions with the Liquidity and Reserve investment managers, it was discovered that the treatment of Supranational Institution securities (Supranationals) was inconsistent. Several of the legacy managers continue to invest in Supranationals while the new managers do not. We believe that inconsistency arose when they were removed as a permissible investment during the 2015/2016 Investment Guideline review process. Based on this discovery, and recent discussions between OST Staff and NEPC, we believe that all parties would be best served by clearly indicating if Supranationals are a permissible investment or not.

Supranationals Defined

Supranational institutions are those owned or established by governments of two or more countries. They are generally established by international treaties to pursue specified policy objectives and are not typically subject to commercial law. Two examples of Supranational institutions are the European Union (EU) and the World Trade Organization (WTO). Multilateral lending institutions (MLIs) are a subset of Supranationals and have been established to promote economic development in their less-developed or regional member countries, facilitate regional integration, or expand cross-border trade. Two examples of MLIs are the Inter-American Development Bank and the African Development Bank.

Supranational securities, including MLIs, are generally highly rated as they carry either an explicit or an implicit repayment guarantee, from their member countries. According to a 2017 special report on Supranational institutions from S&P[1], 100% of the Supranational institutions they cover are investment grade, while 94% of the issuers carry an A or better credit rating. The report also found that default rates on Supranationals are very low and they had lower default rates and higher recovery rates than corporate borrowers. The structure of these securities (embedded repayment guarantees) allow them to trade at spreads comparable to US agency securities.

Recommendation

NEPC believes that updating the Guidelines to expressly permit Supranationals, inclusive of MLI's, is appropriate. We believe that these high-quality securities can provide diversification benefits and offer a yield advantage to Treasury securities. Our recommendation is to explicitly add them as a permissible security subject to the same concentration and quality constraints as corporate securities.

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[1] The S&P Supranationals Special Report can be found at: https://www.spratings.com/documents/20184/908545/US_SR_Event_Webcast_MultilateralNov17_Article2.pdf/fc892865-5302-4dd6-93ca-8469c8752818