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MEMORANDUM

To: Members of the Cash Management Policy Board
CC: Liza Druck Davis, Deputy State Treasurer; Jason Staib, Deputy Attorney General
From: Colleen Davis, State Treasurer
Sent: May 5, 2021
RE: **Recommendation Regarding School and Special Fund Interest Payments**

Synopsis

The Cash Management Policy Board (“the Board”) is tasked with setting the interest rate paid on School and Special Funds (“SSFs”) on deposit with the Office of the State Treasurer (“OST”). The current rate methodology was established by the Board in 2018, following a comprehensive review by OST. OST is recommending that the Board reaffirm the current methodology.

Methodology

In May 2018, the Board approved a collared liquidity rate for the school and special fund interest rate. This methodology reflects the 12-month rolling average return on the State’s liquidity portfolio. The rate is capped at 100% of the 12-month rolling average return on the State’s total portfolio. The cap is applied in months in which the 12-month average liquidity return exceeds the 12-month rolling total portfolio return. The rate has a floor of 0%, which is applied in months when the 12-month average liquidity return falls below zero.

The collared liquidity rate was chosen due to its appropriateness and fairness to both the SSFs and the General Fund. Its appropriateness is demonstrated in how proximate the returns are with government money market returns. Its fairness is demonstrated by the elimination of negative arbitrage months in which the SSFs are paid out interest at the expense of the General Fund. Additionally, the rate floor provides an assurance that SSFs will never be subject to a negative return.

Review

There have been seven months in which the cap was applied in the time since the current rate was approved and implemented--the period from July through December 2018, and again in March 2021.

There has only been one month in which the application of the rate cap prompted inquiry from an SSF recipient. In March 2021, the effects of Covid-19 on the April 2020 portfolio results first appeared in the 12-month rolling average calculation. In March 2021, the 12-month liquidity rate was 1.02% and the 12-month total portfolio rate was 0.34%. The 0.34% that SSFs received in March 2021 was 63 bps below the February 2021 rate. The diminished rate prompted one inquiry from a school district business manager. The school district business manager was satisfied with OST’s response and explanation of the SSF methodology.

Recommendation

OST recommends that the Board uphold the current liquidity rate for FY 2022.