NEPC, LLC

To: Delaware Cash Management Policy Board – Investment Subcommittee

From: John Krimmel, Partner and Kevin Leonard, Partner

Date: May 6, 2020

Subject: CARES Act Funds Investment Options

Background

The Delaware Office of the State Treasurer recently received both installments of the funds as prescribed in the Coronavirus Aid, Relief, and Economic Securities (CARES) Act. In total the state received $927 million. The funds were allocated evenly between the two liquidity managers, PFM and Wilmington Trust, and deposited into newly established custodial accounts at Northern Trust. The funds were initially deposited into a Northern Trust Government Money Market Fund. The CARES legislation requires that the funds be used to cover coronavirus related expenses incurred before December 31, 2020.

Since receiving the funds, OST Staff has attempted to gain clarity into the timing and disbursement amounts to provide guidance to the liquidity managers for investment purposes. The Office of Management and Budget ("OMB") has not yet been able to provide such clarity, as they have yet to finalize a plan for allocation of the funds. As this time, OST has no significant disbursement guidance from OMB other than an initial draw of funds may be requested shortly and there is an expectation that the funds will be depleted within a one-year timespan.

In order to efficiently and effectively manage these assets, OST Staff and NEPC seek guidance from the Investment Subcommittee on developing a suitable investment strategy.

Reasonable Investment Options

Given the uncertainty around the timing and amounts of the expenditures, OST Staff and NEPC believe that there are several reasonable investment strategies that can be followed.

Option 1 – Utilize the Existing Liquidity Guidelines

A reasonable approach would be to follow the existing Guidelines for Liquidity accounts, which were designed to focus on Safety, Liquidity and Return, in that order. The current Guidelines contemplate that funds allocated to the Liquidity managers may be exhausted during a one-year period, which is consistent with the CARES Act timeframe. Further, Liquidity account managers have been instructed to maintain sufficiently liquid portfolios to accommodate cash draws that can be accomplished within a short time frame. Allowing the managers to invest the funds within the existing Guidelines would be efficient as the managers have extensive experience in managing within this approach.

Option 2 – Utilize Government Money Market Funds

The CARES Act Funds were initially deposited into a Northern Trust Government Money Market Fund, the approved cash sweep vehicle. The Fund, ticker symbol NOGXX, is the Northern Trust U.S. Government Money Market Fund. The Fund invests substantially all (and at least

99.5%) of its total assets in cash and securities issued or guaranteed as to principal and interest by the U.S. government. The Fund does include repurchase agreements collaterized by U.S. government securities. As of March 31, 2020, the Fund had total assets of $16.5 billion and a 7-day current yield of 0.27%. Note that the yield will likely fall due to the maturity of securities that were held prior to the Federal Reserves recent actions affecting the front end of the yield curve.

One of the liquidity managers, PFM, has recently held conversations with OST Staff and NEPC regarding the use of their proprietary government securities mutual fund. PFM indicated that their Fund, ticker symbol PFMPSIC, the PFM Government Select Series – Institutional Class currently has a ~25 basis point yield advantage over the Northern Trust offering. NEPC has reviewed the Fund's objectives and find them to be reasonable and appropriate for US Government Money Market Funds. We also reviewed the Fund's Prospectus and find that the permissible investment is consistent with best practices for US Government Money Market Funds. The Fund's service providers consist of Wells Fargo, listed Custodian, US Bank, Depository Agency; Ernst & Young, Auditor.

Two concerns NEPC has regarding the Fund are the size of the portfolio ($1.25 billion) and increased administrative complexity. The Fund, at $1.25 billion is relatively small for a US Government Money Market Fund, and at the PFM-proposed $250 million level, would exceed a 10% investor threshold amount that NEPC believes appropriate. Further, there will be an added step in the transfer of assets, accounting and reporting for these assets that will increase the administrative responsibilities of staff.

Wilmington Trust was contacted as a courtesy, and as of the finalization of this memorandum on April 30, 2020, they had not indicated their desire to utilize a proprietary mutual fund or provided relevant information for NEPC's review and consideration.

Option 3 – Modified Liquidity Guidelines
A third option would be to apply a modified subset of the existing Liquidity Guidelines to the management of the CARES Act Funds. This would entail a review of relevant Guidelines sections to select permissible investments for the CARES Act Funds and potentially apply restrictions or modifications where appropriate. Examples of these modifications could include maturity restrictions, exclusion of foreign securities (Canadian Treasury and Agency securities), reducing of limiting or reducing corporate debt instruments, and reducing or limiting mortgage and asset-backed securities. Guidance on permissible investments and limits would need to be sought from members of the Investment Subcommittee, with concurrence from the CMPB. The modified Liquidity Guidelines for CARES funds could be memorialized in a Resolution. The existing Guidelines would not need to be modified.

Next Steps
We believe that a robust discussion of the investment options and parameters for the CARES Act Funds should be undertaken at the upcoming Investment Subcommittee Meeting. We look forward to that discussion on May 6th.