



**MINUTES FROM THE MEETING OF  
THE CASH MANAGEMENT POLICY BOARD  
AUGUST 10, 2016**

A meeting of the Cash Management Policy Board was held on August 10, 2016, at 10:00 AM  
Public able to attend in-person at the Office of the State Treasurer  
Located at 820 Silver Lake Boulevard, Dover 19720

Board Members in Attendance:

Mr. John Flynn, Chairman (Telephonically)  
The Honorable Kenneth Simpler, State Treasurer (Telephonically)  
The Honorable Thomas Cook, Secretary of Finance (Telephonically)  
The Honorable Jeffrey Bullock, Secretary of State (Telephonically)  
Mr. Warren Engle, Chair, Banking Subcommittee (Telephonically)  
Mr. Mike Karia, Co-Chair, Investment Subcommittee (Telephonically)  
Mr. David Marvin, Chair, Investment Subcommittee (Telephonically)  
Ms. Lynda Messick (Telephonically)  
Mr. Michael Morton, Controller General (Telephonically)

Others in Attendance:

Mr. Ms. Laura Gerard, Deputy Attorney General, OST Counsel (Telephonically)  
Mr. Steve McVay, Director of Investments and Cash Management, Office of the State Treasurer  
Mr. John Krimmel, NEPC  
Mr. Ian Spencer, NEPC Research Associate of Asset Allocation  
Mr. Phil Nelson, NEPC Director of Asset Allocation  
Ms. Susan Steward, Policy Advisor, Office of the State Treasurer  
Mr. James DiDonato, Manager of Banking Services, Office of the State Treasurer  
Ms. Erin Niehorster, Administrative Specialist, Office of the State Treasurer  
No members of the public in attendance

**CALLED TO ORDER**

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

**APPROVAL OF MINUTES**

A MOTION was made by Mr. Morton and seconded by Mr. Karia to approve the minutes from the meeting of the Cash Management Policy Board on May 11, 2016.

MOTION ADOPTED UNANIMOUSLY.

## **REVIEW OF PORTFOLIO PERFORMANCE & STATUS OF LIQUIDITY ANALYSIS- NEPC**

### *Portfolio Performance*

Mr. Krimmel reviewed both the monthly and quarterly portfolio performance reports. The major development for the last quarter of fiscal year 2016 was Britain voting to leave the European Union. The State's Liquidity, Reserve, and Land and Water portfolios were up for the quarter despite the recent instability in the markets. The Liquidity and Reserve portfolios outperformed their benchmark whereas the Land and Water portfolio underperformed its benchmark. The Morgan Stanley Global Strategist Portfolio had a positive return for last quarter but performed at the bottom of the peer group; this was because of their strategy to position the portfolio assuming Britain would remain in the European Union.

Mr. Simpler inquired about managing in the fixed income market and asked what do the managers say about continued movement across the globe towards negative yields and how will this impact US markets? Do they expect the future environments to be more difficult to manage through or are they optimistic? Mr. Nelson elaborated that the asset managers recognize the risks and rewards in regards to investments abroad and have elected to invest in U.S. securities. The negative rate environment in European markets is moving managers towards a credit-oriented focus due to the positive short-term yields available domestically.

Mr. Marvin commented that his concern when considering global investments isn't in interest rates but rather the relative changes in currency markets. He believes that fixed income is extremely risky in the long-term and the risks in earning an additional return is not justified when there is a potential loss of principal.

### *Liquidity Analysis*

Mr. Spencer outlined how NEPC is analyzing the State's typical cash flow in the collection and disbursement accounts on a trailing 21-day basis. The idea is to identify the extremes, the norm, and then reconcile the data to determine if there is a more optimal liquidity/reserve blend that allows for a higher return.

Mr. Simpler addressed the current architecture in the State and the new guidelines to express a view of using liquidity and reserve accounts as a way to guard against duration risk. Currently, our structure keeps sixty to ninety day needs in cash management banks whereas the liquidity accounts are used on an annual basis to meet anticipated high and low watermarks for cash during the budget cycle. Excess funds may be available to be reallocated from the cash management and liquidity accounts into the reserve funds to meet unanticipated needs. He then concluded with asking if the Board is willing to allow for some volatility in the reserve accounts, regarding market values, to be more focused on yield.

Mr. Krimmel reported that NEPC is working on developing and implementing stress tests to evaluate a shift in the mix of funds to ensure a maximum return on investment with minimum risk.

## **INVESTMENT SUBCOMMITTEE**

Mr. McVay reviewed the RFP for custody services. BNY Mellon is the incumbent, but Northern Trust was recommended by the evaluation committee to be the new custodian, contingent on successful contract negotiation. The Northern Trust online portal was extremely robust and would allow for enhanced and customizable reporting. The evaluation committee was also impressed with the low relationship manager to client ratio practiced by Northern Trust. The investment subcommittee recommended that the full board select Northern Trust to begin contract negotiations as an investment custodian.

Mr. Karia moved to authorize the Office of the State Treasurer to begin negotiations with Northern Trust to be the State's new investment custodian. Ms. Messick seconded this MOTION. MOTION ADOPTED UNANIMOUSLY.

Mr. Simpler reviewed the Operating Accounts memorandum which summarized the recommendation of the investment subcommittee to the Board in regards to handling these accounts. He suggested that there should be a series of motions about the designations of accounts and how the monies in each of those accounts are to be managed. Secretary Bullock asked that the accounts outlined in the memorandum be reviewed during this meeting.

Mr. Simpler began with the Health Fund Account which is a special fund receiving annual payments under the Master Settlement between the State and Tobacco Manufacturers. This account was set up in 2005. Monies deposited to the account are appropriated within a fiscal year. Currently, this fund is held in the "reserve" category although the funds are more liquid in nature. Mr. Simpler believed this account more accurately reflects the definition of an "operating account" and that the subcommittee recommends this account be treated as a liquidity account.

The next account is the Budget Reserve Account or "Rainy Day Fund", which is held with JP Morgan. The investment subcommittee recommends this account continue to be managed as a reserve account since no draws have ever been made from the account.

The next account discussed was the Land and Water Endowment Cash Account. Mr. Simpler stated that Board approved the policy of keeping a separate and sufficient cash account to satisfy the minimum 5.00% cash requirement for these accounts; this allows the mutual fund managers to invest in all other permissible endowment securities and not be constrained by the 5.00% limitation. The monies in this account are invested in Blackrock Money Market Funds.

Mr. Simpler described the Bond Proceeds account and outlined that this account is used to for monies that are earmarked to fund specific capital projects. The projects aren't always funded immediately, but proceeds are normally used within twelve months. The Division of Revenue leads the process of bond issuance for the State of Delaware. The monies held in this account are at the discretion of the CMPB and currently held in a Fidelity Government money market fund. There are no bond indenture provisions addressing the investment of these proceeds.

The final types of accounts discussed are what the OST calls "Outside Bank Accounts." These accounts are held by state agencies and school districts for petty cash and other allowable non-petty cash purposes. Mr. Simpler cited statutes regarding the Board's responsibility for setting policy rather than assuming a fiduciary role for monies in these accounts. The Division of Accounting (DOA) is the organization that allows these types of accounts to be permissible. DOA and OST are responsible for ensuring accounts are opened with the right entities and used for approved purposes while being compliant with the state's Budget and Accounting Manual (BAM). Currently, the procedures concerning compliance and enforcement are being drafted by OST and DOA with a focus on annual compliance through self-reporting as well as periodic auditing. Mr. Engle asked about the effect of moving accounts from local banks. Ms. Steward elaborated that there are only approximately four local banks and fourteen accounts that would be effected.

Mr. Simpler made a MOTION that the Board adopt the recommendations of the investment subcommittee as they have been provided approved regarding Operating Accounts and was seconded by Mr. Karia. MOTION ADOPTED UNANIMOUSLY.

### **BANKING SUBCOMMITTEE**

Mr. Engle summarized the collateralization of cash management deposits with PNC Bank, Citizens, and BNY Mellon as well as the current banking services contract negotiations with Wells Fargo and Bank of America Merchant Services.

Mr. McVay summarized the current procedure banks use to collateralize the State's deposits. The banks look at the previous month's daily average closing balance and adjusts the collateralized amount in the following month to this cover this average. This current level of collateralization does not take into account intraday balance fluctuations that occur in these accounts, increasing the risk that should a bank fail in the middle of the day, the amount of collateral would be insufficient. OST reached out to each of the three primary cash management banks to determine their ability to address our intraday collateralization needs. Each bank responded with individual proposals though none can entirely eliminate the risk associated with intraday fluctuations.

Mr. McVay outlined the collateralization information recommended for BNY Mellon. Over the last thirty-three months, the average intraday risk for monies held at BNYM was just under \$100 million. BNY Mellon has a daily sweep vehicle which will allow the State to mitigate intraday risk. The new investment vehicle is known as an automated investment sweep. At 4:00 pm every day the main operating account balance will be reviewed and see if there is a net deficit or surplus of funds from the target balance of \$5 million. Any surplus over the \$5 million will be swept overnight into a money market fund or net deficit under the target will be swept from the money market into account. OST and NEPC will select the best available government money market fund as the sweep vehicle.

Mr. McVay discussed PNC Bank, which is the State's main disbursement bank. The risk is in the daily incoming wire to pay the daily disbursement liabilities (vendor ACH payments and checks); this amount stays parked in PNC, uncollateralized, until the end of the day. Typically, the level of exposure in this account is around \$20 million. However, on the first Thursday of the first full week of the month, the State sends out a Medicaid payment (included in vendor wire payments) which total approximately \$150 million. That day the balance in the account increases substantially elevating the intraday exposure risk. Currently, PNC Bank is willing to collateralize a flat amount between \$50 and \$100 million at no additional charge. The banking subcommittee recommends that PNC Bank collateralizes \$100 million; this will virtually eliminate risk every day but one day per month.

Mr. McVay reviewed the Citizens account as well as their collateralization solution. There is limited exposure to this bank relative to the other banks. The collateralization proposal from Citizens will collateralize daily based on the prior day closing balance using a safe-keeping agent, BNY Mellon. The concern with this solution surrounds the risk of failure from not only Citizens but BNY Mellon. The collateralization account, as held by BNY Mellon, would not be affected by a Citizens failure. If BNY Mellon were to fail, the funds held in this account are kept in an outside custody account and thus are not subject to any obligations due BNY Mellon.

Mr. Simpler pointed out that the new guidelines (the next item on the agenda) reflect this new standard in collateralization, as stated in Section 5 of the guidelines. To this point, OST and the Board were meeting the

guidelines as originally drafted though this left a meaningful gap in collateralization. Changing the guidelines has addressed this gap and should decrease the State's risk.

Mr. Engle made a MOTION to accept the new collateralization policy as stated in Section 5 of the Guidelines. Mr. Morton seconds this MOTION. MOTION ADOPTED UNANIMOUSLY.

Mr. Simpler presented an update on the current contract negotiations with Wells Fargo for the Direct Deposit services and with Bank of America Merchant Services for credit card processing. The Wells Fargo contract process is in its ending stages, and the Bank of American contract negotiations are just beginning. Mr. Simpler stated that there had been difficulty in closing these contracts. As an example of this difficulty Mr. Simpler addressed the length of time it has taken to close a contract with the incumbent for Direct Deposit services when there has been no meaningful change in the scope of services provided by this vendor. He pointed out that the State is three months into negotiations, and there is no finalized contract. Mr. Simpler pointed out that because the negotiations are with an incumbent, it would not affect the services provided to the State. However, the contract with Bank of America for Merchant Services is a change from the current provider (EPX). The length of the contracting process in this instance will affect the conversion from EPX to Bank of America. The State's contract with EPX expires in May 2017 with no extension available. The current belief is that the time of the conversion could take up to and over a year.

Ms. Gerard discussed the current negotiations between the State and Bank of America. She believed that part of the issue is that the State has a professional services agreement which is very good, but the vendors the State is contracting with are not inclined to use that agreement. Ms. Gerard also pointed out that there have been scheduling issues because of summer vacations as well as the length of time needed for DTI to complete the necessary technology review. Regarding the negotiations with Wells Fargo, Ms. Gerard concurred with Mr. Simpler's assessment of the status of that contract.

Mr. DiDonato stated that although negotiations are taking longer with Bank of America than some may like, progress is being made in preparation for the vendor change. Mr. McVay stated that although we have no more extensions he has spoken with representatives of EPX and they are open to allow the State to utilize either three or six month extensions, if necessary.

#### **APPROVAL OF GUIDELINES IN TOTAL**

Mr. Karia moved to accept the guidelines, as presented to the Board. This MOTION was seconded by Mr. Engle. MOTION ADOPTED UNANIMOUSLY.

Ms. Gerard clarifies that these new Guidelines can be implemented as a matter of practice while the guidelines are going through APA publication and public review processes.

#### **OLD BUSINESS**

Mr. Simpler discussed the request of Ms. Messick and Mr. Engle for the development of vendor management procedures. He updated the Board that OST is still organizing a procedure for the periodic review of the State's vendors. Ms. Messick responded that she appreciated the work Mr. Simpler and his staff are doing and that she will provide the information to him at a later date.

#### **NEW BUSINESS**

Next meeting scheduled for 11/16/16 meeting at Buena Vista.

**PUBLIC COMMENTS**

No public available for comment.

**ADJOURNMENT**

A MOTION was made by Mr. Morton to adjourn the meeting at 11:49 AM and was seconded by Mr. Karia.  
MOTION ADOPTED UNANIMOUSLY

Respectfully submitted,

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John Flynn  
Chairman, Cash Management Policy Board