

MINUTES OF MEETING
STATE BOARD OF FINANCE

FEBRUARY 9, 2017

A meeting of the State Board of Finance of the State of Arkansas was held in the Conference Room, Office of the Treasurer of State, Suite 275, Victory Building, Little Rock, Arkansas, at 10:00 a.m., Thursday, February 9, 2017, pursuant to notice duly given to each member of the Board by the Chairman.

The following members were present:

Larry Walther, Director, Department of Finance and Administration
Dennis Milligan, Treasurer of State
Andrea Lea, Auditor of State
Edmond Waters, Arkansas Securities Commissioner
Candace Franks, Arkansas Bank Commissioner
David Bell, Representing Governor Asa Hutchinson
Cale Turner, Appointed Member
Gabe Holmstrom, Appointed Member
Keith Konecny, Appointed Member
Al Harkins, Appointed Member

Others present were Jason Brady, Grant Wallace, Autumn Sanson, Ed Garner, Ron Roberson, Larry Tate, Stacy Peterson, and Celeste Gladden of the Treasurer's staff; and Paul Louthian of the Department of Finance and Administration.

Larry Walther served as acting Chairman in the absence of Governor Hutchinson and called the meeting to order with recognition of a quorum.

Minutes of the meeting held on November 10, 2016 were approved as distributed.

Chairman Walther recognized State Treasurer Dennis Milligan to present the Treasury Investment Performance Report for the Second Quarter of Fiscal Year 2017. This Report is included in the Minutes as Attachment 1. Treasurer Milligan addressed the Board and expressed pleasure at being the bearer of good news, as he shares the returns for the second quarter of fiscal year 2017 and the combined totals for the first half of the fiscal year. He told the Board that with the increase in the

federal interest rate last December, and the increase in yields after the election, the market has been more favorable. He reminded that Board that he cannot predict future returns, but says that the Treasury appears to be on track to produce similar results as last fiscal year. Treasurer Milligan then pointed the Board to the first slide, Short-Term Portfolio. He told the Board that the short-term investments make up nearly half of total investment revenue, and receipted \$4.8 million in the second quarter of this fiscal year, due in large part to investments commercial paper, which are up more than \$2.2 million compared to this time last year. Treasurer Milligan then pointed the Board to Slide 2, Long-Term and Mortgage Backed Securities Portfolio. He told that Board that in the second quarter, the long term portfolio receipted \$5 million, a little less than reported for the second quarter of 2016, which was \$5.8 million. He told that Board that this is due to due to positioning of the mortgage-backed securities and Ed Garner will explain later in the meeting. The Treasurer then moved on to the third slide, Total Treasury Portfolio Comparison, and said that this slide shows the combined funds generated by both the short-term and long-term portfolios. He said that at the end of the second quarter, December 31st, the Treasurer's office receipted a combined total of \$9.8 million, which is about \$1.6 million more than the second quarter of fiscal year 2016. Next, he pointed the Board to the fourth slide, FY2016/FY2017 Monthly Totals, which he said is a month-by-month comparison of the combined receipted amounts between FY 2016 and FY 2017. The Treasurer pointed out that there are noticeable increases in October and November, and what appears to be a decline in December, which is due to the repositioning of the Treasury portfolio from a large investment in commercial paper into mortgage-backed securities, and because of the premiums paid upfront on those mortgage-backed securities, our receipts were impacted. He stressed to the Board that this occurrence is a one-time impact and the results of this reposition are expected to produce quick results. Finally, Treasurer Milligan pointed the Board to the last slide, which gives a historic view of where the office has been to where it is currently. He explained, for the first half of FY 2017, \$21.67 million has been receipted and at the same point last year, \$16 million had been receipted. This is a 35 percent or \$5.5 million

increase ahead of last year. Treasurer Milligan told the Board that he hopes to show a steady increase in the State's receipted amounts in the years to come, depending on economic variables and federal interest rates and he is excited about where the portfolio earnings are headed. Treasurer Milligan concluded his report and asked if he could introduce a new Treasury employee, Ron Roberson. He said that Ron is joining the office as a Senior Investment Manager, and he comes with 38 years of investment experience, with his last place of employment being Bank of Oklahoma, where he served for 14 years as Vice President and Senior Trader. The Treasurer told the Board that with the additional demands being placed on the investment team, and it being a vitally important area of the office, there was an increased need for backup staff, and he felt it would be prudent to bring on another investor at this time. Treasurer Milligan asked the Board to welcome Mr. Roberson to the team.

Chairman Walther asked each Board member to go around the room and introduce themselves. After that, he recognized Ed Garner to come before the Board to make some remarks about the investment report.

Mr. Garner addressed the Board and stated that in December the investment team redeployed over a billion and half dollars of the portfolio back into mortgage backed securities. He explained that this time last year, after evaluating market conditions, the portfolio became very liquid, with big increases in commercial paper. He said that now the team has begun redeploying into the longer part of the portfolio at much higher interest rates and with much less overall extension risk. Mr. Garner continued by explaining that when this redeployment was made, because of the conservative accounting approach, all of the prepaid accrued interest comes off the top of income the very next month, which explains the big dip in December. Mr. Garner told the Board that now, the Treasury is able to drive its own structures, and negotiate its own terms with Wall Street, so that there is less extension risk and higher returns. He told the Board that they will see a very dramatic upturn in mortgage back performance when returns are reported again next quarter.

Al Harkins asked if the restructuring came about from portfolio maturities or if securities were sold to reinvest. Mr. Garner explained in November or December of 2015 the Treasury deployed into mortgage backed securities, but by February, interest rates went way down and the risk/reward for remaining in securities that could possibly extend out was not worth it. He said that the Treasury began to liquidate or restructure and shorten up, and the portfolio became extremely liquid, with at one point having over 2 billion dollars in commercial paper. He explained that the portfolio remained liquid until around the time of the election and the interest rates increased, and the portfolio was redeployed. He told the Board that now, the Treasury is able to get structures and yields in mortgage backed securities that there was no expectation of getting.

Chairman Walther asked if there were any questions for Treasurer Milligan or Mr. Garner. Treasurer Milligan addressed the Board and stated that the Treasury portfolio is a work in progress and the team is looking at things on an hourly basis, constantly adjusting, but that the results speak for themselves. Chairman Walther thanked the Treasurer and said that he appreciates all of the work that the Treasurer and the investment team are doing. Chairman Walther asked for a motion to accept the Treasurer's Investment Performance Report into the Record. The motion was made by Candace Franks and seconded by Al Harkins. All members were in favor.

Next, Chairman Walther made a motion to establish that no funds are available for deposit into the State Board of Finance certificate of deposit investment program. The motion was seconded by Candace Franks. All members were in favor.

The Chairman then made a motion that the Board direct the Treasurer of State to purchase warrants for the succeeding quarter, April 1, 2017 – June 30, 2017, pursuant to Act 1088 of 2013, and to keep reasonable amounts in demand deposit accounts and money markets during the next quarter for the transactions of the day to day activities of the State. The motion was seconded by Keith Konecny. All members were in favor.

The Chairman then recognized Ed Garner again to discuss the new broker/dealer. Mr. Garner addressed the Board and said that the Treasury has added Amherst Securities as a broker/dealer and is in the final paperwork of adding Credit Suisse to the roster. Chairman Walther asked for a motion to accept the Report. The motion was made by Al Harkins and seconded by Candace Franks. All members were in favor.

Chairman Walther then recognized Jason Brady to give a legislative update to the Board. Mr. Brady addressed the Board and referred them to HB1464 in their packet. He told the Board that this bill is the State Money Management Trust bill proposed by Representative Collins and Senator Rapert, and reminded the Board that they approved the Treasurer's office to pursue this legislation in the last meeting. Mr. Brady thanked the Chairman, Paul Louthian, and their staff for their help getting the bill written. He told the Board that that the bill will go before the insurance and commerce committee the next day, and that he has spoken with about 15 of the 20 members, with no push back anticipated. Next, Mr. Brady referred the Board to SB292 by Senator Maloch and Representative Lundstrum. He stated this this bill is the "Repo" bill, which allows the Treasury to invest funds Repurchase Agreements and also moves the ROI distribution date from the first of the month, to two business days after the 25th of each month. He reminded the Board that this bill was drafted by the Rose Law Firm, and told the Board that Senator Maloch has dropped the bill, but is going to be kind enough to sit on it while the Money Management bill is moved through. Then, Mr. Brady told the Board that he has two more bills to tell the Board of, but they are strictly an "FYI". The Board was provided copies of both bills. The first, HB1448, Mr. Brady told the Board is a bill by Representative Gray that deals with allowing credit unions to serve as depositories for public funds. He told the Board that DF&A has made some comments to Bureau of Legislative Research in regards to this bill. Mr. Brady continued, and explained that the second bill is SB546, by Senator Rapert, which deals with including Israel bonds as an investment. Mr. Brady told the Board that the Treasurer's office has referred this bill to the Governor's office for review.

There was some discussion amongst the Board about the value of Israel bonds and foreign investments in general, although no conclusions were made or actions taken. After that discussion, Gabe Holmstrom referred the Board back to HB1464, and asked if the Treasurer's office looked into a question he asked in the previous meeting in regards to why four-year universities were not included as eligible entities to invest in the fund. Jason Brady responded, and asked Grant Wallace to confirm, that his recollection was that the four-year universities did not wish to participate. Mr. Wallace responded that he agreed but did not recall the exact reasoning, but would get TJ Fowler, legal counsel for the Treasurer's office, to come into the meeting and give an update.

Al Harkins asked about a timeframe for enacting HB1464. Mr. Brady responded that the bill will be enacted upon signature of the governor, but that the policy written for money management was last updated in 2005 and would need to be revamped. Chairman Walther responded that the Treasury may need action by the Board to implement a new policy. Mr. Brady responded that the legislation has been the focus, and that the Treasurer's office will come back to the Board with an answer in regards to a new policy once a timeline is discussed.

TJ Fowler joined the meeting and addressed the Board. He said that he remembers the question being posed about the four-year universities right before going into session. He stated that his response was that the Treasury had not fully vetted the question, and it was unknown if there are any investment restrictions on universities, whether internal or regulatory, from the Department of Education or from the UofA Systems. He said that his fear was, without fully vetting all the laws and regulations surrounding universities, to include them might impact how the money could be invested. He explained that the answer is not "no", but that there was a lack of time fully vet the question. Mr. Fowler added that the assumption was since the two-year universities were added when the Money Management policy was initially written, and the four-year universities were not, there must be a reason, however the reason is unknown.

Mr. Holmstrom responded that it is his feeling that if the Treasury is looking to increase the ability of entities within the state to invest in the program, it seems counterproductive to limit the entities that would have access to those funds. He added that if the Treasury is going through the trouble to pass legislation, some attention to this issue seems worthwhile. Mr. Brady responded that he would make a commitment to get a concrete answer.

The Chairman asked for any other business to come before the Board. There was none. Chairman Walther informed the Board that the next meeting will be May 11th at 10 a.m. in the Treasurer's Victory building conference room (Secretary's Note: the meeting has since been changed to May 9th). The meeting was adjourned.

ATTEST:

Secretary of the State Board
of Finance of the State of Arkansas

Acting Chairman of the State Board
of Finance of the State of Arkansas

Secretary's Note: All documents pertaining to the issues considered are filed in the permanent records of the State Board of Finance.