

MINUTES OF MEETING
STATE BOARD OF FINANCE

MAY 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., Tuesday, May 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
Edmond Waters, Arkansas Securities Commissioner
Candace Franks, Arkansas Bank Commissioner
David Bell, Representing Governor Asa Hutchinson
Skot Covert, Representing Andrea Lea, Auditor of State
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, Stacy Peterson, TJ Fowler, and Celeste Gladden of the Treasurer's staff; Justin Meatte of the Bureau of Legislative Audit; Paul Louthian and Debbie Rogers of the Department of Finance and Administration; and Mike Wickline of the Arkansas Democrat Gazette.

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 February 9, 2017 were approved as distributed.

Chairman Walther recognized State Treasurer Dennis Milligan to present the Treasury Investment Performance Report for the Third Quarter of Fiscal Year 2017. This Report is included in the Minutes as Attachment 1. Treasurer Milligan addressed the Board and stated that he is pleased to report the investment returns for the third quarter. He reminded the Board that in the last meeting, he

reported an overall increase of \$21.6 million during the first half of the fiscal year, and stated that there is once again an increase in earnings for the third quarter. Treasurer Milligan pointed the Board to the Short-Term Portfolio slide, and said that the office has receipted \$2.8 million in the third quarter, which is about \$312,000 more than receipted in the third quarter of fiscal year 2016. He told the Board that this increase can be attributed to federal rate hikes affecting the commercial paper yields and also the negotiation of better yields on demand accounts. Next, Treasurer Milligan pointed the Board to the Long-Term Portfolio slide. He stated that the long-term portfolio saw growth of about \$1.4 million in the third quarter, compared to the same quarter last year. The Treasurer reminded the Board that some of the short-term commercial paper funds were previously re-positioned into mortgage-backed securities, which is why there is less of an increase in earnings in commercial paper and more of an increase in earnings in mortgage-backed securities. The Treasurer then moved on to the Total Treasury Portfolio slide. He told the Board that the Treasury receipted a total of \$17.7 million for the third quarter, which is \$1.8 million more than last year. Treasurer Milligan pointed the Board to the next slide, which gives a side-by-side comparison of the combined receipted amounts broken down by month for fiscal years 2016 and 2017. He stated that the Treasury averaged about \$5.9 million per month in the third quarter of this year, compared to about \$5.3 million per month in fiscal year 2016, which is a 23% increase. Treasurer Milligan pointed the Board to the next slide, called Fiscal Year 2005-2017 Receipted, which gives a historic view of the Treasury. He stated that for the first nine months of the year, the total receipted amount is \$39.4 million, compared to \$32 million for the first nine months of last year. Treasurer Milligan reminded the Board that last fiscal year's total was \$48.9 million, and he expects to produce similar if not better results this fiscal year. He added that in the two short years he has been in office, the Treasury has receipted \$100 million, which is more than the previous administration did in four years. Treasurer Milligan showed the Board the final two slides. The first is a historical view of the Money Management Fund, which is currently earning an ROI of 1.1%. The second is total earnings for the Arkansas Worker's

Compensation Commission. The Treasurer stated that last year the AWCC tasked the Treasurer's office with investing money from the Death and Permanent Total Disability fund in order to get higher returns. Treasurer Milligan told the Board that the Treasurer's office has returned approximately \$16 million back to the fund in the first three quarters of fiscal year 2017, and is set to outpace last year's \$18 million in receipts. The Treasurer concluded his presentation by saying that he is excited about the future and helping to provide much-needed funds for the State of Arkansas.

Keith Konecny asked if the State has more money coming in now than three or four years ago, and if so, how is the increase brought into returns and projections. Grant Wallace responded that the receipted earnings are higher than in a decade, and even though interest rates are on the rise, they are still historically low rates. Mr. Konecny clarified his question and said, "if you have 100 million dollars versus 90 million dollars, and you say you got a higher return, it doesn't necessarily mean you are making a better rate of return, it just means you are working with more money." Chairman Walther responded that the Treasurer's office is managing somewhere between \$3.7 and \$4.2 billion dollars, depending on warrants, but the amount of money that has been managed since April 2016 is virtually the same.

Chairman Walther addressed the Board and said that he finds it very uplifting to see what has happened in the last two years in the management of the money by the Treasurer's office. He said that the returns play a key role in certain segments of State Government and he appreciates the work that the Treasurer and his team have done. The Chairman then made a motion for the acceptance of the Treasurer's Investment Report into the record. The motion was seconded by Candace Franks. 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, July 1, 2017 – September 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.

Chairman Walther moved on to the next Agenda item, to set the target rate of return on investments for the next fiscal year. The Chairman told the Board that he asked his team to look at the investments that are being made, what is going on in the market place, and what the Fed is doing. He told the Board that the type of securities being invested in, while very low risk, tend to move with the Federal rate. He said that the Fed has changed their rate twice already this year, and there is an anticipation of a couple more rate hikes this year, and probably two or three more next year. He continued by saying that in looking at where we are, over 2% right now, maybe 2.5% would be a reasonable expectation for the Treasurer. The Chairman asked the Board for any comments.

Edmond Waters asked what the target rate was last year. Chairman Walther responded that it was a range. Debbie Rogers responded that the range was 1.0-1.10%. Chairman Walther commented that the earnings were double the target range. Al Harkins commented that obviously there would be more Federal rate hikes, and made the motion that the target rate of return be set at 2.5%. The motion was seconded by Edmond Waters. All members were in favor.

Next, Chairman Walther recognized Jason Brady to discuss the next Agenda item, a Legislative update on Act 555 of 2017, Act 644 of 2017, and Act 710 of 2017. Mr. Brady thanked the Board and said that Act 555 by Senator Bruce Maloch and Representative Robin Lundstrum is the Treasury Management bill that dealt with the rate of return and changed it from an average daily to a daily rate, which was approved by the Board and put forward to the Legislature who approved it. He told the Board that Act 644 of 2017 by Senator Jason Rapert dealt with Israeli bonds. He reminded the Board that this bill was discussed in the last meeting and the Treasurer's office passed the bill

along to the Governor's office because it was a much broader perspective than just the Treasury, as it allows the state, cities, counties, all municipalities, to invest in Israel Bonds. Mr. Brady told the Board that Act 710, by Senator Bart Hester and Representative Jim Dotson, prohibits the state and other entities of the state to invest in companies or countries that boycott the Nation of Israel. He said that in compliance with the law you have to make a good faith effort, and the investment team has said this was not going to be a problem. He continued by saying that the General Services office of the State of New York has a similar proclamation, and they have a website that is updated every 6 months, so the Treasurer's office will be able to comply with this law quite easily. Lastly, Mr. Brady addressed the Chairman and said that Act 296, by Representative Charlie Collins and Senator Rapert, is the Money Management legislation, which was passed, but that there is work to be done to discuss with the Board.

Chairman Walther asked if there was any requirement of the Board in regard to Act 555 and Act 296. Mr. Brady responded that the Board will be updating State Board of Finance policies. With Act 555, the Board will be updating the Treasury investment policy; and with Act 296, the Board will be updating the Money Management investment policy.

Moving on to the next Agenda item, consideration of a special meeting to discuss the Money Management Trust Investment Policy and Operations Manual, the Chairman asked Mr. Brady to stay to discuss this item with the Board. The Chairman told the Board that there are separate policy and operations manuals, and in light of recent legislation the thought is to look at them and bring them together to have one manual. He told the Board that there will need to be a special meeting to discuss the updated policy and operations manual once it is done. Mr. Brady addressed the Board and said that with the passage of legislation, particularly with the money management trust, the policy needed major revision. He said that the State Treasury Money Management law was originally passed in 1996, and the last time it was revised was in 2005. Mr. Brady told the Board that T.J. Fowler, legal counsel, along with the investment team, has been working diligently to update the policy. He stated

that the Treasurer's office is not quite ready to present it to the Board for approval, and is asking for a special meeting in one month to give them more time. Mr. Brady also stated that the Treasury investment policy for the State Board of Finance, which is not as complex, is not ready either.

Chairman Walther asked if the policies will be provided to the Board in advance of the meeting. Mr. Brady answered affirmatively. The Chairman told the Board that he thinks this is a timely exercise where the Board can bring together the operations, practices, and procedures of the Treasurer's office in regards to the investment of funds, which will help the Board set objectives moving forward. He also stated that the results are very encouraging, and that his understanding is looking at the results compared to other states, the Treasurer's office may stand alone at the top of the heap. Chairman Walther then made a motion to hold a special meeting of the Board on June the 19th, 2017. The motion was seconded by Al Harkins. All members were in favor. ***Secretary's note: the special meeting has since been rescheduled for June 28, 2017***

Next, Chairman Walther addressed the next agenda item, a letter sent to the members of the Board of Finance by Senator Terry Rice. This letter is included in the Minutes as Attachment 2. The Chairman stated that he had himself read the letter many times in trying to decide how the Board should respond. He continued by saying what stood out to him in the letter was, quote, "these employees, while under the hiring authority of the Treasurer should be held to the same high standards in place for the Chief Investment Officer to include educational and experience qualifications". The Chairman stated that he could not see how anyone could disagree with that statement. Chairman Walther asked for discussion from the Board, and recommended that his staff and the Treasurer's staff take a look at the requirements between now and the next meeting and report back to the Board. Keith Konecny addressed the Board and asked if the positions in the investment division are connected politically, and if those positions turn over when a new administration comes in, and stated that this gives him much concern with regard to how much money is managed. Chairman Walther stated that there is that element within the hiring and retention of employees in most state agencies, and that

Treasurer Milligan has a significant amount of discretion. Al Harkins then addressed the Board and asked for clarification of the structure between the Board and the Treasurer's office in regards to the employees. Chairman Walther answered that the Treasurer has the day-to-day supervisory responsibility of the entire staff including those who are managing the money, with the exception of the Chief Investment Officer, who by law, reports to the Board and could be hired or fired by the Board based on the recommendation of the Treasurer. Treasurer Milligan agreed and responded that the Treasurer nominates the Chief Investment Officer, with the Board approving the individual. Treasurer Milligan also added that an individual would not run for Treasurer or any other constitutional office if a Board was responsible for the hiring of employees, but the Treasurer was responsible for their actions. Chairman Walther added that the Board plays an important role by helping to establish the criteria for who the Treasurer hires, but is not in the role of hiring or firing the employees. TJ Fowler addressed the Board and added that there is a statute that makes the Treasurer criminally liable for acts of the Treasury employees, and said that it would be in violation of the Treasurer's due process rights to have someone else select those employees. Chairman Walther responded that if a new Treasurer came in, it would be incumbent upon him to select the best person that meets the criteria to do the job. He added that Treasurer Milligan is doing a great job right now. Treasurer Milligan responded that what has happened in his administration has been by design and by a plan, and he feels like the "proof is in the pudding". Getting back to Senator Rice's letter, the Chairman asked the Board if they would be agreeable with the Treasurer and his staff and the Governor and his staff, working to develop a response. There were no objections to this by the Board.

Next, the Chairman told the Board that the Treasurer's office has four new positions: Chief Legal Counsel, Director of 529 and Financial Education, Senior Investment Manager II, and Treasury Manager V. Included in the Minutes as Attachment 3, is a handout provided to the Board by Paul Louthian of DF&A: Fiscal Year 2017 Current Qualifications. Chairman Walther told the Board that

the positions highlighted in yellow are those involved in the management of investments. He also told the Board that at the bottom of the page are the four new positions and the proposed qualifications: Chief Legal Counsel would be required to have a high school education, bachelor's degree in a business related field of study, and seven years of experience; Director of 529 and Financial Literacy would be required to have a high school diploma, bachelor's degree in a business related field of study, and seven years of experience; Senior Investment Manager would be required to have a high school diploma, would be preferred to have a bachelor's degree in a business related field, and required to have fifteen years of experience; Treasurer V would be required to have a high school diploma, would be preferred to have a bachelor's degree in a business related field, and required to have seven years of experience. The Chairman told the Board that the qualifications for these four positions will require a Board vote.

Al Harkins asked if the four positions are new positions. Grant Wallace responded and said that the positions are reclassifications of existing positions: Chief Legal Counsel is currently a Chief Deputy Treasurer that has been retitled Chief Legal Counsel; the Director of 529 and Financial Education is currently a Division Director; the Senior Investment Manager II is currently a Division Director; and the Treasury Manager V's include some Treasury Manager IV's who are moving up to a V. Mr. Harkins asked where the Investment Manager II will fit into the chart. Mr. Wallace responded that the position is currently classified as a Division Director, and the reclassified position would fall under the CIO and Senior Investment Manager II. Chairman Walther asked for clarification of the degree requirement for the Senior Investment Manager. Mr. Wallace responded that if there is a college degree, then a minimum of seven years investment banking would be mandatory, but if there is no college degree, then there would be a minimum of 62 college credit hours required and 15 years of experience in investments or banking. Gabe Holmstrom asked why the Investment Manager II has a requirement of 15 years, while all others require 7-12 years. Mr. Wallace responded that this is to allow a substitute for a college degree, to offset education with years of experience. Mr. Holmstrom

asked if the other positions would have this allowance. Mr. Wallace responded that it could be something to look at with DF&A as the FY18 classifications are revisited. Al Harkins asked if in the past the positions of those managing the investments have a mandatory degree requirement. Mr. Wallace responded that the requirement for a degree was added to the Senior Investment Manager position, the Chief Investment Officer position has always required one, but the Manager IV and Manager II positions have always only preferred a degree. Mr. Harkins responded that he has some concerns with someone making decisions at the investment level who does not have a degree, and said that if anything should go wrong, it may be the Board who is responsible if they were to accept these standards. Keith Konecny responded that in all of the major corporations there are levels that require degrees, but it is nice to have both a degree and the experience.

Paul Louthian addressed the Board and stated that there had been questions about how these changes would affect an incumbent versus new hires. He told the Board that they are setting the standards for new hires, or people who are to be transferred into these positions, but this will not affect the incumbents that are in the positions currently. Chairman Walther added that if there is an incumbent who did not have the degree, he could still continue to do the work and retain that position, but whenever the next one is hired, the degree would be required. Gabe Holmstrom asked of the positions where the college degree is preferred, how many of the employees in those positions have the college degree. TJ Fowler interjected and said that he is not comfortable with the Board getting into personnel records of active employees of the Treasury in an open meeting.

Al Harkins addressed the Board and said that the Board should consider what would happen in the future with other boards and other administrations and that they should remember that a precedent is being set. He told the Board that he thinks they should keep the degree mandatory for the Senior Investment Manager II position. Mr. Wallace responded that a degree is mandatory, but if there is no degree then years of experience can be substituted. Mr. Harkins responded that years of experience should not replace a degree. Chairman Walther suggested that since the change would not affect an

incumbent, one path would be to make the change so that it would be mandatory for future hires. Al Harkins made a motion that the Investment Manager II position require a mandatory college degree. The motion was seconded by Candace Franks. All members were in favor. Chairman Walther asked for a vote on the requirements of all four positions, with the change made to the Senior Investment Manager II position. All members were in favor.

Chairman Walther asked for any further business to come before the Board. Candace Franks asked if the updated money management policy could be sent to the Board in a red-line version so that the Board can see what the changes are. Chairman Walther responded affirmatively, telling the Board that there were many changes being made.

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.