

MINUTES OF MEETING
STATE BOARD OF FINANCE

JUNE 21, 2016

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, June 21, 2016, 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
David Bell, Representing Governor Asa Hutchinson
Ann McDougal, Representing Edmond Waters, Arkansas Securities Commissioner
Susannah Marshall, Representing Candace Franks, Arkansas Bank Commissioner
Cale Turner, Appointed Member
Gabe Holmstrom, Appointed Member
Al Harkins, Appointed Member
Keith Konecny, Appointed Member

Others present were Jason Brady, Grant Wallace, Autumn Sanson, Ed Garner, Larry Tate, Melissa Corrigan, Gary Underwood, Jim Harris, T.J. Fowler, and Celeste Gladden of the Treasurer's staff; Paul Louthian of the Department of Finance and Administration; Jim Fowler and Jacob White of the Rose Law Firm; Tony Williams and Mark Conine of the Arkansas Student Loan Authority; Jack Williams of Williams & Anderson Law Firm; Tony Minicozzi of the Arkansas Rural Endowment Fund; Charlie Lynch of the Arkansas Development Finance Authority; Mike Wickline of the Arkansas Democrat Gazette; and Steve Brawner of Talk Business & Politics.

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 March 22, 2016 were approved as distributed.

Chairman Walther recognized State Treasurer Dennis Milligan to present the Treasury Investment Performance Report. This report, “Investment Operation and Projections – June 2016”, is included in the Minutes as Attachment 1. Treasurer Milligan told the Board that he has fantastic news to present. He stated that the numbers being presented today are through the month of May, with the fiscal year not being concluded yet, and hopes to present final year-end numbers in August. Treasurer Milligan pointed the Board to the first chart, Short Term Portfolio Earnings, which includes Commercial Paper, Demand Accounts, Insured Cash Sweep Accounts, and Money Market Funds. He reported that as of May 31st, the short term portfolio generated a total of over 10 million. He then pointed the Board to the second chart, Long Term Portfolio & Mortgage Backed Earnings. He reported that as of the end of May, the long term portfolio generated 32.14 million in investment returns for the state. Treasurer Milligan moved on to the third chart, Total Treasury Portfolio Comparison, and stated that a total of approximately 42.2 million was received from returns on all of the investments. The Treasurer then pointed the Board to the fourth chart, Total Earnings by Fiscal Year, and said that this chart shows a comparison of where the Treasury was at the end of May, with a month still to report, to previous years. The Treasurer told the Board that the Treasury has nearly doubled last year’s earnings by 20 million dollars, to 42.2 million dollars. The Treasurer then thanked the members of the Board for their trust in him and his staff. He said that it has allowed the team to take a more active management style in the investment of Arkansas’s funds, which is what has generated these results. He then asked Autumn Sanson to come before the Board to go into specifics with the remaining charts, and also to present some historical information.

Ms. Sanson started by reiterating that because the Board has approved changes to the investment policy, the Treasury has been able to generate better results even with interest rates not being as favorable as they had been in past years. She pointed the Board back to the first chart, the Short Term Portfolio Earnings. She said that dips in revenue generated in the short term portfolio usually indicate heavy activity in mortgage-backed securities. She told the Board that in April and

May there was an increase in returns in this portfolio, this is because the long-term market has not been as favorable, and the Treasury has had to take a more defensive stance and a shorter average life on mortgage-backed securities. She then pointed the Board to the second chart, the Long Term & Mortgage Backed Earnings. She said that after November 2015, there was a dramatic increase in receipted revenue from mortgage-backed securities, then in February another dramatic spike as some bonds were sold. She explained that this occurred after a routine evaluation of the portfolio, and a decision to sell certain bonds that were no longer advantageous. Ms. Sanson told the Board that the Treasury is currently earning an average of \$3 million a month with mortgage-backed holdings, and that the portfolio has decreased from about \$2.1 billion in mortgage-backed securities to roughly \$1.7 billion as of the end of May. She pointed the Board to the third chart, and stated that she would like to highlight the fact that since December of last year, the total portfolio is averaging over \$4 million per month in receipted totals to the state. Finally, Ms. Sanson pointed the Board to chart 6, Comparison of Interest Rates. She said that in this chart, the Board can see historically where interest rates have been compared to what they are now. She said that the quick analysis is that the Treasury is producing better results with less favorable interest rates. She continued, saying that in 2007 when the Treasurer's office earned \$112 million the Federal Fund Rate was 5.25%, whereas now the rate is 0.25%. She pointed the Board to the last chart, and said that the orange line shows how the Federal Funds rate correlates with the short term investment portfolio, and the green shows how the 3 Year Treasury rate correlates with the long term investment portfolio. She said that, as the Board can see, once the Treasury was fully invested in mortgage-backed securities, there was a clear "lift off" in earnings. She pointed out that the Treasury is closing in on earnings similar to 2009, which clearly shows the positive difference of what can happen with a more active management style of these funds. Ms. Sanson asked the Board if there were any questions.

Chairman Walther asked for clarification on chart 3 and chart 4. Ms. Sanson explained that chart 3 is total earnings by month, the short term portfolio and the long term portfolio per month; and

chart 4 is earnings to date by year, which shows an entire fiscal year in the past, and through May for 2016, which is 42 million.

Mr. Harkins then asked if when the mortgage-backed security portfolio was cut in half, were those funds moved over to the short-term portfolio. Ms. Sanson responded affirmatively and stated that the investment team is in a waiting game to see what the Federal Reserve is going to do with interest rates.

Treasurer Milligan then spoke and said that the investment team is making adjustments every day, every hour, and even at some points every minute, which is something that had been unheard of in past Treasury operations. Chairman Walther thanked the Treasurer and his team for the report and asked for a motion to accept the report into the record. The motion was made by Al Harkins and seconded by Cale Turner. All 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 Treasurer Milligan. 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, 2016 – September 30, 2016, 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 Andrea Lea. All members were in favor.

Chairman Walther then recognized Mr. Jim Fowler and Mr. Jacob White of the Rose Law Firm to present the next item on the agenda. However, Treasurer Milligan asked to speak again to give background information on this agenda item. The Treasurer addressed the board and stated that there was legislation passed during the third extraordinary session of the Arkansas General Assembly that has impacted the Treasurer's office. He explained that the increased investment returns generated by the Treasurer's office will be used in the future to fund the Governor's new highway plan and

create a long term reserve fund for the state. The increased returns will be used to match available federal highway dollars, 1.5 million this fiscal year, 20 million for fiscal years 2017 through 2020, and 25 million for fiscal year 2021. Treasurer Milligan stated that the highway plan is going to create more jobs in Arkansas, provide for safer, better highways, and will aid in recruiting more industry. He continued by saying that the additional returns above the highway funding will be put away in a long term reserve fund so that when we have a downturn in the economy or a deep recession, the state will be in a better position to weather the economic storm. Treasurer Milligan said that neither program will raise taxes on the taxpayers of Arkansas, but instead the Governor and the legislature were innovative and thoughtful in addressing problems. The Treasurer also commended Senator Dismang for his forward thinking approach in creating the long term reserve fund. Treasurer Milligan stated that he promised to voters of Arkansas when he ran for office that he would do everything he could to generate the most return from the investments of their tax dollars. He said that the way the Treasurer's office has transformed is already making a real impact for Arkansas. He continued by saying that the investment returns have opened the door for the legislature to find additional uses for the increased returns that they will continue to be able to produce. Treasurer Milligan then thanked the Board again for their support, and stated that he looks forward to continuing to produce great results and allow the Governor and the legislature to do innovative things without raising taxes.

Treasurer Milligan continued, and said that last year the investment team started looking at the potential for another investment option, sale and repurchase agreements, better known as "repos", to continue maximizing returns. In those conversations, the team decided that legal help was needed. He explained that staff first visited with the Attorney General's office, who decided that the Treasurer's office needed legal expertise that their attorneys did not have. Following the process outlined by law, both the Attorney General and the Governor gave the Treasurer's office permission to seek outside legal counsel for our investment team. The office received 5 statements of qualifications and after review and interviews with each firm, staff recommended the Rose Law Firm. Mr. Jim Fowler and

Mr. Jacob White have been working with the investment team and they have discovered some items that will need to be addressed by future legislation and action in 2017 by the General Assembly. He continued by telling that Board that the Treasurer's office did try to have some of the items addressed during the fiscal session and in the third special session, however, the Governor's office decided not to add these items to the call for the special session. The Treasurer then asked Autumn Sanson to continue with the presentation.

Ms. Sanson told the Board that the Treasury has a responsibility to the State Board of Finance to keep the members informed of activities of the office with regards to the investments. She continued, explaining that the office can invest in repurchase agreements, however clarification is needed regarding the types of collateral that can be used. This is the first item that the Rose Law Firm has looked into. She asked Mr. Fowler to expand on this.

Mr. Fowler addressed the Board and stated that the firm did take look at the authority of the Treasurer to invest in repurchase agreements. He explained that repurchase agreements involve securities where there is an agreement by another party to repurchase them and they are secured by that security as opposed to collateral. He said that in the statutes the Treasurer is authorized to collateralize repurchase agreements with direct obligations of the United States government and general obligations of state and local governments anywhere in the United States. He noted that there is a pretty wide disparity in credit quality. He explained that the Treasurer is authorized to make direct investments in the United States government with agencies and obligations that are unconditionally guaranteed by the full faith and credit of the United States, but those are not included as permissible collateral for repurchase agreements. He stated that what they have recommended in amendatory legislation is that the full-faith and credit of the US obligations, the agencies, be added and the state and local government obligations be eliminated.

Ms. Sanson again addressed the Board and stated that the second item discussed with the Rose Law Firm is safekeeping. She explained that around three weeks ago, the current safekeeping agent

for the Treasury, First National Bankers Bank (FNBB), requested a meeting and informed the Treasury that they had outgrown their operation. She stated that in the past, the Treasury would typically have around 100 transactions a year, and last year there were around 1100 transactions. She said that FNBB could not continue to handle the safekeeping at this volume with the amount of capital they have. She explained that the Treasurer's office needed to know exactly how to work within this industry when many banks have merged with direct issuers and how the federal reserve has made provisions to address this. She then asked Mr. Ed Garner and Mr. Fowler talk more about this.

Mr. Fowler addressed the Board first and said that in regards to safekeeping, the legislation that governs the Treasury is not very informative. He said that in a couple of references, repurchase agreements for example, there are provisions for custodial agents but otherwise there is no statutory guidance. He continued, stating State Board of Finance rule regarding cash funds does have some guidance with regard to safekeeping, and there is a lot of secondary authority out there. He stated that this is a topic that the firm is in ongoing discussions with the Treasurer's office about, and there are industry guidelines and best practices out there that can be discussed. He then asked Ed to elaborate.

Mr. Garner explained to the Board that the Treasurer's office along with the Rose Law Firm are beginning an exploration into both the statute and the intent of the statute, with regards to who will safekeep our securities. He said that they are also being very mindful of the operational efficiency that can be gained using a money center type safekeeper. He said that they have already reached out to several of the major safekeeping operations within the US and have been exploring what they have to offer and how it will fit operations to make things more efficient. Mr. Garner told the Board that the Treasury is very appreciative of all the work that FNBB has done, but operations have exceeded their capabilities. He stated that he thinks they will have something to report to the Board in the near future.

Mr. Fowler spoke again and said that his firm has reviewed the statutory and regulatory authority of other State Treasuries in comparison and they are using information as a framework for some recommendations.

Auditor Lea asked how the contract with Rose Law Firm is structured. Mr. Grant Wallace responded that they were paid a retainer and the investment team is able to reach out as needed.

Mr. Harkins asked if the efforts to find a safekeeper will be brought back to the Board. Ms. Sanson responded affirmatively. She then told the Board there was one more item being addressed, which is the timing of the monthly distribution to agencies. She said that the distribution is currently done on the first of the month but with the investments being in mortgage-backed securities, they need to align the distributions with the pay-downs. She said that the Rose Law firm is going to review the legislation that has already been drafted. She asked the Board if there were any questions.

Chairman Walther asked if there is any action required by the Board today on these items. Ms. Sanson responded in the negative. Chairman Walther stated that he assumed the Board will be part of the recommendation that will come before the legislature next year. Mr. Wallace responded affirmatively, and said that the Treasurer's office would need the Board to support those initiatives. Mr. Garner added that the safekeeping issue may not require legislation, but it is unclear at this time.

Next, Chairman Walther recognized Mr. Tony Williams of the Arkansas Student Loan Authority (ASLA) to present the next item on the agenda. Mr. Williams thanked the Board and introduced himself as the Director of ASLA. He also introduced Mr. Mark Conine, the CFO of the ASLA; Mr. Jack Williams, of the Williams & Anderson Law Firm, legal counsel for the ASLA; and Mr. Tony Minicozzi, Director of the Arkansas Rural Endowment Fund (AREF). Mr. Williams told the Board that the ASLA is asking for approval to finance a student loan purchase 5.4 million dollars. He continued by explaining that the Arkansas Rural Endowment Fund is selling their federal student loan portfolio to the Arkansas Student Loan Authority. Buying student loan portfolios from Arkansas lenders is standard business for the ASLA, and they have been doing so for the past 35 years. State

statute requires the ASLA to come before the Board of Finance whenever they enter a debt obligation. Mr. Williams explained that in this transaction, AREF is not only selling the loan portfolio to the ASLA, but they are also financing this transaction. Mr. Williams told the Board that this is the second time the ASLA has entered into a transaction such as this, the last time was in 2014 with Simmons Bank. Mr. Williams gave a brief summary of the transaction to the Board. This summary is included in the Minutes as Attachment 2. After going over the summary, he asked the Board if there were any questions.

Mr. Cale Turner asked if there is a cap on the interest rate. Mr. Williams responded that since the interest rate yielded on the loans is also based on the LIBOR rate, no matter how high the LIBOR goes, the yield increases at the same amount, so the spread is always moving upward and downward together. He explained that within that spread, the ASLA is able to pay for all of the loan servicing and the administration of the loan portfolio, and absorb any possible defaults.

Chairman Walther asked if there were any other questions. Treasurer Milligan told the Board that he also sits on the AREF Board, and will abstain from voting. Chairman Walther then recognized Mr. Jack Williams to review the Resolution. Mr. Williams stated to the members of the Board that the Resolution in front of them authorizes the ASLA to enter into the transaction with the AREF. The Resolution reads, in words and figures, as follows:

RESOLUTION

WHEREAS, the Arkansas Student Loan Authority (the "Authority") was created by Act 873 of the Acts of Arkansas of 1977, codified, as amended, at Arkansas Code Annotated §§ 6-81-101 through 6-51-131 (the "Act"), which describes the Authority's responsibilities and authorizes it to issue obligations to provide funds to accomplish the purposes for which it was created and established and to acquire and sell student loans; and

WHEREAS, to continue its statutory responsibilities, the Authority proposes (1) to acquire the remaining Student Loan portfolio owned by the Arkansas Rural Endowment Fund ("AREF") in the approximate amount of not to exceed \$6,000,000; (2) to finance the purchase with a loan in the amount of the purchase price from AREF, such loan to be evidenced by a loan agreement with AREF and a promissory note of ASLA (the "Note")

given in consideration of such purchase and sale and loan; and (3) to provide funds for a Reserve Fund and to pay costs of issuance; and

WHEREAS, the Promissory Note involved in this transaction shall be the obligation only of the Authority, neither the faith and credit nor the taxing power of the State of Arkansas, or any political subdivision thereof, will be pledged to the repayment of the principal of or interest on the Note; the Note will not be secured by a mortgage or lien on any lands or buildings belonging to the State of Arkansas; and the Notes shall not constitute an indebtedness of the State of Arkansas within the meaning of any constitutional or statutory limitations; and

WHEREAS, the Authority's Board of Directors at its May 17, 2016 meeting adopted a resolution authorizing the purchase of the Student Loans from AREF and the Loan Agreement and Note to evidence the obligation owed to AREF to fund the purchase price; and

WHEREAS, the Authority has held a public hearing on June 1, 2016 as required under Arkansas law; and

WHEREAS, Section 6 and Section 8 of the Act, Arkansas Code Annotated § 681-107-108, requires that prior to the issuance of any obligations by the Authority, the State Board of Finance shall first give its consent by Resolution to the issuance of such an obligation; and

WHEREAS, the State Board of Finance is charged with the responsibility of maintaining and improving the credit standing of the State of Arkansas.

NOW, THEREFORE, BE IT RESOLVED by the State Board of Finance of the State of Arkansas that:

Section 1. The State Board of Finance has reviewed the proposed transaction, and based upon such review the consent required by Section 6 and Section 8 of the Act, Arkansas Code Annotated § 6-81-107-108, is hereby given to the Authority, this current authority carrying with it the issuance of the Note by the Authority, as set forth herein and in the authorizing resolution of the Authority.

Section 2. The consent given by this Resolution does not extend to any swap agreement or other derivative agreement, and the Authority shall obtain the specific approval of the State Board of Finance before entering into any interest rate swap agreement or other derivative agreement.

Section 3. Pursuant to Arkansas Code Annotated § 6-81-108, a copy of this Resolution shall be provided to the Office of the Governor.

ADOPTED: June 21, 2016.

/s/ Larry Walther
Chairman

ATTEST:

/S/ Dennis Milligan
Secretary

Chairman Walther asked if there were any further questions from the Board. Auditor Andrea Lea asked if there were any comments from the public hearing. Mr. Jack Williams responded there were not, as there was no one in attendance, and the hearing was held open for 20 minutes. There being no further questions from the Board, the Chairman asked for a motion to approve the Resolution. The motion was made by Al Harkins, and seconded by Ann McDougal. All were in favor.

Next, Chairman Walther proposed that the next two scheduled meetings be Thursday, August 4th at 10am, and Thursday, November 10th at 10am, 2016, in the Conference Room, Suite 275 of the Victory Building. To conclude, the Chairman asked if there was any other or new business to be brought before the Board. There being no further business, the Chairman declared the meeting 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.