

MINUTES OF THE TREASURY OVERSIGHT COMMITTEE
ORANGE COUNTY, CALIFORNIA

REGULAR MEETING

October 15, 2008

APPROVED

October 30, 2008

The Regular Meeting of the Treasury Oversight Committee (TOC) was held on October 15th and called to order by Tom Mauk, Chair, at 2:30 PM.

Committee Members:

Present:

Tom Mauk, CEO (Chair)
David Sundstrom, Auditor-Controller
Bill Habermehl, O.C. Board of Education

Absent:

None

Also present were:

Chriss Street, Treasurer-Tax Collector; **Paul Gorman**, Chief Assistant Treasurer-Tax Collector, **Jennifer Burkhart**, Assistant Treasurer-Tax Collector, **Paul Cocking**, Chief Portfolio Manager, **Fahad Haider**, Assistant Portfolio Manager, **Keith Rodenhuis** and **Yvette Clark** from the Treasurer's office; **Angie Daftary**, County Counsel; **Bob Franz**, **Tom Beckett** and **Richard Mendoza**, from the office of CEO Public Finance; **Nancy Ishida** from Auditor-Controller's office; **Lou Bronstein** from Supervisor Campbell's office, **Don Hughes** from Supervisor Bates' office and **April Rudge** from Supervisor Moorlach's office, **Steve Kozak** from the Children & Families Commission, **George Jeffries** as a member of the public, **Terry Fleskes**, **Darlene Hibbs** and **Don Hamptman** from the Grand Jury.

1) Meeting Called to Order

Mr. Mauk called the meeting to order.

2) Welcome and self-introductions

Introductions were made.

3) Public Comments

None.

4) Approval of Prior Meeting Minutes

The Minutes of the July 30, 2008 Regular Meeting were reviewed.

Recommended Action: Mr. Mauk called for a motion to approve the Minutes. Mr. Sundstrom moved to approve the Minutes, 2nd by Ms. Benkert, Passed 3-0

5) **Chairman's Report**

None

6) **Treasurer's Report**

The Treasurer's Report was given by Mr. Street.

Sigma Finance

- At the last TOC meeting, the ability of Sigma Finance to continue to obtain funding through repurchase agreements given the size of notes maturing in August was discussed.
- During September, Sigma's ability to continue funding through our maturity date of October 30th became increasingly uncertain.
- We decided to sell our entire position on 9/17/08 at 91.5% of par.
- Two weeks later, Sigma went into receivership.

Whistlejacket

- Staff participated in a conference call with Deloitte, as Trustee, on 10/7/08
- They are continuing to consider an update to the auction process and how best to run it. These are higher quality assets than contained in other SIVs. As such, they are considering two things:
 - Setting the auction time frame to 2.5 hours vs. previous 24 hour auctions
 - Having the investors set a floor whereby if the prices come in above the floor price, then cash is distributed. If prices come in below the floor price, then returns would be made via pass thru notes.
- "New Co." documents are being drafted, and the signature process is underway. Deloitte has a meeting scheduled with Goldman Sachs in NY this week to iron out further details
- They indicated the timing of the auction process is unclear. They want the documents in executable form as soon as possible, but "want to check the weather conditions before we fly."
- Dividend distribution issue has pretty much been resolved. A redemption price has been agreed to and payments are aimed to be made at the end of the week of 10/22 in the amount of approximately 18% of Sr. Secured claims.

Remaining SIV's

- We hold approximately \$395 million par value in the remaining SIVs. About \$115M are due to mature in November, including Tango and Five Finance. These

have been absorbed onto the balance sheet of Citicorp, and we feel comfortable that we will receive full principal on schedule.

Repo Counterparties

- We have an agreement with only one counterparty, Greenwich (a subsidiary of Royal Bank of Scotland, RBS.) While we had another agreement in place with Lehman Brothers, they were never actually used as a repo counterparty. Due to our strategy during this time of uncertainty, my office has made the decision not to engage in any Repurchase Agreements. Should we decide to change our position on this issue, members of TOC will be advised.

TOC Membership

- The status of the appointment of George Jeffries as a representative member of the TOC was discussed. County Counsel is reviewing a potential conflict of interest between his appointment to TOC as well as his membership on the Board of OCERS. Until this can be resolved, George is here as a member of the public.
- With respect to our public member vacancy, we need to post the vacancy for 10 days prior to recommending our new member to the Board. We plan on bringing this to the Board at the October 28th meeting, in which Dr. Raghu Mathur, Chancellor of the South Orange County Community College District, will be up for nomination.

7) Update on Financial Market's Impact on County Portfolio

- Mr. Street stated that over the past year the Treasurer's office has shifted from 60%-70% of the portfolio in Finance companies to 60-70% US Government Agencies and Treasuries. The portfolios have also generated approximately \$12 million in interest last month.

8) Receive & Approve the Final Treasurer Implementation Plan

- **Items # 53 Consider possible inequity in the allocation of earnings that may occur if the County continues to use the amortized cost basis of accounting to compute earnings for the Extended Fund versus the complexity of attempting to account for market value fluctuations in either the income allocation or share price. #54. Distribute earnings on the first business day of each month.** Mr. Sundstrom raised questions on Item #'s 53-54 where PFM recommended some changes to the method in which earnings are allocated as well as the earnings distribution. He indicated that nine years ago the then Treasurer wanted to accrue interest earnings and post the accruals to all different accounts. This method entailed posting interest on interest that wasn't there yet, so it hadn't been invested yet. Mr. Gorman added that the outstanding issue was that one fund was

required to have a negative cash balance. Mr. Sundstrom said he didn't see a way around it. Mr. Gorman indicated we've been operating this way for a long time. We include in our monthly report what we think the interest payments will be based upon cash flows. It's not a promise to pay, but rather a forecast of when the monthly payments will be deposited in the participants' bank account.

- Mr. Street added that the current method is well-trying method that conforms to Government code.
 - Mr. Sundstrom recommended the response read that the Auditor/Controller and the Treasurer have reviewed the recommendation and found that the existing policy conforms with government county practices.
 - Mr. Mauk called for a motion for #53-54 that the TOC does not concur with the recommendation and the existing policy be retained.
 - **Mr. Habermehl made the motion. Mr. Sundstrom seconded. All voted in favor.**
- **#13 – Maximum Maturity: set a maximum duration for the Extended Fund in order to better manage market risk.**
 - Mr. Street said that the Treasurer's office has been calculating duration since July and feels we're positioned to be able to state duration. The current IPS does not allow for the use of duration, and uses the Weighted Average Maturity(WAM) instead.
 - Mr. Street feels that duration is the next step in bringing a high level of professionalism and confidence to our processes.
 - Mr. Mauk asked if the Treasurer's Office concurs with having duration as a benchmark and Mr. Gorman's compliance group is able to check compliance with the IPS then we can add it as part of the Investment guidelines. The recommendation is to use the Merrill Lynch 1-3 year index plus 25%, meaning the duration of the Extended Fund can exceed the duration of the index by up to 25%. A motion was made to amend the Implementation language to say the TTC concurs with the recommendation. Mr. Mauk called for a new motion approve item 13 with language to change the index to read "a Leading 1-3 year index" rather than the Merrill Lynch index.
 - **Motion was made by Mr. Habermehl. Mr. Sundstrom seconded. All were in favor.**
- **Item # 70- Have County Executive Office contract with independent firm to produce an annual review and report of the Treasurer-Tax Collector's Investment Pools**
 - Mr. Franz stated that TTC recommended whether the contract for the outside review should be managed by CEO's office or Treasurer's office through the TOC. Mr. Mauk stated their concern was related to the principal that you cannot audit yourself and recommended that it be done through the CEO's office.
 - Mr. Sundstrom added that it would work similar to the SB866 review in that the TOC would be performing the oversight and it would be a way to strengthen the role of the TOC.

- Mr. Mauk agreed and indicated his support for whatever will strengthen the role of the TOC.
- Mr. Sundstrom suggested that as long as TOC is the client, and the TOC is involved in the selection of the contract, then he would agree. Mr. Franz added that the TOC can be the client and the CEO's office can manage the contract.
- Mr. Mauk called for a motion, stating that the recommendation is for the CEO to be the contract administrator with the TOC as client to engage an external advisor one year from approval of the IPS. **Mr. Sundstrom moved. Mr. Mauk seconded. All were in favor.**
- **#16 - Engage external investment advisor to assist the TOC with deliberations**
 - Ms. Burkhart said the recommendation from PFM would be to have an advisor attend some of the TOC meetings and assist in deliberations as needed, whether it is one time or periodically to review issues.
 - Mr. Street recommended the TTC have someone contracted and available to use on an "as needed basis."
 - Mr. Mauk called for a motion to concur with the recommendation to allow the engagement of an external advisor to assist the TOC, and the Treasurer's office will be seeking an on-call advisor.
 - **Mr. Sundstrom made motion. Habermehl seconded. All were in favor.**
- Ms. Burkhart explained that there were some items on the PFM which had a December 31st follow up date which had been updated to completed as follows:
 - Items #37, 38, 46, 47 and 48
 - #40 – recommendation for Standard & Poor's to rate the portfolio was updated to reflect that the contract is with S & P for execution.
 - Regarding staffing requirements,
 - #45 is waiting for the CEO's office to unfreeze the position, and #46 has been completed with the hire of Mr. Fahad Haeder.
 - #49-Add more details about the credit rating of individual portfolio holdings to the report. It was recommended to replace the WACR chart in the Monthly Report with a clearer break down of the percentage of each rating category is in the portfolios. This will commence with the October 2008 report.
 - #57 - Consider adding another pricing methodology for SIVs. We recently received Board approval to upgrade our Quantum accounting system and will not be using IDC as a pricing source, but will stay with Bloomberg in a different format. The upgrade to the system cannot take IDC prices without further cost and programming time. Additionally, the recommendation was a result of the SIV positions which we will no longer be buying so there is not a reason to contract with another firm. Mr. Gorman has been in discussion with the Bank of NY, our custodian and they will be able to provide their prices sourced from IDC for the remaining SIV holdings.

a) **Recommended Action: Approve Implementation Plan**

- Mr. Mauk called for a motion to approve the Implementation Plan with the changes discussed. **Mr. Habermehl moved. Mr. Sundstrom seconded. All were in favor.**

9) **Discuss and/or propose recommended changes to Investment Policy**

- A. The Treasurer would like to propose changes to the IPS as part of the Implementation plan.

Discussion:

Mr. Cocking explained the changes made to the IPS.

- **Regarding Roman Numeral 3, paragraph 2, PRUDENCE**, Mr. Sundstrom stated he would have to refer to the government code on this one.
- **Regarding Roman Numeral 5, page 5, OBJECTIVES**, Mr. Sundstrom stated that he believed Liquidity & Safety of Principal should all be at the same level. .
- **Regarding Roman Numeral 2, SCOPE**, Mr. Jeffries stated he is confused with the sub-heading “Specific Investment Pools.” He suggested the word “pools” be removed for clarification.
- **Requirements of the Money Market Fund on page 7 under COMMERCIAL PAPER**
 - Mr. Sundstrom stated that there was some question by Internal Audit whether the County’s SIVs complied with the requirements of the IPS as “being operated in the US as a general corporation” and questioned whether European operations under the laws of Europe should be excluded.
 - Mr. Jeffries also expressed his concerns regarding sovereign risk, stating that it’s a major issue that entails headline risk.
 - Mr. Sundstrom suggested on page 10, item 10 MEDIUM TERM NOTES that there be a statement stating that they must be organized and operating under the governing laws of the U.S.
- **Commercial Paper Holdings**
 - Mr. Jeffries expressed his concern regarding the 45% allowed of Commercial Paper holdings.
 - Mr. Street and Mr. Cocking explained that the guideline states they can invest “up to” 45%, but this does not mean they will purchase this amount
- **Credit Ratings**

- Mr. Cocking explained it was important to allow double A investments to allow the Investment Team to purchase corporates past 13 months maturity without the AAA rating requirement.
- Mr. Street added that diversification is needed in the portfolio and purchasing AA credits will allow us to buy some highly rated US corporations, such as Coca-Cola & Wal-Mart.
- Mr. Sundstrom said he was in favor of the AA ratings because in very good times you have a larger array of triple A companies to choose from, but in more difficult times this is more challenging. Allowing the flexibility to diversify the portfolio where needed entails going down to AA rated entities.

B. Recommended Action:

Motion to approve the changes to the IPS in their current form and have the final IPS come back to the TOC for review in a special meeting within the next two weeks. **Mr. Habermehl made the motion. Mr. Sundstrom seconded the motion and all approved.**

10) Public and Committee Member Comments

none

11) Schedule Next Meeting Date

- a) A special meeting will be scheduled within the next couple weeks to review and approve the final PFM Implementation Plan & IPS.
- b) The next quarterly meeting is scheduled for January 28, 2009.

12) Adjournment

- a) Mr. Mauk adjourned the meeting at 4:17 p.m.