

MINUTES OF THE TREASURY OVERSIGHT COMMITTEE
ORANGE COUNTY, CALIFORNIA

SPECIAL MEETING

June 4th, 2008

FINAL
Approved on June 19, 2008

The Regular Meeting of the Treasury Oversight Committee (TOC) was held on June 4th and called to order by Bob Franz, Chair, at 11:07 AM.

Committee Members:

Present:

Bob Franz for Tom Mauk, CEO
David Sundstrom, Auditor-Controller
Bill Habermehl, O.C. Board of Education

Absent:

Also present were:

Chriss Street, Treasurer-Tax Collector; **Jennifer Burkhart**, Assistant Treasurer-Tax Collector
Paul Gorman, Chief Assistant Treasurer-Tax Collector, **Paul Cocking**, Chief Portfolio
Manager, **John Byerly**, Financial Analyst, **Yvette Clark** and **Keith Rodenhuis** from the
Treasurer's office; **Angie Daftary**, County Counsel; **Wendy Benkert**, from the OC Board of
Education, **Tom Beckett** and **Richard Mendoza**, from the office of CEO Public Finance,
Kristine Young and **Samantha Yung** from Auditor-Controller's office..

I. Meeting Called to Order

A. Mr. Franz called the meeting to order.

II. Welcome and self-introductions

A. Introductions were made.

III. Public Comments

A. None.

IV. Approval of Prior Meeting Minutes

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

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

V. Chairman's Report

- A. There was no Chairman's report.

VI. Treasurer's Report

- A. The Treasurer announced that the British appellate court reversed the prior ruling in March concerning the priority and distribution of payments. However, this ruling has now been appealed to the House of Lords by Party A, whose interest in Whistlejacket came due for payment on the insolvency date, February 15th. According to the receivers, Deloitte and Touche, we will wait to determine whether the higher court accepts Party A's appeal.

VII. Review and Discuss Treasurer and T.O.C. responses to and related to the implementation plan for PFM Asset Management's Final Report on Risk Analysis of the Treasurer's Investment Pool.

Items of Concurrence without Discussion:

- A. **PFM Recommendations #2-6, 8, 9,12,14,23,24, 26, 27,30-32, 36-51:** see attached report

Concurrence: Concurred by both TTC and TOC.

Discussion: Mr. Franz requested that the last column of PFM Recommendations Implementation plan be stricken and the following put in its place:
Implementation upon Board Approval of IPS.

Recommended Action: The IPS will be amended as recommended in cases where needed, and will be submitted to the Board for approval.

Items of Discussion:

- B. **PFM Recommendation #1:** Incorporate deposit placement services into Investment Policy Statement.

Concurrence: TTC does not concur.

Discussion: Mr. Cocking noted that a firm is already utilized for the purpose of direct CD placement at no charge. The TOC agreed with the TTC.

Recommended Action: No further action required.

- C. **PFM Recommendation #7:** Securities Lending: (1) develop detailed written policies describing how and when securities lending will be used; (2) establish

limits on the investment of cash collateral; (3) limit securities lending to the Extended Fund.

Concurrence: TTC does not concur with this recommendation as the incremental return is not commensurate with the additional risk

Discussion: Mr. Cocking recommends removing the authorization for Securities Lending from the IPS as this activity is not something the Investment Team does.

Recommended Action: The action will be to concur with TTC and remove Securities Lending from the IPS.

- D. **PFM Recommendation #10:** GSE Diversification – PFM recommends limiting holdings of any GSE issuer to no more than 35% per fund.

TTC Concurrence: TTC concurs with this recommendation.

Discussion: Mr. Cocking stated that the current IPS does not have any diversification limitations for GSEs. The TTC is proposing to lower the limit to 30% per issuer. Mr. Franz requested clarification in the statement of concurrence that the limit is “per issuer per fund”.

Recommended Action: The IPS will be changed to limit the exposure of GSEs from 100% to 30% per issuer per fund and submit to the Board for approval.

- E. **PFM Recommendation # 11:** PFM recommends limiting holdings of commercial paper to 40% in each fund.

TTC Concurrence: TTC does not concur with PFM as the money market fund is managed under government code section 53601.7, which parallels SEC Rule 2a-7, thus allowing up to 100% of the fund to be invested in commercial paper. County Counsel has reviewed the IPS and is of the opinion that the IPS is compliant with government code standards. TTC would like to continue investing up to 45% in commercial paper in the money market fund.

Discussion: Mr. Beckett stated that we are currently in conformance with the County Counsel memo that there is no government code violation. Mr. Sundstrom understood County Counsel’s position on this, but wanted to know if this was a good idea or not to do it anyway.

Mr. Cocking stated the TTC is trying to move toward two distinct investment processes; money market for liquidity and extended fund for longer term needs. TTC would like to restrict the level so that it is not unlimited and is comfortable with the current level of 45%.

Mr. Sundstrom was fine with the recommendation to keep the level at 45%.

Recommended Action: Concur with TTC

- F. PFM Recommendation # 13:** Maximum Maturity: set a maximum duration for the Extended Fund in order to better manage market risk.

TTC Concurrence: TTC concurs with the PFM recommendation

Discussion: Mr. Cocking explained that duration is a difficult concept for the general public to understand, however agrees that it would be a good idea to manage the Extended Fund to a duration rather than weighted average maturity (WAM). Mr. Street added that it is difficult to explain duration to people, however maturity is not a problem to explain.

Mr. Cocking provided an explanation of duration and how it differs from WAM. While the WAM is not concerned about any features of the bond other than portfolio weighting and final maturity, duration calculations take into consideration the price, coupon and current interest rate environment. The duration will be much shorter for a bond that has a call feature based on the probability of early maturity. Anything different about a bond, such as put or call features, are taken into consideration for duration calculations.

Ms. Burkhart stated that although the TTC concurs with the recommendation, the mechanics of tracking duration on a per security and portfolio level are challenging with our current systems. Mr. Street suggested that the TTC concurs, but will seek to achieve implementation over time as systems become available. Mr. Sundstrom added that the implementation should state that placing this in the IPS at this time is not technically feasible due to audit monitoring requirements.

Mr. Sundstrom suggested the TTC monitor duration for a period of time rather than report on it using existing applications. Mr. Franz suggested to concur with the recommendation, then report whether duration can be monitored and how it would be implemented. Mr. Street concurred.

Recommended Action: Concur with PFM, but monitor feasibility and report back to TOC on recommendation.

- G. PFM Recommendation # 15:** Have Treasury Oversight Committee participate in more detailed discussions with Treasury staff regarding investments.

TTC Concurrence: TTC concurs with PFM

Discussion: It was suggested that a requirement for TOC to approve new investment types prior to investment by the TTC should be stated. Jennifer Burkhart stated she will add this to the IPS under the section titled “Authorized Investments”.

Recommended Action: TOC concurs with TTC & PFM and will add to the IPS under Authorized Investments

- H. PFM Recommendation #16:** Engage external investment advisor to assist the TOC with deliberations.

TTC Concurrence: TTC concurs

Discussion: Members of TOC had questions about the intent of the recommendation and what PFM was suggesting.

Mr. Street said we would concur if necessary. Mr. Franz asked if we could do a contract for periodic review, then keep the advisor on-call. He suggested for the TTC to prepare a scope of work for the external advisor. Ms. Burkhart questioned where the funds would come from to hire an outside advisor. Mr. Street suggested we find out the scope of costs first and present to the TOC at the next regular meeting.

Recommended Action: Concur with TTC and PFM

- I. PFM Recommendations # 17-20:** Concerned TOC activities and joint meetings with TAC. (see attached)

TTC Concurrence: TTC concurs

Discussion: The TOC members felt a joint meeting with the TAC would be helpful, and much information could be gleaned by sharing perspectives.

Recommended Action: Concur with TTC and PFM. The TOC agreed to have a joint meeting annually with TAC.

- J. PFM Recommendation #21:** Consider whether an online trading platform providing access to more inventories and documented competitive processes for buying and selling would be practical.

TTC Concurrence: Concur, will consider

Recommended Action: Concur with PFM. We considered the recommendation, but determined our existing automation is sufficient.

- K. PFM Recommendation #22:** Consider alternatives to pre-trade compliance procedures.

TTC Concurrence: Concur, will consider

Recommended Action: Concur with PFM. We considered the recommendation, but determined existing pre-trade compliance procedures are sufficient.

- L. PFM Recommendation # 25:** Perform a formal annual credit and performance review of all firms on the approved broker/dealer list.

TTC Concurrence: TTC partially concurs

Discussion: Discussion occurred regarding the current procedure used by the County to review firms on the approved broker/dealer list. Mr. Street emphasized that the TTC does business with firms, not people. As long as a firm meets the criteria of the application, then they should be approved. He indicated we have purged some firms in the past, and currently have approximately 27 firms approved.

The criteria suggested by PFM, including background checks of personnel assigned to the County's account and verification of registrations, was not concurred.

Recommended Action: Partially Concur – no change in current procedures.

- M. PFM Recommendation # 28:** Tri-Party Repo: (1) money market funds should use repurchase agreements more strategically as part of sector allocation decision; (2) adopt collateralization policy to include only Treasuries and Agencies; (3) establish additional Tri-party repo relationship(s); (4) bid out to obtain more competitive rates; (5) bid early in the day.

TTC Concurrence: TTC does not concur with PFM, with the exception of (2) as it is the current practice of accepting only Treasuries and Agencies as collateral.

Discussion: Mr. Sundstrom stated that PFM recommends using longer-term repos in the portfolio. He continued that unless you want to extend your repos to be more than overnight, then everything else does not apply. Mr. Sundstrom stated that he assumed the TTC doesn't want to move forward with other comments, therefore we should indicate we do not concur with the recommendation.

Mr. Franz questioned whether we wanted to continue with our recommendation to consider a dollar amount over which we would use more than one counterparty. Mr. Cocking said \$500million may not be an exact number during tax time, so we do not want to necessarily hold ourselves to a limit for the busier times. Mr. Franz indicated that we should not amend the IPS to include these limits if we want the flexibility.

Concerning the other items in the recommendation, Mr. Cocking stated the process used to determine competitive rates and bidding is currently effective. Mr. Sundstrom requested to add how we keep the process competitive, and that we shall seek to review offerings on a daily basis.

Recommended Action: Do not concur with PFM, but will add some verbiage to seek to review offerings on a daily basis.

- N. **PFM Recommendation # 29:** Develop policies, procedures for evaluation and trading of mortgage-backed securities.

TTC Concurrence: The TTC is developing policies for evaluation of these securities.

Discussion: Mr. Cocking stated that TTC would be interested in evaluating the appropriateness of mortgage-backed securities. Mr. Sundstrom suggested to respond that while the policies are being developed, we do not intend to make investments in these securities until economic conditions change and discussions with the TOC occur.

Recommended Action: Concur with PFM, in the process of developing policies for evaluation of these securities

- O. **PFM Recommendation # 33:** Adopt the same methodology in selecting ABCP programs as in selecting Structured Investment Vehicles (SIVs).

TTC Concurrence: TTC concurs

Discussion: Ms. Benkert requested more clarification in the IPS regarding the elimination of SIVs as an authorized investment. Mr. Street agreed and stated that the IPS would be amended to reflect this.

Recommended Action: Concur with PFM

- P. **PFM Recommendation # 34:** Purchase only ABCP programs with liquidity providers that are approved issuers.

TTC Concurrence: TTC concurs.

Discussion: Mr. Cocking stated we have not changed the IPS, but we have changed the internal process to follow this recommendation. Ms. Burkhart stated she will change IPS.

Recommended Action: Concur with PFM and add verbiage to IPS.

- Q. **PFM Recommendation # 35:** Split the approved issuer list into a short-term and medium-term list.

TTC Concurrence: The TTC does not concur.

Discussion: Mr. Street stated if we feel confident to approve an issuer based on short-term investments, then we would also be confident with medium-term investments. Mr. Sundstrom suggested that we respond with adding that TTC will maintain its same high standard of review for both short-term and medium-term issues.

Recommended Action: Do not concur with PFM, but will maintain TTC's same high standard for short-term and medium-term issues.

VIII. 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.
- B. Recommended Action: The action will be to defer changes until the proposed changes are reviewed by members of the Committee.

IX. Public and Committee Member Comments

None

X. Schedule Next Meeting Date

- A. A special meeting is to be scheduled between now and June 30th to continue review of both the PFM Implementation Plan and recommendations for changes to the IPS.

XI. Adjournment

- A. Mr. Franz adjourned the meeting at 12:53 p.m.