















# Delaware State Treasury

State Treasurer Chip Flowers



economic data from Delaware, the region and the nation to evaluate the state's economic position and assess the performance of the state's economy over the prior sixty (60) day period. The early warning system is a powerful tool in informing Delawareans of changes in the economic climate that can impact their livelihood. The Early Warning System is available on the treasury's website and is distributed with the Index on a bimonthly basis through various media outlets.

## *Signed Delaware Money in Delaware Banks Directive*

The importance of supporting banking institutions chartered or having a significant presence in Delaware is paramount to the People's Treasury. Under the "Delaware Money in Delaware Banks" Directive (the "Directive"), up to \$250,000 of state funds are deposited in qualified Federal Deposit Insurance Corporation ("FDIC") insured banks having an active presence in Delaware. This innovative program deposits state funds in secure savings accounts and/or certificates of deposit that are paying a rate of return equal to or higher than the rate the state is currently receiving on similar deposits. Spreading deposits over a large number of banks will diversify our state funds, thus increasing safety while supporting our local banks.



## *Established and Strengthened Relationships with Federal Agencies (Proposed in the First Report)*

The People's Treasury has worked to establish strong ties with key federal agencies tasked with issuing financial and economic policies. Meetings with senior White House officials and representatives of Federal Reserve Banks and the United States Treasury Department have enhanced the voice of our treasury in these policymaking venues. These relationships can influence critical financial decisions made at the national and regional level that impact the fiscal health of our state. Through these cooperative efforts, Delaware can be an active stakeholder in influencing the policies and practices necessary to restore our economic prosperity.

## *Selected New Merchant Services and Credit Card Processing Vendor*

The state's bank card acceptance program is organized and centralized under the purview of the People's Treasury. Bank card acceptance is one element in the overall plan of the People's Treasury to streamline revenue collection, speed receipt of payments, and lower overall banking costs while maximizing interest income. Recently, EPX, Inc. ("EPX"), a Delaware company, was awarded the treasury's merchant services and bank card processing contract to provide a central e-payment gateway for all state agencies. EPX will serve as the first stop for all virtual terminal and Internet-based transactions in the payment stream. By providing local vendors an opportunity to compete to receive state funds in major contracts, the People's Treasury is playing its part to support economic growth in the First State.



## CHALLENGES FACING THE PEOPLE'S TREASURY

**W**hile significant progress has been made by the People's Treasury over the past year, new challenges have emerged that will require the treasury to allocate resources and implement innovative ideas during the next twelve (12) months to continue delivering high-quality services. With the continued support of the People and their elected representatives, the treasury shall rise to meet these new challenges with the same spirit, dedication and determination that have guided this institution to date.

Below are a few of the major challenges facing the People's Treasury:

### *Technology and Security (Ongoing)*

While great strides have been made in modernizing the People's Treasury to meet the requirements of a 21st century financial office, work in this area must continue. Currently, the Treasury's critical financial data is stored in a manner that is not consistent with best practices. Failing to store data consistent with best practices causes concerns for the safety and security of confidential information as well as the ability of the People's Treasury to access critical information in cases of disaster. The security of our state funds is the primary concern of the People's Treasury. The office's technology needs to be modernized to ensure the highest level of protection.

### *The State's Deferred Compensation Plans*

Investment contracts for the state's 457(b) and 403(b) Defined Contributions Plans (the "Plans") have not been subject to rebid for an extensive period of time. As a result, the People's Treasury is unable to ensure that participants of the Plans are receiving the best possible benefits at the lowest fees available for such services. Only an open and competitive bid process can ensure that the Plans meet the highest industry standards while providing superior services for our state employees.

### *Transparency of Policies Issued by the Cash Management Policy Board*

Under Delaware law, the provisions of the Administrative Procedures Act ("APA") govern the activities of nearly all state boards and commissions that propose to adopt, amend, create or repeal a regulation. The APA requires, among other things, public notice of any proposed regulatory changes and provides the People with an opportunity to comment on proposals prior to implementation. Current practices of the Cash Management Policy Board are ambiguous with respect to the APA and should be clarified. Since the policies promulgated by the Cash Management Policy Board, a fiduciary of public funds, impact the state's over \$2 billion investment portfolio, it is necessary and proper that these policies be subject to the APA. The APA is a crucial component of the effort to promote transparency throughout the State of Delaware. Not only is compliance a legal imperative, it is a moral imperative as the People deserve an opportunity to comment on regulatory decisions that will impact their money.



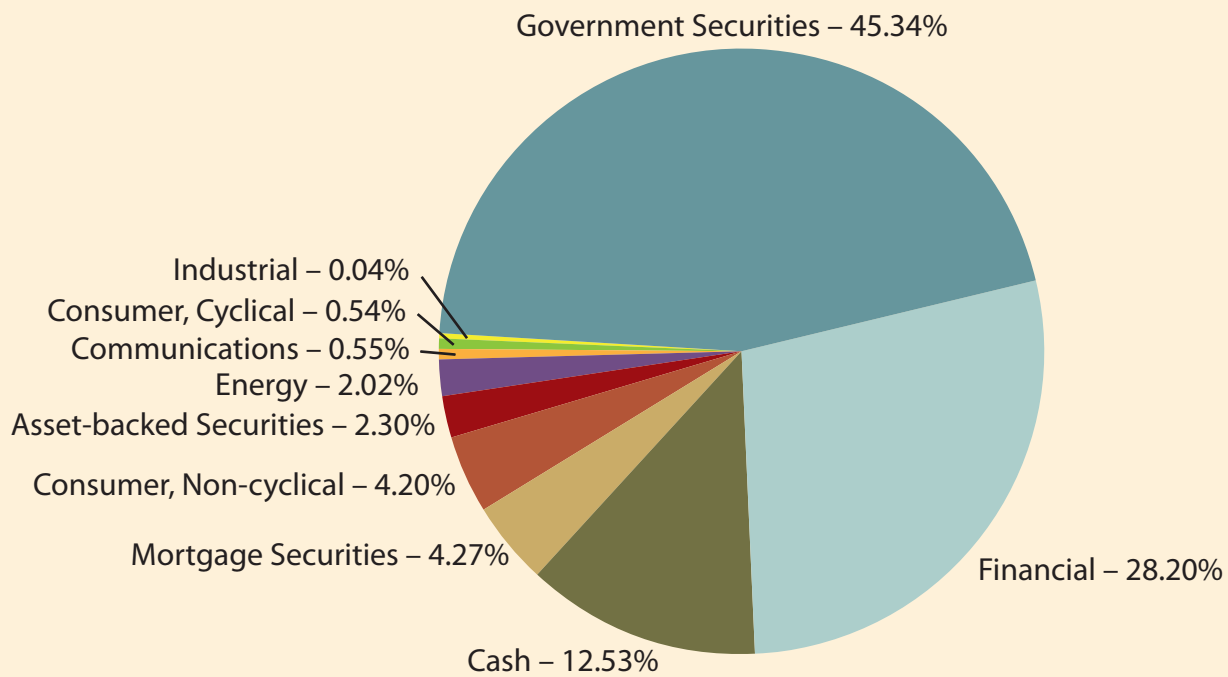
### ***Insufficient Number of Investment Managers***

With only five (5) investment managers, ensuring a competitive and diversified distribution of state funds remains a challenge for the People’s Treasury. To increase competition among investment managers with regard to the services they provide and thus increasing the benefits achieved by the state, it is essential that the number of approved investment managers be increased. Furthermore, despite the increasing number of small, women- and minority-owned investment firms, the state does not have a single contract for investment services with a women- or minority-owned investment firms. The treasury does not have a single contract for investment services with any of these investment firms. Without expanding the number of investment managers (inclusive of small, women- and minority-owned businesses), the state is unable to leverage its funds to increase investment returns safely through competition while diversifying qualified investment managers.

### ***Structure of State Investment Portfolio***

Protecting and safely investing the state’s financial assets are the primary responsibilities of the People’s Treasury and the Cash Management Policy Board. While the policies promulgated by the Cash Management Policy Board have guided the state’s investment strategy for over three decades, such policies fail to create an investment portfolio that protects and secures our state’s assets. Dated investment policy guidelines that may have met the challenges of the 1970s, 1980s and 1990s are no longer appropriate for handling the complexities of our dynamic 21st century global economy. Lacking an independent financial advisor with expertise in the niche area of government finance, the state's current investment portfolio fails to adhere adequately to the principles of diversification, liquidity and yield. The structure of the state’s investment portfolio requires an extensive overhaul based upon the guidance and recommendation of financial experts to meet the challenges of today’s global economy, maintain our state’s AAA rating and ensure the safety of our state’s funds.

## **Asset Allocation of State of Delaware Investment Portfolio**



Approximate Asset Allocation as of December 2011



## PROPOSED INITIATIVES OF THE PEOPLE'S TREASURY

**I**n light of the aforementioned challenges facing the People's Treasury, and to further its mission, the People's Treasury hereby proposes the following initiatives for the upcoming year:

### ***Clarify Applicability of Administrative Procedures Act to Cash Management Policy Board Policies***

Ensuring the policies adopted by the Cash Management Policy Board that impact our state's investment portfolio are subject to transparency and accountability to the People is needed to counter any opinion to the contrary. Policies enacted to secure, protect and invest public funds should be subject to "open government" laws without any ambiguity. To this end, the People's Treasury will work with members of the General Assembly, the Office of the Attorney General and members of the Governor's Administration to clarify, under the Delaware Code, that the Cash Management Policy Board is subject to the Administrative Procedures Act. In doing so, an important set of policies that impact the financial health of our state will be subject to review by the People.

### ***Engage an Independent Expert Investment Advisor***

To ensure that the policies promulgated by the Cash Management Policy Board are consistent with best practices in light of the changes undergoing global financial markets, the People's Treasury will engage an independent financial advisor having expertise in government and public finance to assist the Board, in collaboration with the treasury, in making critical policy decisions that impact our ailing state investment portfolio. The advisor will also perform a variety of financial analyses and tasks on behalf of the People's Treasury to ensure that the state is managing its funds in an optimal manner. In order to qualify to serve as the independent investment advisor, the advisor will be prohibited from managing state funds while serving in that capacity.

### ***Restructure the State's Investment Portfolio***

Based upon the advice of the investment team of the People's Treasury and a selected independent financial advisor having expertise in government and public finance, the treasury will restructure the state's investment portfolio in a manner consistent with the challenges of today's 21st century dynamic global economy. Because safety and liquidity of the state's investment portfolio remain the top priorities of the People's Treasury, this initiative will seek to restructure the portfolio to achieve a higher level of asset diversification while maximizing return with minimal risk. Adhering to the principles of the Administrative Procedures Act, the People's Treasury will ensure that, in the course of restructuring the state's investment portfolio, the underlying policies that result in a change to our portfolio will be subject to our state's open government laws.

### ***Implement and Expand Delaware Money in Delaware Banks Directive***

Pursuant to the statutory preference to deposit state funds in accounts secured by the United States Government, supporting financial institutions located in Delaware remains a top priority for the People's Treasury. In connection with the "Delaware Money in Delaware Banks" Directive signed last year, the treasury intends to begin depositing up to \$250,000 in FDIC-insured accounts at qualified financial institutions this year. Additionally, with local credit unions offering competitive rates in FDIC-insured accounts, the treasury will expand the directive to include credit unions that are offering rates equal to or greater than rates received by the treasury on similarly situated funds – thus increasing the return on the state's investment portfolio without incurring additional risk.



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## ***Increase the Number of Investment Managers***

Guaranteeing an open and competitive environment among those who manage our state funds can be accomplished (in part) by increasing the number of investment managers. Based upon the advice of treasury personnel and the selected independent investment advisor, the People's Treasury will increase the number of investment managers pursuant to an open and fair request for proposal ("RFP") process. With a limited number of investment managers, the state lacks a sufficient threshold of managers to measure the performance of both the state investment portfolio in the aggregate and the individual investment managers. Additionally, increasing the number of investment managers will allow the state to select investment managers that have expertise in a variety of asset classes. Finally, an increase in the number of investment managers will allow qualified small, women- and minority-owned businesses an opportunity to compete to manage our state funds.

## ***Reduce the Number of Checks Issued by Using Prepaid Debit Cards***

Though the People's Treasury has significantly reduced the number of checks processed and issued over the past several years (14% reduction in FY11), the rate of reduction is beginning to stabilize due to the lack of additional payment mechanisms available to state vendors and employees. To increase the rate of reduction of checks issued, the People's Treasury seeks to implement a Prepaid Card Program during the next fiscal year. The use of prepaid debit cards will streamline operations by eliminating time-consuming processes associated with printing checks and vouchers and having to replace them if they are lost or stolen. Funds can be loaded onto the prepaid cards in real time and remotely, reducing paperwork and disbursement costs. The program will allow cardholders to make purchases from vendors or access cash from ATMs. This program is expected to reduce treasury expenses upon full implementation through larger state departments and agencies.

## ***Migrate Major Treasury Operational Systems to the State's Server***

With significant advances in technology, the ability to provide a high level of security to the treasury's major operational systems for a minimum cost is plausible. During the upcoming year, the People's Treasury will undertake an initiative to transfer a significant portion of the treasury's confidential information to the state's secure server network hosted by the Delaware Department of Technology and Information ("DTI"). Under the proposed arrangement, DTI will provide information technology services to the People's Treasury to ensure that critical and confidential financial information is secured properly and managed by those tasked with safeguarding our state's confidential data.

## ***Expand Financial Education and Outreach Programs***

The current financial outreach programs of the People's Treasury have been extremely successful. Given the success of these projects, the People's Treasury intends to expand our financial education and outreach programs in the coming year. An expansion of the Prosperity Portal is planned, providing even more hands-on information and resources, including a new section that will bring financial education directly to the next generation of Delawareans. It is this goal of providing the next generation with this basic financial knowledge that will drive the Treasury to work on efforts to bring more financial education into the Delaware classrooms. It is essential that every citizen has access to the information and resources they need to plan for a solid financial future and the treasury looks forward to expanding its role in that effort.



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## *Propose Investment Warrants for State-Funded Projects*

The People's Treasury remains a center for generating fresh and innovative ideas to fulfill its constitutional and statutory mandates. In an effort to supplement the state's effort to support certain economic development projects, the People's Treasury advocates the ability of the treasury, based upon the structure of the financial incentive packages offered by the Delaware Economic Development Office ("DEDO"), to negotiate the purchase of warrants of companies that receive taxpayer dollars. Under this proposal, the People's Treasury, using the authority vested in the office, would work with state officials to negotiate warrants with selected companies. In addition to the other benefits associated with a state-funded project, warrants would (i) provide an additional protection mechanism if the state project is unsuccessful, and the recipient company relocates outside of Delaware and (ii) allow the People's Treasury to receive funds at a higher rate of return for investing in a project without incurring additional risk.\*



## CONCLUSION

**T**he State Treasurer and his administration, upon careful consideration of the matters set forth herein, have detailed the state of the People's Treasury in this *Second Report on the Delaware State Treasury*. This report is humbly submitted to the People of the State of Delaware for their proper consideration. Let our discussion begin.

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This *Second Report on the Delaware State Treasury* was made possible through the hard work of a great team of individuals committed to the cause of public service. I am personally indebted to each of them and their commitment to revitalizing the People's Treasury serves as an inspiration. To this end, a special note of gratitude and appreciation to the following contributors:

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\*For information purposes, a warrant is a type of security that gives the holder the right to purchase a security (usually stock) from a company at a specific price at a later date. The warrant is only exercised by the holder if the value of the stock at the date of exercise is higher than the purchase price set forth in the warrant. For example, a warrant to purchase Company ABC stock for \$1 per share is issued to the treasury in May 2012 and the warrant may be "exercised" (or executed) in May 2015. If in May 2015, Company ABC stock price is \$5 per share, then the treasury has made \$4 per share in unrealized gain (\$5 - \$1 = \$4). If in May 2015, Company ABC stock price is less than \$1 per share, the treasury loses no money as the warrant has no value (the treasury is under no obligation to purchase Company ABC stock). Thus, a warrant provides the treasury with an opportunity to reap the benefits of a state investment without losing additional state funds if the state-funded company falters.