

MINUTES OF THE TREASURY OVERSIGHT COMMITTEE
ORANGE COUNTY, CALIFORNIA

REGULAR MEETING

July 28, 2010



The Special Meeting of the Treasury Oversight Committee (TOC) held on July 28, 2010 at the Orange County Auditor/Controller's Office, 12 Civic Center Plaza, Conference Room #300, Santa Ana, CA 92701, and called to order by David Sundstrom, Chair, at 3:03 PM

Committee Members:

Present:

David Sundstrom, Auditor-Controller (Chair)
Tom Mauk, CEO, Public Finance (arrived at 3:10pm, just after agenda item #3)
Mr. Bill Habermehl, Superintendent, O.C. Dept of Education
Mr. George Jeffries, Treasurer, City of Tustin

Also present were:

Bob Franz, CFO from the CEO's office, **Paul Gorman, Paul Cocking, Leslie Morales, Ginika Echebiri, Fahad Haider, William Chau** and **Yvette Clark** from the Treasurer's Office; **Angie Daftary** from County Counsel; **Nancy Ishida, Dat Nguyen, Christine Young** from Auditor-Controller's Office, **Kenneth Wong** and **Alan Marcum** from Internal Audit; **Wendy Benkert** from Orange County Department of Education, **Brian Probolsky** from Supervisor Bates' Office.

1) Meeting Called to Order

Mr. Sundstrom called the meeting to order.

2) Welcome and Self-introductions

Introductions were made.

3) Public Comments

- Mr. Sundstrom announced Dr. Mathur's resignation from the TOC and suggested that we start looking for his replacement in order to submit a nomination to the Board.
- Mr. Habermehl suggested that we continue to have a member from the Community College District.

- Ms. Benkert stated that she meets with the vice-chancellors of the colleges quarterly and she would bring it up to them to see if anyone was interested in filling the position.
- Mr. Franz, more important that its someone that has an interest in this type of portfolio management.
- Mr. Sundstrom suggested that it be someone that is abreast with economic issues & current events.

4) Approval of the April 28 & May 26, 2010 Meeting Minutes

- Mr. Habermehl moved to approve the meeting minutes. Mr. Jeffries seconded the motion. **All approved 4-0.**

5) Chairman's Report

None

6) CFO Report

None

7) Receive & File Treasurer's Monthly Management Reports for April 2010 through June 2010.

- Mr. Habermehl moved to receive & file. Mr. Jeffries seconded the motion. **All approved 4-0.**

8) New Procedure for the Orange County Extended Fund & Money Market Allocation

- Mr. Franz explained the new procedure the TTC has put in place accompanied with a handout.
- We've gone through an analysis and staff prepared the attached report describing the new internal policy we put together with an objective to develop a more systematic way of determining liquidity. The policy requires a quarterly meeting to monitor liquidity needs.
- The Money Market Fund will maintain a balance that the policy dictates. We modeled it according to historical data over the last few years. It would allow more of the cash balances to be put in the Extended Fund. We wanted to show you the analysis to let you know how we will be monitoring the liquidity needs going forward.
- Mr. Gorman added from the school standpoint we started this first just for the County Pool. Our goal is just to have it in place for a few months & then get together with you. Our assumption is that with the school's cashflow, there

- are more unknowns & more variables than what we can rely on just from analyzing history.
- Ms. Benkert agreed stating that we're being hit by state deferrals. This year, they're deferring \$2.5 billion statewide for schools for different periods of time.
 - Mr. Jeffries asked Ms. Benkert, if the problem had more to do with timing or the actual receipt of the money.
 - Ms. Benkert answered that it is both. Normal apportionment that we would get in July, we won't get until August. She explained that they are not getting money because the State Budget isn't passed and they're also not getting money because of these deferrals which compounds the problem.
 - Ms. Benkert added that the ARRA money from last year is saving them. Also, districts went out for TRANS and doing inter-fund borrowing. We are watching cash on a daily basis.
 - Mr. Habermehl mentioned that he spoke with Senator Lou Correa. His opinion will be that there will be 2 budgets this year. The real budget will take place after the November election. A budget built on a house of cards with a lot of assumptions isn't realistic & we should wait until after the November election for final assessment.
 - Mr. Sundstrom stated we are concerned with the deferral of payment for very large ticket items. Modified Accrual basis of accounting, does not allow you to accrue anything in the prior year for anything that's going to be more than 60 days outstanding. It's not a bad thing for budgetary purposes, but most budgets are close to the line as they are for financial reporting purposes. This not only affects financial reporting, but also TRANS.
 - Ms. Benkert commented that the funds are paying less attention to the rating agencies. Half of our districts have self-qualified. When they go to go out for TRANS it really creates anxiety on the behalf of others. Ms. Benkert added the school year for most districts are going to be reduced to 175 days when a year ago there were 185 days. They've made some serious concessions. They've cut programs & increased class sizes.
 - Mr. Habermehl added, We've asked teachers to take a 10% pay cut, eliminated librarianship, and have eliminated counselors. We may have not gone deep enough. If the state doesn't turn this around then we're not going to see money coming to us. We're cutting off a finger at a time & you've got to cut off the whole arm. Their morale & optimism is good, but I'm concerned that it's not going to get better quick enough.

9) Approve Selection of Northern Trust as the Treasurer-Tax Collector's (TTC) Custodian Bank subject to Final Contract Negotiations

- Mr. Gorman explained that staff talked to the top 3 contenders for the custodial bank, asked for their references and then followed up with those references.
- Mr. Gorman went over the handout detailing the references that were called for each bank. He stated that there was nothing alarming found at any of the three banks. He continued to say that Northern Trust had the attributes that

- they liked including their comprehensive platform. He stated that both US Bank & Wells Fargo both had good references as well.
- US Bank was our 2nd preference. They received very good reference checks as well. Wells Fargo was our 3rd choice.
 - Mr. Gorman continued stating that the nearby Counties of Los Angeles & San Diego were using Bank of New York Mellon (BONY) as their custodial bank. The County of L.A. was still using the BONY L.A. branch while San Diego was transferred to BONY's Syracuse branch. They had been through about eight different staff. They haven't been told about any pending change to their platform like we were. Mr. Gorman stated that although the local counties are still using BONY, the RFP Committee likes the results from Northern Trust. He stated that once the TOC takes action on this, they will go to the Board for the approval.
 - Ms. Benkert asked if Northern Trust was \$50,000 less per year than BONY and if so, would it compromise the service received by them?
 - Mr. Gorman confirmed that Northern Trust was \$50,000 less and stated that he believes they will provide better service than BONY. He stated that Northern Trust was the most impressive & intelligent about what the TTC does on a daily basis. US Bank was pretty good too. With Wells Fargo, they felt a little bit of disconnect.
 - Mr. Sundstrom asked what the longevity typically is of these teams.
 - Mr. Cocking answered that the TTC had Barbara from BONY as their rep for 14 years. He specified that this is unique. The big firms have taken more of a commodity approach. They have service teams on a larger scale. When they interviewed Northern Trust, they didn't have any newcomers.
 - Mr. Mauk questioned how much money the TTC would have with Northern Trust at any particular point in time.
 - Mr. Gorman responded with approximately \$6-7 Billion.
 - Mr. Mauk remarked that it doesn't look to him like Northern Trust has any public clients except for some retirement funds. Mr. Gorman stated that the State of Hawaii would be considered a government fund/public fund
 - Mr. Mauk stated under the operational outlook presented by the TTC, the rankings for Northern Trust & US Bank were pretty good. In his opinion Northern Trust did finish by a better margin.
 - Mr. Mauk passed out a packet of articles he brought with him regarding pension fund lawsuits filed against Northern Trust by the pension funds of Chicago Teachers, the City of Atlanta Firefighters & Exxon Mobil. The articles were dated February & March 2010.
 - Mr. Mauk then asked if the RFP committee took into account that Northern Trust has billions of dollars in lawsuits against them right now for alleged faulty investments of trust funds of clients. Did that come up at all?
 - Mr. Gorman answered that it did not.
 - Mr. Mauk stated that he noticed Northern Trust supplied a quote based on fixed pricing. He asked if the transactions increase or the accounts increase than you go back to the bargaining table on prices. If they go back to adjusted pricing and if all the custody banks quoted their prices the same way.
 - Mr. Cocking responded with yes to both questions.

- Mr. Mauk stated that he was concerned with the cloud of allegations Northern Trust has right now. It is in connection with Chicago Teachers fund, they were supposed to be in short term liquid safe investments and the pushed it over into SIV & illiquid investments. He asked what safeguards the TTC would have to ensure its money is safely invested.
- Mr. Gorman replied that the losses appear to be related to securities lending. This is where you provide a security out of your portfolio to the custodial bank & then that custodial bank basically goes out & sells it in the market. He continued to say that the TTC is prohibited from engaging in securities lending. We are not looking to invest money with Northern Trust. Mr. Gorman emphasized that Northern Trust will not be providing investment advice to the TTC. He also explained that Northern Trust would just be the custodian bank for electronic payments and settling TTC's trades on a daily basis, making sure that accounting records state for example when we will be receiving a coupon payment or receiving a maturity on an investment, & then we match up and settle. Northern Trust will receive a security from someone we were buying it from. They receive money from the county & then we basically deliver upon payment receipt. Without a security, we don't provide payment. Once we provide the securities, then they are the custodian for that security and that security almost in all cases is electronic.
- Mr. Cocking stated that would be the case for any custody bank that is picked.
- Mr. Mauk asked How TTC's experience in the interim has been with BONY and being run out of Syracuse?
- Ms. Morales explained it's gone fairly smoothly. We've asked for an extension until December. They've had turnover in their staff. So far the team we've worked with is not as skilled as Becky. At this point we are getting through it. We have had insufficient service from the Treasurer's current custodian bank BONY. She is a daily user of the system.
- Mr. Mauk asked Ms. Morales what her recommendation was.
- Ms. Morales responded that she would recommend moving to Northern Trust.
- Mr. Franz stated that Ms. Morales & Ms. Echebiri have done a lot of the work on this RFP and made the reference calls.
- Ms. Echebiri stated that PIMCO uses Northern Trust and they rate Northern Trust in their top 10% of all banks they do business with. In terms of customer service that's what we are looking for in order to turn things around from where we are today with BONY.
- Mr. Mauk confirmed that Northern Trust was AA rated.
- Mr. Jeffries stated in regards to the lawsuits it looks like most of these accounts are semi-retirement or liquidity driven funds. It's too bad they did that. One wonders how guided they were when setting up the contracts with respect to the freedom to lend. After all if I could see a way of making a buck it's not illegal, or ethical, you can't tell me I can't do it. Northern certainly has the size, to some degree they have the composition, but I don't think any one of these including the State of the Hawaii, will be undergoing the same review that Orange County is going to have. Not only is there TIC, TAC, and TOC, but you have everyone else as well, constantly on the review of the

Treasurer's Office. Everyone is under a microscope more than ever with a respect to compliance. None of the calls were to a California large county that had Northern Trust as a custodian. You have no idea how important that is to a lot of people. I certainly wouldn't argue against staff's recommendation but I urge them as they go forward with the approval that they never forget the cloud you have as Orange County. It's key for staff though that if they can't work with a company then that should be the deal breaker cause if they don't work well with you, it's not good news.

- Mr. Habermehl stated he thinks it would be prudent to raise the issue and have the discussion regarding the lawsuits. I think we would look as if we didn't act prudently if this was ever raised by the media or anyone else.
- Mr. Mauk asked whether Northern Trust took Federal Bailout Funds. He requested full disclosure. He stated that that concerns him as well. He stated that he doesn't believe the lawsuit is as separate as the TTC thinks. Having said that, he stated that he is going to support the staff recommendation.
- Mr. Cocking stated that Securities Lending did come up during staff inquiry since we knew there were a lot of lawsuits out there for that. We kind of discounted it as a group because we're not allowed to participate in Securities Lending. I think in general it's because those involved didn't look to their Securities Lending agreement & realize they could invest in whatever they wanted to. Unfortunately, I do believe it was a Merrill Lynch event where most of the big players got burned.
- Mr. Sundstrom requested that the minutes from this meeting be very robust to include all the questions the TOC members asked. We have performed a lot of due diligence.
- Mr. Sundstrom asked how long the conversion process would take to switch from BONY to Northern Trust.
- Ms. Echebiri responded that Northern Trust provided them with a very detailed implementation plan of about 3 months.
- Mr. Mauk asked where the office is that would be servicing the Treasurer's account.
- Mr. Cocking replied Chicago.
- Mr. Gorman stated each of the top three banks said that the type of the securities we have lend themselves very well to an easy implementation. One aspect is to make sure it is reconciled which they take on a huge responsibility for that. And also for us it is the training and getting used to a new platform. Because it happens every day you can determine fairly quickly what's working and not working.
- Mr. Habermehl asked how many trades the TTC does per day.
- Ms. Morales replied with 15 to 25 trades per day.
- Mr. Franz asked if there was a volume for this contract.
- Ms. Echebiri stated that there is. In the RFP they listed, it is about 5,500 trades annually based off 2009's count.
- Mr. Franz we have to stay on top of those.
- Mr. Cocking stated that Northern Trust's biggest concern was that they've had clients they locked into contracts who then have gone out & drawn assets

- dramatically & it increased their trading volume. So they are definitely trying to protect themselves from that.
- Mr. Sundstrom asked how many times a year did the TTC money turn over.
 - Mr. Haider responded that there is a 55 day WAM, so approximately 6 times a year.
 - Mr. Jeffries asked if BONY would serve the TTC from their LA Branch is that something that would be comparable in terms of ease of relationship.
 - Ms. Morales answered that BONY stated they would move the TTC to the LA Branch if they gave them a second chance. She stated however that they would not move to the new platform if they did and a new team would provide their coverage. Just like when we moved to Syracuse we got a new team & we were not happy and it progressively got worse. You can not go to the new platform if you stay in L.A. They also came down to \$168,000, but less customer service.
 - Mr. Habermehl moved to approve the recommended action authorizing TTC to execute a Custody Service Agreement with Northern Trust. Mr. Jeffries **seconded** the motion. Mr. Mauk concurred but requested the stipulation that the TTC notify the TOC members if volume pricing changes from \$135,000 before it's finalized. Mr. Habermehl accepted that stipulation and concurred. Mr. Jeffries agreed. All approved the recommended action with the added stipulation that TOC members are notified of any changes in volume pricing. **All approved 4-0.**

10) Public Comments

None

11) Schedule Next Meeting

- The next meeting was scheduled for October 27, 2010 at 3:00 pm at the Auditor-Controller's Conference Room 300, 12 Civic Center Plaza, Santa Ana, CA 92701.

12) Adjournment

- Mr. Sundstrom adjourned the meeting at 4:02 pm.