MINUTES OF THE MEETING
OF THE
COMMITTEE ON GOVERNMENT AFFAIRS

Seventy-Eighth Session
March 6, 2015

The Committee on Government Affairs was called to order by Chairman John Ellison at 8:36 a.m. on Friday, March 6, 2015, in Room 4100 of the Legislative Building, 401 South Carson Street, Carson City, Nevada. Copies of the minutes, including the Agenda (Exhibit A), the Attendance Roster (Exhibit B), and other substantive exhibits, are available and on file in the Research Library of the Legislative Counsel Bureau and on the Nevada Legislature's website: www.leg.state.nv.us/App/NELIS/REL/78th2015. In addition, copies of the audio or video of the meeting may be purchased, for personal use only, through the Legislative Counsel Bureau's Publications Office (email: publications@lcb.state.nv.us; telephone: 775-684-6835).

COMMITTEE MEMBERS PRESENT:

Assemblyman John Ellison, Chairman
Assemblyman John Moore, Vice Chairman
Assemblyman Richard Carrillo
Assemblywoman Victoria A. Dooling
Assemblyman Edgar Flores
Assemblywoman Amber Joiner
Assemblyman Harvey J. Munford
Assemblywoman Dina Neal
Assemblywoman Shelly M. Shelton
Assemblyman Stephen H. Silberkraus
Assemblywoman Ellen B. Spiegel
Assemblyman Lynn D. Stewart
Assemblyman Glenn E. Trowbridge
Assemblywoman Melissa Woodbury

COMMITTEE MEMBERS ABSENT:

None

GUEST LEGISLATORS PRESENT:

Assemblywoman Victoria Seaman, Assembly District No. 34

STAFF MEMBERS PRESENT:

Jered McDonald, Committee Policy Analyst
Jordan Neubauer, Committee Secretary
Cheryl Williams, Committee Assistant

OTHERS PRESENT:

Alvin P. Kramer, Deputy Treasurer for Investments, Office of the State Treasurer
Brian McAnallen, Government Affairs Manager, City of Las Vegas

Chairman Ellison:
[Roll was called. Committee rules and protocol were explained.] I will open the hearing on Assembly Bill 196.

Assembly Bill 196: Makes various changes relating to investments of public money. (BDR 31-857)

Assemblywoman Victoria Seaman, Assembly District No. 34:
Assembly Bill 196 makes various changes relating to investments of public money. In 1993, Alvin Kramer was made Deputy Treasurer for Operations under State Treasurer Robert Seale. In 1994, he was elected Carson City Treasurer and served as such until this past January when he was hired by State Treasurer Dan Schwartz to be the Deputy for Investments. Alvin Kramer is prepared to present the bill and answer all of your questions.

Alvin P. Kramer, Deputy Treasurer for Investments, Office of the State Treasurer:
This bill does five things: it standardizes investment language between the state and local governments, it cleans up some language that is not needed, it allows better use of corporate bonds, it relaxes restrictions on collateral for repurchase agreements, and it allows for repurchase agreements as an eligible investment for the state of Nevada and local governments. I am prepared to go through the bill and describe the changes (Exhibit C).

Section 1, subsections 5 and 6, allows reverse-repurchase agreements to be an eligible investment for the State Permanent School Fund. Reverse-repurchase agreements are an investment instrument where one party having securities agrees to sell securities to a counterparty with the stipulation that they be bought back on a specific date at a specific price. During this time, the cash received would be invested to return more revenue to the fund than the cost of the transactions. The duration of the repurchase agreement and the investment would be matched within two weeks to mitigate interest rate risk. These agreements have withstood the test of time and trying conditions. The secondary investment would have the same restrictions as any other investment for the State Permanent School Fund.

The state of Nevada has not allowed reverse-repurchase agreements in the past. I took a poll from other states, and 24 states allow reverse-repurchase agreements, 12 do not allow them, and 13 did not respond to my query. The states that allow reverse-repurchase agreements do not have restrictions like those that we are requesting: the matching of maturities. When the Orange County Treasurer, Robert Citron, invested in reverse-repurchase agreements back in the mid-90s, he borrowed short and invested long, and then when short-term interest rates went up, he found himself underwater and bankrupt. That is a big deficiency with reverse-repurchase agreements. What we are doing in this bill is saying you have to match the maturities, so what happened in Orange County cannot happen here in Nevada. It takes away the interest rate risk, which is what caused Orange County problems. If you are within the two-week limit, you are not subject to the interest rate risk.

The counties have the ability to invest in the securities of any of the government agencies, whether it is Fannie Mae, Freddie Mac, et cetera; and if a new agency were to be created tomorrow, they would have the ability to invest in those, but the State General Fund does not have that ability to do that. What page 5, lines 37 and 38 would do is add, "or other instrumentality or agency of the United States." For example, Tennessee Valley Authority securities have been around for a long time and they are a bit illiquid, but because of that, sometimes there are great opportunities. Allowing the state to invest in such a government agency would be a bit of standardization between the state and local governments.

Removing section 2, subsection 1, paragraph (i), subparagraphs (1) and (2), helps standardize language between the state and local governments. Local governments can invest in municipal bonds of other entities of the state. The state has this language in there for general improvement districts saying the district has to have a population over 200,000 and has to be in two or more counties in the state. I do not think we have any general improvement districts that are in two or more counties. This means the state cannot invest in the municipal bonds of general improvement districts with the additional language in the bill, not that we would anyway, but it is a difference in language between local governments and the state. I am asking to have those restrictions on municipal bonds for general improvement districts removed.

In section 2, subsection 1, paragraph (p), subparagraph (3), on line 22 of page 2, we are asking to be allowed to buy corporate bonds with an A- rating. You can see on the top right of the chart (Exhibit D) we are allowed to invest in prime, high grade, and upper medium grade bonds; that includes A- ratings. When we talk to brokers and say we can buy A grade paper or the top three grades of prime, it is different. It is like when I was in school, we had letters for grades and when people said they were a straight A student, I always counted the A-. We are trying to make it clearer. We do not want to end up having a broker bring us something, we are ready to buy it, and when we go to do our own personal credit check, we find out that it is an A- corporation and realize we cannot do it. It wastes both parties' time. It may be that we never buy A- rated companies, but we would like clarity.

In section 2, subsection 1, paragraph (p), subparagraph (3), on line 24 of page 7, we are asking that corporate bonds be allowed at 25 percent of the total portfolio instead of 20 percent. I also surveyed other states, and they range from 20 percent to 30 percent, so we are not the only state at 25 percent. More specifically, during the housing crisis and the Wall Street upheaval we had over the last ten years, the number of agency bonds, Fannie Mae and Freddie Mac type bonds, has gone from $7.6 trillion to $3.4 trillion, and that is as they have been bought up by the government to take them out of circulation. It means that the bonds that are out there have been bid up to where there is not much difference in yield between a United States Treasury bond and some of the agency pieces of paper, 8 or 10 basis points, and that is it when the spreads used to be 30 and 40 basis points, seven or eight years ago. It has dried up the amount of securities that are out there and you have to put your portfolio into something, especially if you are going to try to get something out there two years or longer.

The industry of the people who manage portfolios has put more emphasis on quality for corporate bonds to try and develop a risk-return ratio that we are happy with and how we can figure out who fits into the category. For example, Cantor Fitzgerald has developed a program that monthly evaluates the 210 different issuers of corporate bonds to see who the top 50 are. [The list is included as (Exhibit E)]. Our internal policy is not to buy anything other than the top 50 unless there is a really good reason for it. A good reason might include some of the foreign banks like the Bank of Nova Scotia that have high ratings, but are not rated on Cantor Fitzgerald's top 50 list. It is an alternative to try to get some yield, but it has also been prefaced with a higher quality credit check to make sure we do not go astray.

I have explained what a reverse-repurchase agreement is and a repurchase agreement is the opposite side of that transaction. It is where you have money and someone else has securities, you loan them money, and they put the securities up as collateral. You buy the securities, but you agree to sell them back on a specific date.

The law currently says the securities we take in collateral cannot have a maturity of more than 10 years. When the securities went from $7.6 trillion to $3.4 trillion, the custody banks that held the collateral stopped segregating it by less than 10 years and more than 10 years. If you say you have to have a maturity of less than 10 years, then they have to secondarily segregate your collateral. It reduces the yield, and instead of getting 10 basis points for a repurchase agreement, you are going to get 8 basis points. It brings the basis points down to the point where we question why we do it. It becomes competitive with other things we do. We have not done a repurchase agreement in several years because of this.

The fact is, a contract was developed in 1996 for the repurchase agreements, and they have held solid throughout all of this. When Bear Stearns and Lehman Brothers collapsed, not one repurchase agreement failed, mainly because of the 102 percent collateral. If a repurchase agreement is failing, they want the 2 percent to help pay other bills. When we do a repurchase agreement, by law, we have to deal with a primary broker-dealer. If the repurchase agreement starts to fail, the first assets on the line are the assets of the primary broker-dealer. They have to go broke first, and then we go after the collateral. Repurchase agreements have never failed, and if they do, there is double collateral behind it, the net worth of the broker-dealer and the 102 percent collateral.

Using repurchase agreements and having them competitive with the yields we are trying to get for the State General Fund could be a tool. When you try and improve the return on a portfolio, you do not look for home runs; you are not going to find something that will get you 3 percent. You look for many little things that can help improve what you are doing, whether it is better execution on trades or trying to get 2 extra basis points on an overnight repurchase agreement. This is one thing that has held us back, and I want to resolve it.

Section 2, subsection 3, and section 2, subsection 4, paragraph (c), both refer to reverse-repurchase agreements for the State General Fund.

Section 3 is under *Nevada Revised Statutes* (NRS) 355.170, which deals with local governments. Section 3, subsection 1, paragraph (k), subparagraph (1), states that the state has the ability to go directly to an issuer of corporate paper, and the counties cannot do that. Clark County has a portfolio that is bigger than the state's portfolio. Making your yield better is done by many little things and if you can reduce the cost of execution of a trade, it goes to your bottom line. We are removing this language to allow Clark County and other local governments to go straight to the issuer of corporate paper and not have to pay the broker-dealer to get there.

Section 3, subsection 3 and subsection 4 are allowing repurchase agreements by local governments.

According to section 4, subsection 1, paragraph (a), right now we can buy corporate bonds for United States organizations and banks, but there is a little bit of uncertainty about whether the local governments can buy corporate bonds from, for example, the Bank of Nova Scotia or the World Bank of Scotland. This language is a bit of standardization that allows for depository institutions licensed by the United States or any state and operated in the United States.

Section 4, subsection 1, paragraph (a), subparagraph (3), allows local governments the same ability to buy A- rated bonds.

Section 4, subsection 2, paragraph (a) changes 20 percent of the portfolio of corporate bonds to 25 percent. Right now, Washoe County has a really aggressive stand on corporate bonds. Their manager handles it and what they do best is quality checks and looking for good credit. They are right at the 20 percent mark for corporate bonds. This is something they are going to use. I have received information from Clark County and the Association of County Treasurers of Nevada, and they see this bill as enabling and will be happy to see it pass.

Chairman Ellison:
Why would we add A- for the rating?

Alvin Kramer:
We have been allowed to buy A rated paper corporate bonds all this time. Investment grade starts with BBB. We do not want to be in investment grade, we want to be above it and A- is above it. I think this started when someone wanted an A rating or better when they really meant they wanted above investment grade. An A- rating belongs with the class of A rated securities because it is above investment grade. When I talked about the prime, high grade, and upper medium grade, those are the only ones we want to be associated with, but we are not. Currently, we have to cut out the A- rated bonds.

What I am bringing today is a list of tools that would help us in what we do. Obviously, we have gone a long time without these tools and if you do not want to do this, I understand, but give us what you can. I will say if you pass this bill, the next step would be to take our investment policy to the State Board of Finance to allow whatever investment it is that you are now going to authorize us to do. It is very likely that the State Board of Finance will let us try it but want us to report back every three months to let them know how it is working, or they may put other restrictions on us other than what is in the NRS. Even though this is enabling, you meet every two years, the State Board of Finance meets every three months, and they can help tailor the policy to feel more comfortable with what is going on.

I look at the A- rating and I think it is a step in the right direction, but I also look at the tool we have for our in-house policy on what issuers of corporate bonds and paper we would deal with, and I would venture to say that of the top 50 companies, there are probably two that are rated an A-. Maybe there are none, but at any various time we probably would not buy the security with the A- rating. I am looking for clarity in dealing with brokers so we can tell them we can buy A rated paper, and they understand what we are talking about. We would not be saying we can buy A rated paper except for A- rated paper. If the appetite for this Committee was to say no to this change, I am not sure it would affect us too much, but it does affect the clarity when we are dealing with people.

Assemblywoman Neal:
In 2011, then-State Treasurer Kate Marshall got a judicial determination to start investing and to widen the pool of what the state can invest in. At the time she asked for the determination, reverse-repurchase agreements were still prohibited by statute. Did the lack of inclusion in the statute, which expressly prohibited the reverse-repurchase agreements, fail to fit under the judicial determination? When you think about statutory construction, you have to look at each one as having weight as to what they mean and at the time of the judicial determination of whether or not this was included as an investment strategy, it was prohibited by statute. Are we running into a situation where it is unconstitutional? The debate in 1989 was that reverse-repurchase agreements could be a buy-sell or a loan type of scenario, either/or, depending on the base of the security or the underlying base for that transaction.

Alvin Kramer:
The judicial determination was dealing with whether or not we could invest the State Permanent School Fund in equities at all. If we did reverse-repurchase agreements for the State Permanent School Fund, would it then give us the ability to invest in equities with the results of the repurchase agreement? I have not anticipated that and it would be good to say no, I think we want to keep what we have here. Section 1, subsection 3 says, "The State Treasurer shall

not invest any money in the State Permanent School Fund pursuant to paragraph (i), (j) or (k)..." which are the equity parts of the bill, except through a money manager. The reverse-repurchase agreements are not being done through a money manager. If it was the desire of this Committee, we could probably tighten that up, but right now, the reverse-repurchase agreements would not fit under what we are talking about with the equities at all. I did not anticipate that, but I can see where the confusion might be. Did I answer your question?

Assemblywoman Neal:
Yes, your answer tells me that we need to think about the application of this language and whether or not we are going to get into some issues if it really is prohibited and the judicial determination did not include that prohibition.

Alvin Kramer:
My intent for this was to not have it for reverse-repurchase agreement investments from that to never encroach on equities. That is why section 1, subsection 3 is important. The only way to do equities or mutual funds is through the approved broker who is handling the equity.

Assemblywoman Neal:
On the last part of your presentation, section 4, subsection 1, paragraph (a), I had to look up the language, it adds, "or by depository institutions licensed by the United States or any state and operating in the United States." I looked up "depository institutions" because it seemed like a blanket definition. The Legislative Counsel Bureau did a Policy and Program Report (Exhibit F) in April 2014 and "depository institutions" include commercial banks, credits unions, thrifts, savings banks, savings and loan associations.

I then looked up Bankruptcy Code and I do not know if it changed, but it said that part of the problem with the blanket definition is that thrifts are not subject to Bankruptcy Code and therefore there is no protection when they engage in repurchase agreements. Is the intent to drop every depository institution licensed by the United States or any state operating in the United States to engage in this business at an A- rating? If that is the case, then what is our protection if the Bankruptcy Code does not protect us if we engage in the reverse-repurchase agreements?

Alvin Kramer:
This language is not directed towards reverse-repurchase agreements; however, are you asking what would happen if we took the proceeds of a reverse-repurchase agreement and invested it into corporate bonds and those corporate bonds failed?

Assemblywoman Neal:
We are not dealing with reverse-repurchase agreements?

Alvin Kramer:
This particular language in section 4 is saying that the local governments can invest in bonds, notes, and obligations of corporations, in other words, corporate notes and bonds.

Assemblywoman Neal:
Reverse-repurchase agreements do not apply to section 4?

Alvin Kramer:
The reverse-repurchase agreement would apply only in this type of situation. When a reverse-repurchase agreement is established, you are selling your securities with the idea that you are going to buy them back in a particular time frame and the cash you get for selling them is usually invested in something else. You are concerned that the cash you get for selling them is invested in corporate bonds that could go south, correct?

Assemblywoman Neal:
The language of "depository institutions licensed" is a catchall phrase for all depository institutions that exist in the United States. It includes several different types of depository institutions such as savings and loan associations, thrifts, banks, et cetera, but thrifts in particular are not covered under the Bankruptcy Code in terms of giving protection when you engage in reverse-repurchase agreements. You say that section 4 does not apply to reverse-repurchase agreements, yet I thought this entire bill was the removal of the prohibition to use then in different environments where we are trying to get cash to get a higher yield investment or cash if we are running into a situation where we do not have enough money to cover our bills.

Alvin Kramer:
This bill was not anticipated to be an investment for reverse-repurchase agreements; it was supposed to be a standardization between local governments and the state. If you look at section 2, subsection 1, paragraph (o), subparagraph (2) you will see the same language is there under state investments. If it is the appetite for this Committee to not only restrict reverse-repurchase agreements to having a matching maturity of no more than two weeks to further say that the purchase should not include depository institutions, I would be willing to amend the bill. I think it would take care of the things that are not covered with Bankruptcy Code. I would be prepared to present that further qualification on reverse-repurchase agreements. It is not something I thought of, and it is a good point.

Assemblywoman Neal:
I pulled information on the Orange County bankruptcy related to that failure. I was not knowledgeable on maturity terms matching and what it looked like. What I found was they had extended their maturity to 180 days, but what caused the problem was they invested in inverse floaters, and that is what put them in bankruptcy. It had a negative interest rate relationship to the market, and they had invested so heavily in it that when the market did not give them the interest rate that they thought, it caused a serious destructive behavior to what they had invested in. The maturity date was a small part. The inverse floaters is what caused the issue.

Alvin Kramer:
We talk about not allowing investment in depository institutions; maybe we should also add language that says no floaters.

Assemblywoman Neal:
I would say that is a good idea.

Alvin Kramer:
I have no problem with that.

Assemblywoman Joiner:
When you talk about the reverse-repurchase agreements and the matching maturity dates, it is my understanding that part of the problems in Orange County were related to that, the interest rates can go up or down quickly. How did you choose two weeks, and why not have them match entirely? Also, you said not one reverse-repurchase agreement failed. What is your definition of failure? I think the Orange County example is a failing. Do you mean they have never gone completely under?

Alvin Kramer:
The reverse-repurchase agreements in Orange County did not fail. They had securities they loaned out and they borrowed cash against them, and when they went to buy the securities back, they did not have the money. The next step of the contract took place, they had to come up with the other assets and they did. In a sense, the person who lent the money got their money back, and it was a completed transaction. Orange County spent their money, so when they went to liquidate it to satisfy the contract, they did not come up with their money. That was a bankruptcy on the part of Orange County, and then they had to liquidate other assets in order to pay off the reverse-repurchase agreements and give the counterparty their cash back. The reverse-repurchase agreement contract was satisfied.

Assemblywoman Joiner:
Why two weeks? What are the fees on these particular instruments? If they did not have enough money to pay it back, I am curious to know what they are skimming off the top.

Alvin Kramer:
The fees vary based on the amount of time. The fee for the actual transaction costs is approximately a tenth of a basis point; it is very low. Are you talking about the fee to the broker?

Assemblywoman Joiner:
Yes, the fee to the broker.

Alvin Kramer:
It might be $20 on a $1 million transaction; the fees are very reasonable. The interest rates you are talking about can vary anywhere from overnight repurchase agreements or 16 basis points, so 0.16 percent per year and if you did it overnight, you would get 1 out of 365 pieces of that for however much money you had.

Why two weeks? Unless you are dealing with the same exact type of paper, for example, U.S. Treasuries that are sold and delineated on the fifteenth of the month for maturities, any day of the month can be a day a piece of paper matures, so if you are buying something that is going to mature on a specific date and you owe the money on a specific date, the money might be sitting for two weeks to pay it. It is hard to design cash flows so that everything comes out on a specific day. There is always a bit of a liquidity fund that takes care of the difference in days. I would not feel comfortable going farther than two weeks, but I would not want to try to tie it down to the day either. Two weeks was the outside limit of what we would want to consider.

Assemblyman Stewart:
This is a very complicated bill, and it seems like there might be a number of unintended consequences. You were hired and trained by Mr. Seale, is that correct?

Alvin Kramer:
I was hired and trained by Treasurer Seale, yes.

Assemblyman Stewart:
In my opinion, he was one of our most able treasurers. In your opinion, would he think that this was a wise bill?

Alvin Kramer:
Frankly, I think he would tell me this bill is too complicated, and I would not get it passed. I was hoping I would be able to explain the bill well.

Assemblyman Stewart:
I think you have done a good job. All of this must be reviewed by the State Board of Finance, correct?

Alvin Kramer:
Yes, sir. Our investment policy does not allow any of the things I am coming forward with, except the small change to municipal bonds. To allow any of these things, even changing to the A- rating for corporate bonds or the 25 percent, there would need to be a change to the investment policy, which would be presented to the State Board of Finance and approved by them.

Assemblyman Stewart:
Please remind us who sits on the State Board of Finance.

Alvin Kramer:
The Governor, the State Controller, the State Treasurer, and two persons appointed by the Governor: Steven E. Martin and David A. Funk.

Assemblyman Stewart:
It gives me great comfort that they would be reviewing this.

Assemblyman Flores:
Can you give me a real-world example of an A- rating versus an A rating?

Alvin Kramer:
When I looked a while back, an A rating was Berkshire Hathaway and an A- was Fred Meyer. They are both good quality, but if you had a choice you would go with the A rated company. We have securities maturing on a regular basis, every couple of days you will have $5 million to $15 million worth of securities that will mature. We put that into our pool of liquidity to see what bills we have to pay and what obligations the state has. Once we determine we have the liquidity, we try to put everything above that and ladder it out in a portfolio so we can get yield on it. When we go to look, it is not like you have every "50 company" there issuing; you are in a secondary market trying to buy those and in a secondary market, it is very competitive. The best quality has the lowest yield. We are interested in a risk-yield relationship that we can live with. I do not want a high yield because that usually means there is more risk involved, and yet I want more return than the very lowest risk firms that are out

there. We try to turn it into a ratio and as long as we are above a particular point on the ratio, we say it is acceptable for us to buy.

Assemblyman Flores:
Maybe the more appropriate question is, what is the difference between a BBB rating and an A- rating? I was reading online, and it seemed that there are a lot of instances where a BBB rating and A- rating are interchangeable, where there may be one little thing that will put the BBB rating below the A- rating, can you explain that?

Alvin Kramer:
That is a good point. Lehman Brothers was AA one week before they went bankrupt. You always have to look under the covers. The Cantor Fitzgerald issuer focus list (Exhibit E) is color-coded. If somebody was ranked first a year ago and ranked first last month, they are high and stable. There is a possibility for someone to be ranked first last year and ranked twentieth last month, and that is kind of what happened with Lehman Brothers. If you can see that happening, you can wonder why it happened and not associate with the company. It enters into the risk-return ratio that we monitor. The first thing you look at is something like the issuer focus list (Exhibit E) but it is not enough. You have to look at what they have done lately, not just last year. Where is the smart money going on these people? There is no one place to go, and it is prudent for us to look three layers deep to see the company is in a cyclical industry, mining may be one of those, and you do not buy paper from a company that is cyclical because the bottom may cut them out and they go broke. We are careful in what we invest in regardless of whether it is AAA or not.

Assemblyman Flores:
Can you explain why you think a scenario similar to the Orange County scenario will not happen in Nevada?

Alvin Kramer:
I mentioned the matching maturities and that is part of it, but our policy would say that I would not invest money in anything other than Treasury bonds and agency bonds; I would not invest the money in corporate bonds either. The issue for reverse-repurchase agreements is we are allowed to do security lending. It has not worked out well for Nevada because the firms we had managing the securities lending program would not do the credit check well or the yield risk return analysis correctly and they ended up buying stuff that ended up not being good, and we took a loss on it. If you do it as a reverse-repurchase agreement, you have complete control and it is 100 percent transparent. You can see every transaction, and we are in control as to what

we buy. My objective would be to buy only Treasury bonds and agency bonds. If they did not make a profit, they do not use them. If you look at something and there is no money in it, you do not invest in it. There is no cost to it. At the same time, you are not dealing with someone else who does not make any money unless he makes risky trades for you. Our investment policy says no to securities lending, which I am happy with, but I am saying that reverse-repurchase agreements are a way to do security lending where we are in control, and we are not investing in stuff that might turn out to be bad. I would only want to go with stuff that has a guarantee with the United States Government behind it.

Assemblyman Trowbridge:
A repurchase agreement is simply a government term for a secured loan. It is a situation where you sell me something, I give you cash, I hold whatever you gave me as a security for a predetermined amount of time, and you assure that you are going to buy it back at whatever the value is that we establish.

Alvin Kramer:
Plus a little bit for your effort.

Assemblyman Trowbridge:
Yes. That is the profit for my risk, the interest if we were talking common loans. I was taught that these are typically short-term loans, overnight, 10 days, 2 years maximum; but you are talking 10 years in this bill. That is what causes me concern. Who determines the value of the security, what types of securities will we accept, how can we project out 10 years what the value of the security is and the appropriate interest, and how do we ensure that the seller is going to be around in 10 years to buy it back at the predetermined rate?

Alvin Kramer:
We can only go out 90 days with a repurchase agreement.

Assemblyman Trowbridge:
I saw 10 years in the bill.

Alvin Kramer:
Right now, it says that the collateral for a repurchase agreement has to be less than 10 years. That is something I am trying to change. It is still collateral and it is still at 102 percent. The 102 percent is by the custody bank, and they revalue it weekly, so it should be in line, and it is done by a third party custody bank.

Assemblyman Trowbridge:
If you have a 10-year bond, we are only interested in the first 90 days?

Alvin Kramer:
Yes, that is correct.

Assemblyman Trowbridge:
A couple of times you said, "we would do this unless there is a good reason." Your good reason might be different from my good reason. Does this have to go before the State Board of Finance to be approved on a case-by-case basis or is it a blanket approval of the entire investment policy?

Alvin Kramer:
The investment policy is approved in its entirety. We listen to Bloomberg and if we find out that certain companies come under extreme pressure, there is a raid on their stock, and there is a lot of short selling, we would look at that and not buy those corporate bonds. I am saying that "good reason" is what we are hearing on the market daily or hourly and that determines some of the decisions we make. We do not want to be caught holding something that has diminished in value and if we have to sell, it is not worth as much as it was before or if there is even a risk of that corporation failing down the road. This is not so important with Fannie Mae and Freddie Mac and other government agencies, but it certainly is with corporate paper. We only want to deal with the top 50 issuers and the prime corporations. There are some things we look at and other considerations come up. If oil is going crazy and firms are losing their business, we would not want to buy from any oil corporations and, by the way, we are in that mode right now; we do not buy corporate paper from oil companies.

Assemblyman Trowbridge:
Are there any restrictions on types of securities we can accept?

Alvin Kramer:
Yes, sir. They are in statute. Section 2, subsection 1, paragraph (p), says, "issued by corporations organized and operating in the United States..." and "At the time of purchase have a remaining term to maturity of not more than 5 years." Also, the rating must be A or better, but we wanted to change that to an A- rating or better. This is as far as corporate notes. Land in the rural areas would not qualify with an A rating.

Chairman Ellison:
They would not qualify?

Alvin Kramer:
If there was a corporation that owned land in Nevada that was trying to borrow money against it and issue a corporate note, you would not be an A rated company, and we would not be able to buy your corporate bonds.

Assemblywoman Spiegel:
We have been doing repurchase agreements for a while. Can you tell me what the average rate of return is, how it compares to the Standard and Poor's 500 Index (S&P 500), and what kind of rate of return we would expect to be getting on reverse-repurchase agreements?

Alvin Kramer:
We have not been doing repurchase agreements for the last several years, but if we were doing them right now, we would expect an overnight repurchase agreement to yield between 8 and 12 basis points. The alternative to that is a money market account where we earn 4 basis points or to hold it in a demand deposit at a bank where we have an agreement that it is 15 basis points, but it costs us transaction fees to move the money in and out. If we do that, we try not to move it. It is difficult to compare against the S&P 500 because that is equities, and we are dealing with fixed income, but the U.S. Treasury 3-Month Bill Index is running about 6 basis points which is right about where we are. The repurchase agreements would yield a little better than Treasuries. Last quarter our State General Fund earned 42 basis points, and we should be attaining well over 100 basis points, maybe 150 basis points. I know Treasurer Dan Schwartz's goal is 200 basis points and part of our investments will earn that. Almost a third of our portfolio is short term for liquidity purposes. I am hoping we can get to 150 basis points. Overnight at 6 or 8 basis points is better than 6 basis points. The little things you do add to the portfolio.

Assemblywoman Spiegel:
What would the reverse-repurchase agreements bring in?

Alvin Kramer:
The issue with the reverse-repurchase agreement is we, in a sense, still own the security. If we have a security that is yielding 100 basis points or 1 percent, we would still get the 1 percent and for the time period that we loaned it out, it is a reverse-repurchase agreement for us, but also a repurchase agreement for the other party, we are going to pay them the 10 or 12 basis points. The difference between those we would keep, and we would turn around and invest that at 3 or 4 basis points more than what we are paying for the money. In a sense you are picking up 4 or 5 basis points, which is not a lot, but it is on a large amount of money. If you cannot find someone who will pay that amount,

you do not do it. You cannot lose money, but you can make a small amount. It is incremental with reverse-repurchase agreements.

Chairman Ellison:
What is a basis point?

Alvin Kramer:
There are 100 basis points to 1 percent, so each basis point is 1 percent of a percent.

Assemblywoman Joiner:
Section 2, subsection 1, paragraph (i), subparagraph (2), is stricken. Why would you remove the minimum assessed value? Right now, it looks like the property has to be an assessed value of not less than five times the amount of the bonded indebtedness.

Alvin Kramer:
If you look back at section 2, subsection 1, paragraphs (e) and (f), you can see the state can invest in any county bonds or city bonds in the state, in fact the bonds of any other states, without the requirements you pointed out. I think the requirement is there because we looked at general improvement districts in Nevada, and this does not say Nevada general improvement districts, however, it says that the population of the district is 200,000 or more and is situated in two or more counties in the state or any other state. When I look at this, I am thinking that Nevada does not really have a general improvement district that is in more than one county; there are not any. This language was suited to fit something at a time that has gone away. This is an attempt to clean it up. There are no restrictions on assessed valuations for other municipal bonds we buy. We wanted to standardize the language between counties and state in regards to other investments in municipal bonds.

Assemblywoman Neal:
You said that the language in section 2, subsection 1, paragraph (i), subparagraphs (1) and (2), regarding the general improvement districts is outdated. I want to know how many do not have that legal structure because we have 84 active general improvement districts in the state. The most recent report in 2013 cited that Douglas County had 21 general improvement districts and Humboldt County had 10 general improvement districts. Each general improvement district has a different valuation. I do not know what the strike-through means.

Section 3, subsection 1, paragraph (k), is about commercial paper and you struck through subparagraph (1), "Is purchased from a registered broker-dealer."

I cannot figure why you struck this language. You used Lehman Brothers as an example, so I started looking up some U.S. Securities and Exchange Commission agreements, and Lehman Brothers was a dealer in a commercial paper dealer agreement with an issuer. Was the striking of that language a mistake?

Alvin Kramer:
It is not a mistake. We struck that language to bring the counties in line with statutes for the state. If you look at section 2, subsection 1, paragraph (o), subparagraphs (1) and (2), it says, "At the time of purchase has a remaining term to maturity of not more than 270 days" and "Is rated by a nationally recognized rating service as 'A-1,' 'P-1' or its equivalent, or better." If you look at that and then look where we struck the language you are talking about, the state requirements do not say, "Is purchased from a registered broker-dealer," but the counties do. This is a request from Clark County. They would like to have the language for the county the same as the state as far as buying commercial paper directly from the issuer and not having to go through the broker-dealer and pay the extra commission.

Assemblywoman Neal:
It is an alignment?

Alvin Kramer:
Yes, ma'am.

Assemblywoman Neal:
On page 13 you talk about obtaining liquidity for local governments using the reverse-repurchase agreement. There are two basic uses for reverse-repurchase agreements: to liquidate a portfolio to meet unexpected or immediate cash flow requirements and to enhance a portfolio return through the purchase of securities financed through repurchase transactions. The cash obtained can be invested. You said you do not want high yield, you want the low yield. I am trying to make sure we are being prudent.

Under the investment policy of the Treasurer, there are three responsibilities: first safety because the money is not ours, it belongs to the state; then liquidity; and there is a third responsibility. I want to stick to safety and liquidity. The U.S. Securities and Exchange Commission did a guidance update (Exhibit G) in July 2013, which was about local and state risk that we can get involved in with reverse-repurchase agreements. It said, that the risk of fire sales in a triparty repurchase agreement market could potentially cause defaults of a triparty repurchase agreement counterparty because it can lead to predefault fire sales of assets by the counterparty or post-default fire sales of collateral by the triparty repurchase agreement. The reason I thought about this is because you changed one of the provisions in the bill to adjust the collateralization, and you did not have to be fully collateralized in one instance in the bill.

The bill speaks to the State Permanent School Fund, State Insurance Fund, and local governments, and all of this speaks to liquidity, the ability to get cash and take care of issues as we run into them. What protections will be put in place when we run into a situation where some of the collateral that is undermining the repurchase agreements are not eligible securities?

Alvin Kramer:
We would not go to corporate bonds, and those are the ones that can fail. Is that what you are talking about?

Assemblywoman Neal:
I am talking about the ones that can fail. Sometimes we can have securities, which have other things wrapped inside of them that we may not be aware of, and then you become aware. The guidance update (Exhibit G) gives the example of sometimes in money market fund portfolios there are securities inside that are not eligible to be held in the money market fund. Say we engage in a money market fund portfolio; what do we do when we find out that something was hidden in there that does not fit the federal rule in the *Code of Federal Regulations* Title 17, Section 270.2A-7. What do we do with that? It happened with mortgages. We had mortgage-backed securities, and we did not know that there were about 1,000 owners, and we did not know that a particular portion of the security was going to fall out and make it a dead piece of paper.

Alvin Kramer:
First off, a money market fund is not proper collateral for a repurchase agreement; it is not allowed. I understand your terminology. In Florida, one of the state local government investment pools that is trying to be a 2a-7 fund did fail, and they did not get a dollar-for-dollar return like ours does. This does happen when they have paper in there that is not any good. By the way, this is what happened to the state of Nevada's securities lending program. There happened to be securities in there that turned out to be not so good, and we ended up paying for it. It is why the reverse-repurchase agreement is more secure. You can choose what you are accepting for collateral and you know what you are buying on the second investment because you are the one doing it. You are not allowing someone else to do it or buying into their pool of investments which may include things you do not want to own.

As to what you do when you find something that you do not want to hold, you unwind that part of the transaction and get out of it. That is possible even with securities lending, but with a reverse-repurchase agreement, it is even easier. You can unwind a reverse-repurchase agreement because there is a date that it is supposed to unwind on. You can unwind it anytime you want. All you have to do is pay it off.

Assemblywoman Neal:
Under NRS 355.140, authorized and prohibited investments of state money, subsection 1, paragraph (q) says, "Money market mutual funds which: (1) Are registered with the Securities and Exchange Commission; (2) Are rated by a nationally recognized rating service as 'AAA' or its equivalent; and (3) Invest only in securities issued by the Federal Government or agencies of the Federal Government or in repurchase agreements fully collateralized by such securities." It does not list money market funds as a prohibited repurchase agreement investment and that is why I wanted clarification.

Chairman Ellison:
It looks like there are many questions. Mr. Kramer can you please get with Assemblywoman Neal?

Alvin Kramer:
If we restrict what the reverse-repurchase agreements can invest in, not allowing floaters and only allowing agency bonds and U.S. Treasury bonds, that would be an important amendment that we could talk about.

Chairman Ellison:
Assemblywoman Neal and Assemblyman Trowbridge have valid points, please get together with them.

Alvin Kramer:
I would be happy to.

Chairman Ellison:
Is anyone in favor of this bill?

Brian McAnallen, Government Affairs Manager, City of Las Vegas:
We are in support of this bill. I know it is a complicated issue for all of you. There was one point in this discussion that was raised, and I thought I would highlight one of the reasons why we support this bill. The measure allows commercial paper to be purchased not only from a broker-dealer, but also directly from the issuer like American Express or General Electric Capital and our finance department sees this as a significant benefit to the City of Las Vegas.

Chairman Ellison:
Is anyone else in favor of the bill? [There was no one.] Is anyone in opposition? [There was no one.] Is anyone neutral? [There was no one.] Are there any closing arguments? [There were none.] I will close the hearing on A.B. 196. Is there any public comment? [There was none.] The meeting is adjourned [at 9:52 a.m.].

RESPECTFULLY SUBMITTED:

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Jordan Neubauer
Committee Secretary

APPROVED BY:

____
Assemblyman John Ellison, Chairman

DATE: ______________________________

EXHIBITS

Committee Name: Committee on Government Affairs

Date: March 6, 2015 **Time of Meeting: 8:36 a.m.**

Bill	Exhibit	Witness / Agency	Description
	A		Agenda
	B		Attendance Roster
A.B. 196	C	Alvin Kramer / Office of the State Treasurer	Changes to the bill
A.B. 196	D	Alvin Kramer / Office of the State Treasurer	Chart
A.B. 196	E	Alvin Kramer / Office of the State Treasurer	Issuer Focus List
A.B. 196	F	Assemblywoman Dina Neal	LCB Policy and Program Report
A.B. 196	G	Assemblywoman Dina Neal	U.S. Securities and Exchange Commission Guidance Update