South Dakota
INVESTMENT
— COUNCIL —

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MEMORANDUM

TO: Matthew L. Clark

FROM: Sherry Z. Nelson

DATE: August 9, 2022

RE: Certificate of Deposit (CD) Program Review Update

The South Dakota Investment Council CD program is a modest program designed to benefit economic development in South Dakota by making funds available to local financial institutions for loans. Below is a discussion of the CD Program including information on the purpose of the program, the pros and cons of the program and return comparisons.

1. Purpose of the CD program:

   - Provide funds to South Dakota financial institutions for loans within the state.
   - Provide the South Dakota Cash Flow Fund with a market rate of return.

2. Pros and Cons of the CD Program

   A. Pros
      - Provides a safe and predictable one-year return based on the Treasury note plus a risk premium for liquidity and collateral risk.
      - Safety provided by 100% governmental security collateralization above FDIC insurance of up to $250,000 at each participating financial institution.
      - Standardized low labor-intensive process to administer program.
      - Provides capital to South Dakota institutions for potential loans within the state which can help the state economy.

   B. Cons
      - CD program investments may be giving up return if the appropriate return comparison is not the one-year Treasury note plus an assigned risk premium.
      - CD program investments provide less liquidity than T-note or agency securities.
      - Cost of administering the program.

3. Return Comparisons

    - CD program provides return identical to the one-year Treasury note return with a floor of 0% plus a risk premium for liquidity and collateral risk, while providing slightly more credit risk and much less liquidity than Treasury notes.

    - CD Program investments can be compared to one-year government-sponsored agency investments. CDs offer a comparable risk profile and less liquidity than agency investments.

One-year agencies offer a good comparison for the one-year South Dakota Investment Council CDs. Prior to 2010, the CD Program provided, on average, a return of 20 basis points less than investments in government-sponsored agency securities with like maturity dates. Thereafter, the rate-setting methodology changed to incorporate a risk premium to account for illiquidity and collateral risk. Currently, agency bonds yield approximately 15 basis points more than Treasury bills for the same one-year maturity. Therefore, we recommend using a 15 basis point premium to account for illiquidity and collateral risk for the CDs maturing 9/29/23. The level of risk premium will be reevaluated each year.

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