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Donna Little
REGULATIONS COMPILER

1 FINANCE AND ADMINISTRATION CABINET

2 Department of the Controller

3 Office of Financial Management

4 (Amendment)

5 200 KAR 14:081 Repurchase Agreement

6 RELATES TO: KRS 41.610, 42.500(9)-(14), 42.520, 42.525

7 STATUTORY AUTHORITY: KRS 42.500(10), 42.520(2), 42.525

8 NECESSITY, FUNCTION, AND CONFORMITY: KRS 42.500(10) requires the State
9 Investment Commission to promulgate administrative regulations for the investment and
10 reinvestment of state funds. KRS 42.520(2) requires the commission to promulgate
11 administrative regulations concerning the assignment of priorities to public depositories. KRS
12 42.525(1) requires the commission to promulgate administrative regulations for the investment
13 and reinvestment of state funds and the acquisition, retention, management, and disposition of
14 investments. This administrative regulation establishes the general standards which shall apply to
15 the employment of repurchase agreements as investment vehicles with eligible financial
16 institutions.

17 Section 1. Definitions. (1) "Commission" means the State Investment Commission.

18 (2) "Eligible financial institution" means:

19 (a) A commercial bank, or savings and loan association:

20 1. Chartered to do business in Kentucky by the Commonwealth of Kentucky, or by an agency
21 of the United States government; and

1 2. That maintains an office in Kentucky; or

2 (b) A broker-dealer approved pursuant to the provisions of Section 10 [8] of 200 KAR
3 14:011.

4 (3) "Office" means the Office of Financial Management.

5 (4) "Repurchase agreement" [~~or "reverse repurchase agreement"~~] means an actual,
6 conditional purchase or sale of securities of the United States Treasury, an agency,
7 instrumentality, or corporation of the United States, or another security authorized for investment
8 pursuant to KRS 42.500(9)(a) or (b), with an agreement to resell or repurchase the securities to
9 their original owner on a specific date in the future.

10 Section 2. Minimum Interest Rates. Except as provided by KRS 41.610, the commission
11 shall not invest public funds in a repurchase agreement with a yield less than could be received
12 on a directly purchased United States Treasury security of comparable maturity.

13 Section 3. Reporting Requirements for Eligible Investment Institutions. The commission
14 shall inform eligible financial institutions of the reporting requirements for the investment of
15 state funds in eligible financial institutions established by this section.

16 (1) An eligible financial institution shall:

17 (a) Submit a copy of its quarterly financial reports as furnished to Department of Financial
18 Institutions, including accompanying schedules, to the commission within thirty (30) days from
19 the end of each quarter; and

20 (b) Complete and sign the "Public Securities Association Master Repurchase Agreement,
21 incorporated by reference in 200 KAR 14:011".

22 (2) An approved broker-dealer shall:

1 (a) Submit a copy of its annual audited financial statements and copies of quarterly financial
2 statements, as published, to the commission; and

3 (b) Complete and sign the "Public Securities Association Master Repurchase Agreement",
4 incorporated by reference in 200 KAR 14:011.

5 Section 4. Eligible Securities. Investment securities authorized for investment pursuant to
6 KRS 42.500(9)(a) and (b) shall be considered eligible securities for repurchase agreements.

7 Section 5. Sufficiency of Securities Purchased. (1) The securities purchased shall have a
8 market value, including accrued interest, of not less than 102 percent of the face value of the
9 repurchase agreement.

10 (2) The state's custodian banking contract shall require the custodial bank [~~general~~
11 ~~depository~~] to review the sufficiency of collateral on all repurchase agreements, except those
12 subject to a triparty agreement. The review shall occur at least every seven (7) calendar days
13 with periodic reviews made by the Office [~~office~~].

14 (3) The commission shall demand additional securities to be delivered immediately, if market
15 conditions cause the value of the securities purchased to drop below 102 percent of the face
16 value of the repurchase agreement.

17 Section 6. Status of Parties. (1) The commission and the eligible financial institutions
18 authorized to enter into repurchase agreements:

19 (a) Shall be considered principals in repurchase agreements; and

20 (b) Shall not be considered agents for third parties.

21 (2) Contractual obligations shall apply to and be binding on the commission and the specific
22 eligible financial institution with which the repurchase agreement is initially negotiated and
23 settled.

1 Section 7. Default. (1)(a) If an eligible financial institution with which the commission has
2 entered into a repurchase agreement defaults, or is determined by the commission to be in danger
3 of default, the commission shall set off claims and liquidate property held in respect to the
4 repurchase agreement against obligations owing to the eligible financial institution under other
5 repurchase agreements.

6 (b) Payments, deliveries, and other transfers made under a repurchase agreement shall be
7 deemed to have been made in consideration of payments, deliveries, and other transfers made
8 under any other repurchase agreement by the eligible financial institution.

9 (c) The obligation to make payments, deliveries and other transfers under a repurchase
10 agreement may be applied against the obligation to make payments, deliveries and other transfers
11 under any other repurchase agreements of the eligible financial institution and netted.

12 (2)(a) From the proceeds of liquidated property, the commission shall pay itself the full
13 principal and accrued interest due as of the date of liquidation.

14 (b) Remaining cash balances shall be forwarded to the financial institution with which the
15 repurchase agreement was originally executed.

16 Section 8. Kentucky Bank Repurchase Program. (1) Repurchase agreements with commercial
17 banks and savings and loan associations chartered by the Commonwealth of Kentucky or by the
18 U.S. government with offices located in Kentucky before being placed shall meet the following
19 criteria:

20 (a) A loan to deposit ratio equal to or greater than seventy (70) percent;

21 (b) A nonperforming loan to capital ratio of equal to or less than twenty-five (25) percent;

22 (c) A capital to assets ratio equal to or greater than the greater of eight (8) [seven-(7)] percent
23 or regulatory requirements; and

1 (d) A return on assets ratio greater than five-tenths (0.5) percent [~~zero~~].

2 (2) Repurchase agreements with maturities equal to or greater than 365 days with
3 commercial banks and savings and loan associations chartered by the Commonwealth of
4 Kentucky or by the U.S. government with offices located in Kentucky shall be limited to
5 \$5,000,000 per institution.

6 (3) The office shall review the financial ratios listed quarterly to determine eligibility of
7 institutions. Existing repurchase agreements with institutions which fail to meet the minimum
8 criteria for two (2) consecutive quarters shall be subject to call at par value by the commission.

9 Repurchase agreements shall be placed according to:

10 (a) Availability of funds;

11 (b) Demand for funds by the institutions; and

12 (c) Highest loan to deposit ratio of eligible institutions.

13 (4)(a) A repurchase agreement with a commercial bank or savings and loan shall not be an
14 amount in excess of its capital structure or ten (10) percent of the institution's deposits,
15 whichever is less.

16 (b) The commission shall not enter into a Kentucky Bank Repurchase Program repurchase
17 agreement with a commercial bank or savings and loan association that will cause that institution
18 to exceed in aggregate a total of \$25,000,000 in repurchase agreements.

19 (5) Yield charged and collateral requirements for commercial banks and savings and loans.

20 (a) A commercial bank or savings and loan submitting U.S. Treasuries and agencies
21 excluding mortgage backed securities and collateralized mortgage obligations shall be charged
22 the same duration yield generic repurchase rate as quoted by Bloomberg Financial Markets with
23 102 percent collateral.

1 (b) A commercial bank or savings and loan submitting mortgage-backed securities and
2 collateralized mortgage obligations shall be charged the same duration yield generic repurchase
3 rate as posted on Bloomberg Financial Markets, plus fifty (50) basis points with 105 percent
4 collateral.

5 (6) Payment for and safekeeping of purchases.

6 (a) Each transaction shall be conducted on a payment-versus-delivery basis.

7 (b) A party shall not allow state funds to be released until delivery of adequate, negotiable
8 collateral has been verified.

(c) Securities purchased from commercial banks or savings and loan associations in a
repurchase agreement shall be received, verified, and safe-kept by the state's custodial bank or its
agent.

Approved:

F. Thomas Howard by Jeff Masley

F. Thomas Howard, Executive Director
Department of the Controller
Office of Financial Management

9/12/12

Date

PUBLIC HEARING AND PUBLIC COMMENT PERIOD

A public hearing on this administrative regulation shall be held on October 24, 2012, from 10:00 a.m. to 12:00 p.m., in Room 383, Capitol Annex Building, Frankfort, Kentucky 40601. Individuals interested in being heard at this hearing shall notify this agency in writing at least five (5) workdays prior to the hearing, of their intent to attend. If no notification of intent to attend the hearing is received by the required date, the hearing may be cancelled. This hearing is open to the public. Any person who wishes to be heard will be given an opportunity to comment on this proposed administrative regulation. A transcript of the public hearing will not be made unless a written request for a transcript is made. If you do not wish to be heard at the public hearing, you may submit written comments on the proposed administrative regulation. Written comments shall be accepted until October 31, 2012. Send written notification of intent to be heard at the public hearing or written comments on the proposed administrative regulation to the contact person.

CONTACT PERSON: DeVon Hankins, Policy Advisor, Office of General Counsel, Finance and Administration Cabinet, 392 Capitol Annex, Frankfort, Kentucky, 40601, (502) 564-6660 (telephone), (502) 564-9875 (fax).

REGULATORY IMPACT ANALYSIS AND TIERING STATEMENT

Administrative Regulation #: 200 KAR 14:081

Contact person: DeVon Hankins, Policy Advisor and Legislative Liaison, Office of General Counsel, Office of the Secretary, Finance and Administration Cabinet, 392 Capitol Annex, Frankfort, Kentucky, 40601, (502) 564-6660 (telephone), (502) 564-9875 (fax)

(1) Provide a brief summary of:

(a) What this administrative regulation does: This regulation governs the state's investments in repurchase agreements.

(b) The necessity of this administrative regulation: The state invests substantial funds in tri-party repurchase agreements. This regulation requires prudent use of those agreements and establishes monitoring requirements to assure safety of state funds are maintained.

(c) How this administrative regulation conforms to the content of the authorizing statutes: This is required by KRS 42.500 (10) and establishes the limitations required by that clause.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes: This administrative regulation provides guidance on the investment of state funds and requires prudent investment activities which will limit the exposure of state funds to investment losses.

(2) If this is an amendment to an existing administrative regulation, provide a brief summary of:

(a) How the amendment will change this existing administrative regulation: This amendment requires the Custodial Bank to monitor repurchase agreement collateral levels, raises capitol and income requirements for entry into the link deposit program, and further restricts acceptable collateral for repurchase agreements.

(b) The necessity of the amendment to this administrative regulation: This amendment brings the regulation up to the standards adopted by the State Investment Commission.

(c) How the amendment conforms to the content of the authorizing statutes: The amendment is compliant with KRS 42.500 (10).

(d) How the amendment will assist in the effective administration of the statutes: The amendment further clarifies investment activities to reduce the risk of loss of state funds.

(3) List the type and number of individuals, businesses, organizations, or state and local governments affected by this administrative regulation: This regulation only affects actions by the Office of Financial Management.

(4) Provide an analysis of how the entities identified in question (3) will be impacted by either the implementation of this administrative regulation, if new, or by the change, if it is an amendment, including:

(a) List the actions that each of the regulated entities identified in question (3) will have to take to comply with this administrative regulation or amendment: Personnel in OFM will need to assure repurchase agreements meet the newly modified requirements set forth in this amendment.

(b) In complying with this administrative regulation or amendment, how much will it cost each of the entities identified in question (3): No cost.

(c) As a result of compliance, what benefits will accrue to the entities identified in question (3): This amendment clarifies certain requirements for the Office of Financial Management.

(5) Provide an estimate of how much it will cost the administrative body to implement this administrative regulation:

(a) Initially: \$0

(b) On a continuing basis: \$0

(6) What is the source of the funding to be used for the implementation and enforcement of this administrative regulation: None needed.

(7) Provide an assessment of whether an increase in fees or funding will be necessary to implement this administrative regulation, if new or by the change if it is an amendment: No increase needed.

(8) State whether or not this administrative regulation established any fees or directly or indirectly increased any fees: This amendment does not establish or increase any fees.

(9) TIERING: Is tiering applied? (Explain why or why not): There is no tiering because it is not applicable.

FISCAL NOTE ON STATE OR LOCAL GOVERNMENT

Regulation Number: 200 KAR 14:081

Contact Person: DeVon Hankins, Policy Advisor, Office of General Counsel, Finance and Administration Cabinet, 392 Capitol Annex, Frankfort, Kentucky, 40601

Phone number: (502) 564-6660 (telephone), (502) 564-9875 (fax)

(1) What units, parts, or divisions of state or local government (including cities, counties, fire departments, or school districts) will be impacted by this administrative regulation?

This regulation only affects the investment actions of the Office of Financial Management.

(2) Identify each state or federal statute or federal regulation that requires or authorizes the action taken by the administrative regulation.

KRS 42.500 requires the State Investment Commission to promulgate this regulation.

(3) Estimate the effect of this administrative regulation on the expenditures and revenues of a state or local government agency (including cities, counties, fire departments, or school districts) for the first full year the administrative regulation is to be in effect. None.

(a) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for the first year? None.

(b) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for subsequent years?

None.

(c) How much will it cost to administer this program for the first year?

No cost.

(d) How much will it cost to administer this program for subsequent years?

No cost

Note: If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation.

Revenues (+/-):

Expenditures (+/-):

Other Explanation: