

Chapter 14 State Investment Commission

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200 KAR 14:011. Qualified investments.

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

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

NECESSITY, FUNCTION, AND CONFORMITY: KRS 42.500(10) requires the State Investment Commission to promulgate administrative regulations for the investment and reinvestment of state funds. KRS 42.520(2) requires the commission to promulgate administrative regulations concerning the assignment of priorities to public depositories. KRS 42.525(1) requires the commission to promulgate administrative regulations for the investment and reinvestment of state funds and the acquisition, retention, management, and disposition of investments. This administrative regulation establishes the standards that govern the commonwealth's investment and cash management programs.

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

(2) "Floating rate" means that the interest rate:

(a) That is paid on the specific security changes periodically on a pre-established schedule;

(b) May be tied directly to an index plus some spread or margin; and

(c) Includes hybrid adjustable rate mortgages if the first repricing date is less than six (6) years from the issuance date.

(3) "Hedge" means a position in a financial instrument taken to minimize or eliminate the risk associated with an existing instrument or portfolio of instruments.

(4) "Interest rate swaps" means an agreement governed by an International Swap Dealers Association master contract between two (2) parties to exchange, or have the conditional right to exchange, specified cash flows.

(5) "Nationally-recognized rating agency" means "Nationally Recognized Statistical Ratings Organization" (NRSRO) as designated by the Securities and Exchange Commission.

(6) "Office" means the Office of Financial Management.

(7) "Options" means a contract that provides the right, but not the obligation, to buy or sell a specific amount of a security within a predetermined time period and includes specific bonds or notes, an exchange traded futures contract, or the cash value of an index.

(8) "Pools" means the investment pools that are managed by the Office of Financial Management, under the guidance of the commission.

Section 2. The commission shall:

(1) Not invest state funds in an institution or instrument that it deems unsafe and a threat to the security of state funds;

(2) Maintain adequate liquidity to meet the cash needs of the state;

(3) Within the limits established by this administrative regulation, invest in securities that maximize yield or return to the commonwealth; or

(4) Not borrow money to enlarge the pool.

Section 3. Interest earned on the cash balances shall be calculated daily on an accrual basis.

Section 4. Investment Criteria. (1) The criteria to determine the amount of funds per investment instrument shall be the:

(a) Liquidity needs of the state in aggregate as budgeted;

(b) Rates available per instrument; and

(c) Safety of principal and interest.

(2) An investment instrument shall qualify if it is specified by:

(a) KRS 42.500;

(b) This administrative regulation;

(c) 200 KAR 14:081; or

(d) 200 KAR 14:091.

Section 5. Investment Securities. The commission shall invest only in the following security types:

(1) U.S. Treasury, agency, and government sponsored entity agency securities with a maturity of less than seven (7) years, or an embedded put of less than three (3) years.

(2) Mortgage pass-through securities issued by U.S. government agencies or by government sponsored entities, including, government national mortgage association, Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Small Business Administration, and Student Loan Marketing Association with an average life of less than four (4) years at the time of purchase, using Bloomberg consensus prepayment projections, if available, or other reasonable prepayment assumptions if there is no consensus. The commission may hold pass-throughs purchased under this subsection which have an average life of less than six (6) years, using Bloomberg consensus prepayment projections, if available, or other reasonable prepayment assumptions if there is no consensus.

(3) Real estate mortgage investment conduit obligations, as defined by the Internal Revenue Code, also known as collateralized mortgage obligations, or CMOs, rated A or higher by a nationally-recognized rating agency with an average life of less than four (4) years at the time of purchase, using Bloomberg consensus prepayment projections, if available, or other reasonable prepayment assumptions if there is no consensus. The commission may hold CMOs purchased under this subsection which have an average life of less than six (6) years, using Bloomberg consensus prepayment projections, if available, or other reasonable prepayment assumptions if there is no consensus.

(4) Asset-backed securities (ABS) rated in the highest category by a nationally-recognized rating agency with an average life of four (4) years or less.

(5) U.S. dollar denominated corporate and Yankee securities issued by foreign and domestic issuers, rated A or higher by a nationally-recognized rating agency, with a maturity not longer than five (5) years, or an embedded put of less than three (3) years.

(6) U.S. dollar denominated sovereign debt rated A1 or higher by a nationally-recognized rating agency, with a maturity not to exceed five (5) years.

(7) Money market securities, including:

(a) Commercial paper;

(b) Certificates of deposit; and

(c) Eurodollars and time deposits rated in the highest short-term rating with assets in excess of one (1) billion dollars and bankers' acceptances rated A or higher. Maturities shall be limited to six (6) months for bankers' acceptances and nine (9) months for all other money market securities.

(8) Repurchase and reverse repurchase agreements collateralized at 102 percent (marked to market daily) with treasuries, agencies, and collateralized mortgage obligations that meet the requirements established by subsection (4) of this section, with a maximum maturity of one (1) year if executed with approved broker-dealers as provided by Section 8 of this administrative regulation and a maximum of three (3) years for the Kentucky Bank Repurchase Program participants.

(9) Municipal obligations rated A or higher by a nationally-recognized rating agency, with a maturity not to exceed five (5) years. The maturity restriction shall be waived for obligations issued by the Commonwealth of Kentucky or any entity within the Commonwealth of Kentucky.

(10) Mutual funds in which at least ninety (90) percent of the underlying holdings of the fund are in securities in which the pools could invest directly.

(11) Any floating rate securities which would otherwise qualify under this section except for maturity or average life restrictions.

Section 6. Limits on Investment Securities. (1) U.S. agency mortgage backed securities and collateralized mortgage obligations shall not exceed twenty-five (25) percent of total pool assets in aggregate.

(2) Asset-backed securities shall not exceed twenty (20) percent of total pool assets.

(3) U.S. dollar denominated corporate and Yankee securities issued by foreign and domestic issuers shall not exceed twenty-five (25) percent of an individual pool and \$25,000,000 per issuer, inclusive of commercial paper, bankers' acceptances, and certificates of deposit unless:

(a) These securities are guaranteed by the full faith and credit of the United States government; or

(b) These securities were purchased between February 19, 2009 and March 31, 2009.

(4) U.S. dollar denominated sovereign debt shall not exceed five (5) percent of any individual portfolio and \$25,000,000 per issuer.

(5) The limits set forth in this section may be waived by unanimous vote of the commission.

Section 7. Risk Management. The pools may utilize interest rate swaps, over-the-counter and exchange traded U.S. Treasury contracts and options to manage the portfolio's exposure to interest rate risk. These instruments shall only be used if the results are demonstratively superior to cash market transactions.

Section 8. Pools and Operating Procedures. (1)(a) Except for the Budget Reserve Trust Fund, state funds held in accounts the interest of which accrues to the General Fund shall be placed in the short-term pool or the intermediate pool.

(b) The short-term pool shall not purchase a security with a duration exceeding one (1) year.

(c) The duration of the short-term pool shall not exceed ninety (90) days.

(2)(a) Except as provided by paragraph (b) of this subsection, state funds held in agency or university accounts, the interest of which accrues to the agency or university, shall be placed in the intermediate pool.

(b) These funds may be placed in the short-term pool, if the commission determines that the liquidity needs of an agency require shorter term investment.

(c) The duration of the intermediate pool shall not exceed three (3) years.

(3)(a) Bond proceeds from state issued bonds may be placed in the bond proceeds pool.

(b) The bond proceeds pool shall consist of U.S. Treasury, agency and government-sponsored entity notes, bills and bonds, and repurchase agreements.

(4)(a) The portion of the Budget Reserve Trust Fund, the disposition of which the approval of the General Assembly is required, and agency funds which the commission and agency determine need not be expended for a period of two (2) years, shall be placed in the long-term pool.

(b) The duration of the long-term pool shall not exceed four and one-half (4.5) years.

Section 9. Approved Broker-Dealers. (1) A broker-dealer who was approved by the commission prior to the effective date of this administrative regulation shall be considered an approved broker-dealer.

(2) Except as provided by subsection (1) of this section, a broker-dealer shall be approved by the commission if the broker-dealer has met the requirements established by subsection (3), (4), or (5) of this section, as applicable.

(3) An approved broker-dealer shall be a broker dealer who meets one (1) of the following qualifications:

(a) Is a primary dealer of the Federal Reserve rated A1-P1 by a nationally-recognized rating agency;

(b) Maintains an office in Kentucky, and has either \$25,000,000 in excess net capital or has trades that are guaranteed by a primary dealer of the Federal Reserve who is rated A1-P1 or higher by a nationally recognized rating agency; or

(c) Has a minimum of \$100,000,000 in excess net capital.

(4) An approved broker-dealer for repurchase agreements shall:

(a) Be rated A1 or higher by a nationally-recognized rating agency;

(b) Have transaction amounts limited to his excess net capital;

- (c) Have executed the:
 - 1. Public Securities Association Master Repurchase Agreement prior to entering into a repurchase transaction; and
 - 2. Appropriate Custodial undertaking in Connection with Master Repurchase Agreement; and
- (d) Be primary dealer of the Federal Reserve who is rated A1-P1 or higher by a nationally recognized rating agency.
- (5) An approved broker-dealer for hedge vehicles shall:
 - (a) Have at least \$100,000,000 in excess net capital;
 - (b) Be rated A1 or higher by a nationally-recognized rating agency;
 - (c) Have market value transactions limited to his excess net capital; and
 - (d) Have executed the:
 - 1. International Swap Dealers' Association Agreement prior to the implementation of a swap; and
 - 2. Commonwealth of Kentucky Master Agreement, Over-the-counter Option Transactions - U.S. Treasury Securities, prior to the implementation of an over the counter option transaction.
- (6)(a) Within 180 days of the end of each broker-dealer's fiscal year, a broker-dealer shall submit a copy of the broker-dealer's audited financial statements for that fiscal year.
- (b) A broker-dealer who wishes to be approved by the commission as an approved broker-dealer shall submit a copy of the broker-dealer's current audited financial statements

Section 10. Incorporation by Reference. (1) The following material is incorporated by reference:

- (a) "Commonwealth of Kentucky, Bond Proceeds Pool, Prospectus, (12/97)";
 - (b) "Commonwealth of Kentucky, Short-term Pool, Prospectus, (12/97)";
 - (c) "Commonwealth of Kentucky, Intermediate-term Pool, Prospectus, (12/97)";
 - (d) "Commonwealth of Kentucky, Long-term Pool, Prospectus, (12/97)";
 - (e) "Securities Industry and Financial Markets Association Master Repurchase Agreement (12/08)";
 - (f) "Custodial Undertaking in Connection with Master Repurchase Agreement, Bank of New York (12/08)";
 - (g) "Custodial Undertaking in Connection with Master Repurchase Agreement, Chase Manhattan (12/08)";
 - (h) "International Swap Dealers' Association Agreement (12/02)"; and
 - (i) "Commonwealth of Kentucky Master Agreement, Over-the-counter Option Transactions - U.S. Treasury Securities (12/97)".
- (2) This material may be inspected, copied, or obtained, subject to applicable copyright law, at State Investment Commission, Suite 76, Capitol Annex, Frankfort, Kentucky 40601, Monday through Friday, 8 a.m. to 4:30 p.m. (19 Ky.R. 537; Am. 1065; eff. 10-22-92; 24 Ky.R. 1353; 1645; eff. 2-10-98; 26 Ky.R. 418; 993; eff. 10-28-99; 29 Ky.R. 2727; 30 Ky.R. 20; eff. 7-17-2003; 31 Ky.R. 1878; 32 Ky.R. 47; eff. 8-5-05; 35 Ky.R. 2332; 2664; eff. 7-6-2009.)

200 KAR 14:081. Repurchase agreement.

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

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

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

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

(2) "Eligible financial institution" means:

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

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

2. That maintains an office in Kentucky; or

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

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

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

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

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

(1) An eligible financial institution shall:

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

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

(2) An approved broker-dealer shall:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(c) A capital to assets ratio equal to or greater than seven (7) percent; and

(d) A return on assets ratio greater than zero.

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

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

(a) Availability of funds;

(b) Demand for funds by the institutions; and

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

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

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

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

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

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

(6) Payment for and safekeeping of purchases.

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

(b) A party shall not allow state funds to be released until delivery of adequate, negotiable 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. (19 Ky.R. 538; Am. 1066; eff. 10-22-92; 24 Ky.R. 1355; 1647; eff. 2-10-98; 26 Ky.R. 420; 994; eff. 10-28-99; 31 Ky.R. 1880; 32 Ky.R. 49; eff. 8-5-05.)

200 KAR 14:091. Guidelines for money market instruments.

RELATES TO: KRS 41.610, 42.014(1), 42.500, 42.505-42.545

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

NECESSITY, FUNCTION, AND CONFORMITY: KRS 42.525, requires the State Investment Commission to prescribe standards for the operation of the state's investment program. This administrative regulation establishes the standards which shall apply to the use of certain money market instruments which include bankers' acceptances, commercial paper and negotiable collateralized and uncollateralized certificates of deposit.

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

(2) "Office" means the Office of Financial Management and Economic Analysis.

(3) "Bankers' acceptance" means a short-term negotiable discount note drawn on and accepted by a bank or trust company which is obligated to pay the face value amount at maturity, which is rated in one (1) of the three (3) highest categories by a nationally recognized rating agency.

(4) "Commercial paper" means an unsecured promissory obligation having a maturity of less than 270 days and is originated by an institution that is rated in the highest category by a nationally recognized rating agency.

Section 2. Bankers' Acceptances. (1) The office may purchase bankers' acceptances if originated by a bank rated in one (1) of the three (3) highest categories by a nationally recognized rating agency.

(2) The purchase of these instruments shall be:

(a) Made on a payment versus delivery basis; and

(b) Held in the Commonwealth's account in whatever depository shall be designated as eligible by the commission.

(3)(a) Investment in bankers' acceptances shall be made for a period of no longer than six (6) months per investment.

(b) The total amount of the investment in this security shall not exceed the amount of ten (10) million dollars in one (1) institution at a time.

Section 3. Commercial Paper. (1) The office may purchase commercial paper if originated by an issuer that is rated in the highest category by a nationally recognized rating agency.

(2) The purchase of these instruments shall be:

(a) Made on a payment versus delivery basis; and

(b) Held in the Commonwealth's account in whatever depository shall be designated as eligible by the commission.

(3) The investments in commercial paper shall be made for a period of no longer than nine (9) months per investment and the total amount of the investment in this security shall not exceed the amount of twenty-five (25) million dollars by any issuer at a time.

Section 4. Negotiable Certificates of Deposit, Collateralized and Uncollateralized. (1) The office may purchase collateralized and uncollateralized negotiable certificates of deposit if issued by banks rated in one (1) of the three (3) highest categories by a nationally recognized rating agency.

(2) The purchase of these instruments shall be:

(a) Made on a payment versus delivery basis; and

(b) Held in the Commonwealth's account in whatever depository shall be designated as eligible by the commission.

(3)(a) Investment in negotiable certificates of deposits shall be made for a period of no longer than nine (9) months per investment unless specifically authorized by KRS 41.610.

(b) The total amount of investments in certificates of deposit shall not exceed the amount of ten (10) million dollars in any one (1) institution at a time.

Section 5. Limit of Money Market Instruments of the State's Total Portfolio. The aggregate investment in bankers' acceptances, commercial paper, and negotiable certificates of deposit shall not exceed twenty (20) percent of the Commonwealth's total investment portfolio. (19 Ky.R. 540; Am. 1068; eff. 10-22-92; 26 Ky.R. 422; 996; eff. 10-28-99.)

200 KAR 14:200. Linked Deposit Investment Program.

RELATES TO: KRS 41.600-41.620

STATUTORY AUTHORITY: KRS 41.606(1), (2), (5)- (7), 42.510(3), 42.525

NECESSITY, FUNCTION, AND CONFORMITY: This administrative regulation established the conditions for which small businesses and agribusiness are eligible for loans made available through the Linked Deposit Investment Program and provides for agency review of the information provided by the lending institution as part of the loan package. The Linked Deposit Investment Program, as it pertains to agribusiness, will be monitored by the Department of Agriculture and as it pertains to small businesses, will be monitored by the Cabinet for Economic Development.

Section 1. (1) The amount of funds available for Linked Deposit Investment Program loans shall be the amount of cash in the state's Unclaimed and Abandoned Property Program.

(2) Approval for a new application for a linked deposit investment shall be denied or an existing investment revoked by the State Investment Commission for failure of the financial institution to meet and maintain the eligibility requirements prescribed in KRS 42.500 and 200 KAR Chapter 14 for each investment type.

Section 2. Repayments. The eligible lending institution shall remit to the State Investment Commission by June 30 of each year all loan principal repayments for the preceding year beginning June 1 and ending May 31.

Section 3. Reporting Requirements. The State Investment Commission shall submit to either the Cabinet for Economic Development's Small and Minority Business Division or the Department of Agriculture a copy of the letter confirming each approved linked deposit investment with the eligible lending institution no later than thirty (30) days after the date the linked deposit investment program has been funded.

Section 4. Investment Policies. (1) Linked deposit investments in aggregate of less than \$100,000 for any institution may be in the form of a Certificate of Deposit. Aggregate investments between \$100,000 and \$250,000 may be in the form of a collateralized certificate of deposit with collateral meeting the requirements established by 200 KAR 14:081, Section 8, for the Kentucky Bank Repurchase Program. Any institution with linked deposit loans greater than \$250,000 shall be in the form of a repurchase agreement subject to the terms and conditions established by 200 KAR 14:081, Section 8, for the Kentucky Bank Repurchase Program.

(2) The yield on link deposit investments shall be as prescribed in KRS 41.610. (24 Ky.R. 1422; Am. 1649; eff. 2-10-98.)