PRESENTATION

Kentucky State Investment Commission

Investment Program Review

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Investment Authority and Responsibility	• Oversight of Investment Function • Permitted Investment Comparison to Other States • Kentucky Investment Guidelines	• The oversight approach used in Kentucky, in which the State Investment Commission has responsibility for setting investment policies for State Funds, is consistent with the approach taken by the majority of other states. • Investments permitted by Kentucky Statutes and Regulations are comparable to the investments permitted in other states. • Kentucky Statutes provide broad direction for the management of the State's assets. The Statutes specify the list of permitted investments and establish credit standards. Responsibility for setting specific instructions is delegated to the State Investment Commission. This framework provides flexibility, but imposes significant responsibility on the SIC for oversight and management of the investment function.
Regulatory Framework	• Statutes • Regulations	• Modest changes to KRS 42.500 are recommended, including: – Set a short-term credit rating standard for bankers' acceptances. – Limit repurchase agreement collateral. – Allow for expanded use of mutual funds. • Changes to investment regulations are recommended, including: – Specify when borrowing by the pools is permitted – Set higher credit standards for CMOs, sovereign debt and out-of-state municipal bonds. – Eliminate the reference to Eurodollar deposits. – Limit the final maturity of floating rate obligations to 5 years. – Increase the percentage of the portfolio that can be invested in corporate obligations from 25% to 35%. – Use the lowest rating on split-rated obligations. – Limit the percentage of an issue or tranche the State can own. – Prohibit the purchase of privately offered securities.

Executive Summary

Topic	Issues Reviewed	Comments
Regulatory Framework (continued)	• Prospectuses (Short-Term Pool and Intermediate Term Pool) • Use of Securities Lending	• Short-Term Pool Prospectus: – Relabel the document as an Information Statement. – Define different investment approaches for Short-Term and Limited-Term Pools. – Include 2a-7 Rules for the Limited Term Pool. – Eliminate restrictions on the use of Treasury STRIPS. – Fully document and disclose income calculation methodology. – Update custodian and securities lending agents. – Limit illiquid and long-term holdings in the Limited-Term Pool. – Document the Pool's ability to use leverage in certain circumstances. – Consider rewriting the document to include industry standard disclosures for government investment pools. • Intermediate-Term Pool Prospectus: – Relable the document as an Information Statement. – Disclose the possibility of a negative monthly investment income . – Eliminate restrictions on the use of Treasury STRIPS. – Update custodian and securities lending agents. – Document the Pool's ability to use leverage in certain circumstances. – Consider rewriting document to include industry standard disclosures for extended term investment pools. • A written securities lending policy is needed to effectively control and manage the risks inherent in this investment technique.

Executive Summary

Topic	Issues Reviewed	Comments
Investment Approach *Based on 10/20/2011 Portfolio*	• Cash Flow Forecasting • Portfolio Structure (Short-Term Pool, Limited-Term Pool and Intermediate-Term Pool) • Credit Analysis • Management of the Short-Term Pool as a 2a-7 Like Fund • Staffing	• The State's total investment portfolio has grown at a annual rate of roughly 8% over the past three years. • The Short-Term Pool has been the repository for a number of distressed and longer-term holdings. – 19% of investments have below investment grade ratings. – The Pool has a duration of 1.24 years, with 62% of the holdings maturing in longer than 10 years. • The Limited-Term Pool is well diversified and holds high quality investments. However, mortgage backed securities holdings cause the weighted average maturity to be longer than what is permitted for a 2a-7 Like Fund. • The Intermediate-Term Pool is well diversified, has an average credit quality of AA and an effective duration of 1.18 years. It may be possible to enhance the return on the Pool by extending the duration. • Investment staff relies solely on rating agencies for a credit assessment. An industry best practice is for the investor to perform independent credit analysis to augment the work of the rating agencies. • The Limited Term Pool should adopt rules and procedures needed to operate in accordance with the Securities and Exchange Commission Rule 2a-7: – Additional responsibilities for the SIC – Calculation of net asset value (NAV) and shadow NAV – Limits on weighted average maturity, weighted average life and final maturity – Tighter diversification standards – Limitations on repurchase agreement collateral • Additional support for investment staff is warranted: – Continuing education opportunities – Current staff size is modest given portfolio size and complexity

Executive Summary

Topic	Issues Reviewed	Comments
Portfolio Challenges *Based on 10/20/2011 Portfolio*	• Distressed Securities • Private Placements (144A Securities) • Sell/Hold Recommendations	• The State holds a number of distressed securities that are illiquid, have a market value less than 95% of the book value and/or have been downgraded below investment grade. • Thirteen of the obligations in the portfolio were issued under SEC Rule144A. These may only be sold to a Qualified Institutional Buyer (QIB). PFM does not believe that the State qualifies as a QIB. • The State's portfolio contains 29 securities that are either distressed or 144A private placement obligations. The book value of these securities is approximately $149 million; unrealized losses on these holdings are estimated to be between $20 million and $27 million.
		• PFM recommends selling 22 of the distressed and 144A securities and holding 7, if reasonable prices can be obtained.
Accounting	• Unrealized Losses • Net Asset Value Calculation	• For the Short-Term Pools, the State distributes investment income when received in cash. GAAP standards would suggest investment income be distributed on an accrual basis. • A balance sheet should be developed for the Limited Term Fund to aid in the calculation of the net asset value (NAV) and shadow NAV. The balance sheet can also be used to reconcile income distributed as well as income accrued but not yet distributed. • PFM recommends the State begin to record the book value of distressed securities to allow the financial statements to better reflect the true value of the assets.

Executive Summary

Topic	Issues Reviewed	Comments
Performance *For periods ending 9/30/2011*	• Historic Performance • Benchmark Recommendations	• The Intermediate-Term Pool equaled its benchmark for the trailing 10 year period. It underperformed the benchmark for the 1, 3, 5, and 7 year periods. • During much of the decade, the mortgage holdings did little to enhance performance and were a drag on returns (compared to government only benchmarks). Two exceptions to this were 2004 and 2005 in which the mortgage holdings performed well. • PFM is recommending the BofA Merrill Lynch 1 – 3 Year Agency Index as the benchmark for the Intermediate Term Pool. An alternative benchmark with a shorter duration has also been provided. • PFM is recommending the iMoneyNet First Tier Institutional Money Fund Index and Standard & Poor's Rated Government Investment Pool Index/General Purpose Taxable for the Limited Term Pool. • Given the current investment approach for the Intermediate Term Pool includes securities not included in the Agency benchmark, the OFM may wish to establish a shadow benchmark for the Pool to more closely match the actual portfolio allocation. This tool could be helpful in determining how much value is being added by including non-Government securities in the portfolio.

Investment Authority and Responsibility

Oversight of Investment Function

Topic	Observations	Comments/Recommendations
Investment Authority	• In 59% of states and the District of Columbia, a board sets the investment policy for State funds. • In 41% of states, the Treasurer has sole authority to determine the investment policy for state funds. • When a board is employed, it's membership includes the following officials or their designees: – Governor (30%) – Lt. Governor (7%) – Treasurer (80%) – Auditor (17%) – Comptroller (17%) – Attorney General (7%) – Secretary of State (13%) – Secretary/Director of Finance (23%) – Gubernatorial Appointments (50%) – Other (83%)	• The oversight approach used in Kentucky, in which the State Investment Commission is responsible for setting investment policies for state funds, is consistent with the approach taken by the majority of other states. • The composition of the State Investment Commission is comparable to the composition of investment boards in other states. • No changes are recommended.
Investment Management Responsibility	• In 90% of states, some or all of state funds are managed internally by state employees. • In 53% of states, an outside manager is used to manage some portion of the portfolio including: – Longer-term portfolios – Asset classes that require credit work – Complex asset classes – Bond proceeds that must comply with the Arbitrage Rebate Regulations	• Kentucky manages state funds and monies belonging to various state agencies and higher education institutions internally. • No outside managers are used. • No changes are recommended at this time. The use of outside managers could be used to augment internal capabilities if staffing challenges occur or if a different investment strategy is employed.

Source: National Association of State Treasurers, State Treasury Activities & Functions, Seventh Edition

Permitted Investments Comparison to Other States

- Investments permitted by Kentucky Statutes and Regulations are comparable to the investment approaches permitted in other states.
- The use of permitted investment instruments vary considerably from state to state. For instance, mortgage backed securities are permitted in 70% of states, but only 22% reported using these securities in their portfolios.*

Investment Type	Permitted in Kentucky	% of Other States that Permit
U.S. Treasury Obligations	√	100%
U.S. Agency Obligations	√	100%
Commercial paper	√	96%
Repurchase Agreements	√	96%
CDs within state	√	92%
Bankers' acceptances	√	74%
State and Local Gov't Obligations	√	72%
Mortgage backed securities	√	70%
Corporate notes/bonds	√	64%
Mutual/Money Market Funds	√	60%
Other time deposits	√	52%
CDs Nationally	√	48%
Corporate Stocks (domestic)		32%
Other	√	22%
Derivatives	√	20%
Corporate Stocks (foreign)		20%
Real Estate		14%
Eurodollars – CDs or TDs	√	10%
Venture capital/Private Equity		8%

** As reported by the National Association of State Treasurers in State Treasury Activities & Functions, seventh edition. The data in the report is over 5 years old, but illustrates the point that many states do not invest in the full range of securities permitted by statute.*

Kentucky Investments Guidelines

Investment Type	Permitted Investments		Credit Quality Requirements		Maturity Limitations	
	Statute	Regulation	Statute	Regulation	Statute	Regulation
U.S. Treasury Obligations	100%	100%				7 years or with a put of <3 years
U.S. Gov't Corporation	100%	100%				7 years or with a put of <3 years
Certificates of Deposit	100%	$25,000,000 per issuer	A	A		9 months
Bankers' Acceptances	100%	$10,000,000 per issuer	A	A		6 months
Commercial Paper	100%	$25,000,000 per issuer	A-1	A-1		9 months
Municipal Obligations	100%	100%	A	A		5 years
Corporate, Yankee, Eurodollar Securities	100%	$25,000,000 per issuer	A	A		5 years or with a put of < 3 years
U.S. dollar denominated Sovereign Debt	100%	5% or $25,000,000 whichever is less	A	A-1		5 years
Asset-backed Securities (ABS)	100%	20%	AAA	AAA		Average life < 4 years
Mutual Funds	10%	10%	90% of holdings in KY permitted investments	90% of holdings in KY permitted investments		
Repurchase Agreements and Reverse Repurchase Agreements	100%	100%				1 year/ 3 years for the Kentucky Bank Repurchase Program
Mortgage pass-through securities		25%				Average life < 4 years
Real estate mortgage investment conduit obligations (CMO)		25%		A		Average life < 4 years
Eurodollars Deposits		100%		A-1		9 months
Securities Lending Agreements		100%				
Corporate/Yankee/CP/BA/CDs		25%				
Floating Rate Security						No limit

Regulatory Framework

Statutes

Current Statute	Proposed Change	Rationale
Numerous references to "nationally recognized rating agency" appear in KRS 42.500	• Change "nationally recognized rating agency" to "Nationally Recognized Statistical Rating Organization" throughout the statute.	• The Securities and Exchange Act of 1934 (as amended by the Credit Rating Agency Reform Act of 2006), sets specific standards for organizations that provide credit ratings and requires those firms to register with the Securities and Exchange Commission. The registered firms are technically called Nationally Recognized Statistical Rating Organizations.
KRS 42.500, subsection 9(b) allows the State to invest in "Obligations of any corporation of the Unites States government"	• Expand this subsection to also allow investment in U.S. government sponsored enterprises.	• There is no standard definition for a government owned corporation. The term "government sponsored enterprise" or GSE is a standard description of the debt issuing government entities.
KRS 42.500, subsection 9(d) allows the State to purchase bankers acceptances rated in any one of the three highest categories	• Change the minimum credit rating to "the highest short-term category".	• Since bankers acceptances mature in less than one year, the short-term credit rating is applicable. The highest short-term rating is consistent with the State's credit standards for other short-term obligations (i.e. commercial paper).
KRS 42.500, subsection 9(i) allows the State to invest up to 10% of total funds in mutual funds, provided that the mutual fund invests at least 90% of its assets in securities the State may purchase directly	• Eliminate the limit on mutual fund investments. • Require that 100% of the mutual fund's assets be invested in securities the State may purchase directly. • Require the mutual fund be rated in the highest category by a Nationally Recognized Statistical Rating Organization.	• AAA-rated mutual funds invest in high-quality obligations and must meet strict diversification standards. If limited to the securities the State may purchase directly, they are a prudent investment vehicle and should provide a very high degree of liquidity. • To limit the risk to any single mutual fund company, regulations should be enacted to limit investment amounts in each mutual fund.

Statutes (continued)

Current Statute	Proposed Change	Rationale
KRS 42.500, subsection 10 allows the SIC to promulgate administrative regulations for the investment of State funds	• Eliminate this section.	• This section duplicates the language contained in KRS 42.525.
42.500, Section 11 states that any securities permitted in KRS 42.500, subsection (9) may be held under a repurchase agreement	• Amend this subsection to restrict repurchase agreements to only those securities permitted under subsection 9(a) and 9(b), which includes obligations backed by the full faith and credit of the U.S. Government and agencies of the federal government.	• Limiting repurchase agreements to U.S. Government obligations provides a higher level of security in the event of a default by the counterparty. • The definition of repurchase agreements specified by U.S. Bankruptcy Code does not include repurchase agreements backed by corporate obligations. The proposed change would keep the State's repurchase agreements within the Bankruptcy Code definition and provide greater protection in the event of a default by the counterparty.
Overall Impression	• No significant changes to the Statute are recommended.	• KRS 42.500 provides broad direction for the management of the State's assets. The statute specifies the list of permitted investments and establishes credit standards. Responsibility for setting specific instructions is delegated to the State Investment Commission. This framework provides flexibility, which can be helpful in managing the portfolio during periods of changing market conditions. However, it also imposes significant responsibility on the SIC for oversight and management of the investment function.

An edited version of KRS 42.500, which incorporates these recommendations is provided in the Appendix.

Regulations

Current Regulation	Proposed Change	Rationale
200 KAR 14:011. Qualified Investments. Section 1(5) defines the term Nationally Recognized Rating Agency to mean Nationally Recognized Statistical Ratings Organization	• Change this section to define a "Nationally Recognized Statistical Rating Organization". • Change "nationally recognized rating agency" to "Nationally Recognized Statistical Rating Organization" throughout the regulations.	• If KRS 42.500 is amended (as recommended in the last section) to use the term "Nationally Recognized Statistical Rating Organization," it will no longer be necessary to reference the term "nationally recognized rating agency" in the Regulations.
200 KAR 14:011. Qualified Investments. Section 2 states that the commission shall "not borrow money to enlarge the pool"	• Amend this section to permit the Commission to engage in securities lending and to borrow money to meet the short-term liquidity needs of the pool.	• Both securities lending and inter-fund borrowing are current practices. The proposed amendment would allow these practices while prohibiting other leverage techniques.
200 KAR 14:011. Qualified Investments. Section 5(2) allows the State to purchase mortgage pass-through obligations issued by various GSEs including the Student Loan Marketing Association	• Eliminate the reference to the Student Loan Marketing Association.	• The Student Loan Marketing Association was privatized in 1996 and is no longer a GSE.
200 KAR 14:011. Qualified Investments. Section 5(3) permits investments in collateralized mortgage obligations rated A or higher	• Change the minimum credit standard for CMOs to "the highest category".	• As we have seen over the past 5 years, holding CMO tranches rated lower than AAA can subject the portfolio to principal and liquidity risk. A rating of AAA on these obligations is more consistent with the State's standards on other securities and the investment practices of other State governments.
200 KAR 14:011. Qualified Investments. Section 5(6) permits investments in U.S. dollar denominated sovereign debt rated A or higher	• Change the minimum credit standard for sovereign debt to "the highest category".	• The world wide recession has strained the financial condition of governments around the globe. A rating of AAA on these obligations is more consistent with the State's standards on other securities and the investment practices of other State governments.

Regulations (continued)

Current Regulation	Proposed Change	Rationale
200 KAR 14:011. Qualified Investments. Section 5(7)(c) allows the State to invest in bankers acceptances rated in any one of the three highest categories.	• If the recommended statutory change is made, update the regulations to change the minimum credit rating to "the highest short-term category".	• Since bankers acceptances mature in less than one year, the short-term credit rating is applicable. The highest short-term rating is consistent with the State's credit standards for other short-term obligations (i.e. commercial paper).
200 KAR 14:011. Qualified Investments. Section 5(7)(c) specifies credit standards for Eurodollar and time deposits.	• Eliminate the reference to Eurodollar deposits.	• KRS 42.500 does not appear to allow Eurodollar deposits. The statute allows funds to be invested in dollar denominated "Eurodollar securities" but there is no mention of deposits.
200 KAR 14:011. Qualified Investments. Section 5(9) permits the State to invest in municipal obligations rated A or higher.	• Change the minimum credit rating to AA. • Waive the AA credit restriction for obligations issued by the Commonwealth of Kentucky and any municipal entities located within the Commonwealth.	• A minimum credit rating of AA will provide more protection against default during these difficult economic times • The waiver for Kentucky obligations provides flexibility for targeted in-state investments. However, appropriate credit due diligence will be necessary for any lower rated in-state obligations.
200 KAR 14:011. Qualified Investments. Section 5(11) allows the State to purchase floating rate securities without regard to maturity or average life	• Limit the final maturity of floating rate obligations to 5 years.	• Floating rate securities can have considerable basis risk, which can be mitigated by limiting the maximum maturity.
200 KAR 14:011. Qualified Investments. Section 6(3) restricts investment in corporate and Yankee obligations (including commercial paper, bankers' acceptances and CDs) to no more than 25% of the portfolio	• Increase the percentage of the portfolio that can be invested in corporate and Yankee obligations (including commercial paper, bankers' acceptances and CDs) to 35% of the portfolio.	• With the higher credit standards proposed, increasing the percentage of the portfolio that can be invested in corporate obligations will allow the State to enhance earnings. • The 35% allocation is consistent with or more conservative than other State governments.

Regulations (continued)

Current Regulation	Proposed Change	Rationale
200 KAR 14:011. Qualified Investments. Section 6 imposes certain restrictions on the investment of funds, but is silent on several important points	• If the recommended statutory change is made to allow up to 100% of the pool to be invested in mutual funds, update the regulations to limit investment in any single mutual fund to 20% of the total pool. • Specify that for purposes of meeting minimum credit standards, the lowest rating by a Nationally Recognized Statistical Rating Organization applies. • Limit the percentage of an outstanding issue or tranche that the State can own to no more than 25%. • Credit and diversification standards should apply at the time of purchase. • Prohibit the purchase of privately offered securities issued pursuant to Rule 144A of the Securities Act of 1933.	• Diversification standards for mutual funds can protect against principal losses and liquidity problems. • Using the lowest rating for split-rated issues is a prudent approach in situations where an investor is relying heavily on ratings (in lieu of independent credit research). • Holding a relatively large percentage of any security issue or tranche limits the investor's liquidity. Limiting the percentage of an issue that the State owns will increase liquidity. • Portfolio and market conditions can make it difficult to maintain compliance with diversification and credit standards after purchase. It is the industry norm for these guidelines to apply at the time of purchase. • PFM does not believe that the Commonwealth of Kentucky is a Qualified Institutional Buyer under the Securities Act of 1933. Only Qualified Institutional Buyer's may purchase securities issued pursuant to Rule 144A and other privately placed obligations. It should be noted that this opinion is not universally held. The state should obtain its own legal opinion on this matter.

Regulations (continued)

Current Regulation	Proposed Change	Rationale
200 KAR 14:011. Qualified Investments. Section 8 specifies the operating procedures for the pools. It currently limits the duration of the Short-Term Pool to 90 days and the maximum maturity to one year	• Specify that the Limited Term Fund will follow the rules needed to qualify as a 2a-7 Like Fund. • The following recommendations apply only to the Limited Term Pool • Limit the weighted average maturity to 60 days, the weighted average life to 120 days and the maximum maturity to 397 days. • Require that 10% of the pool be invested in liquid securities and that at least 30% in assets which mature within in seven (7) days or less. • Limit illiquid securities to 5% of the pool. • Limit investments to no more than 5% of the pool per issuer, except U.S. Government obligations. • Limit investments in Tier 2 securities to 3% of the pool and investments in individual Tier 2 issuers to .5% of the pool. Limit the maturity of Tier 2 investments to 45 days. • Require the computation of the pool net asset (NAV) value using the amortized cost method and require shadow NAV calculations. • Require quarterly stress testing of the pool. • Require that portfolio holdings be posted monthly to a website and available for 6 months.	• GASB amendments to Statement 31 require pools to comply with SEC 2a-7 rules in order to qualify as a "2a-7 Like Fund". • Recent changes to Rule 2a-7 have added new liquidity, credit, diversification and reporting requirements. These changes have not been adopted for the Limited-Term Pool. • Investors in the Limited Term Pool can avoid complicated mark-to-market accounting requirements if the Pool qualifies as a 2a-7 Like Fund.

A complete copy of Rule 2a-7 is provided in the Appendix.

Regulations (continued)

Current Regulation	Proposed Change	Rationale
200 KAR 14:011. Qualified Investments. Section 9 documents the requirements for broker dealers but is silent on several important matters	• Make clear that securities may be purchased directly from an issuer, without the use of a broker/dealer. • Require that securities be purchased through a competitive process that looks at pricing on comparable securities, except in the case of primary fixed price offerings.	• Some of the largest and most active commercial paper issuers have their own sales desks and do not sell paper through brokers or dealers. The OFM currently does not buy "direct issue" paper because the regulations do not specifically allow it. The ability to purchase commercial paper directly from the issuer will give the State greater access to supply and potentially better pricing. • Competitive shopping can significantly reduce the cost of securities. It is also considered to be a best practice. In cases where the desired security is thinly traded or available from a single firm, the State should look at securities that are comparable in terms of structure, maturity, duration and credit quality to ensure that the purchase price is competitive. Detailed records of this information should be maintained.
200 KAR 14:081 Repurchase Agreements. Sections 1(4) and Section 4 allow the State to enter into repurchase agreements backed by any security permitted by KRS 42.500, subsection (9)	• Amend this section to restrict repurchase agreements to only those securities permitted under subsection 9(a) and 9(b). This will limit repo collateral to obligations backed by the full faith and credit of the U.S. Government and agencies of the federal government.	• Limiting repurchase agreements to U.S. Government obligations provides a higher level of security in the event of a default by the counterparty. • The definition of repurchase agreements specified by U.S. Bankruptcy Code does not include repurchase agreements backed by corporate obligations. The proposed change would keep the State's repurchase agreements within the Bankruptcy Code definition and provide greater protection in the event of a default by the counterparty.

Regulations (continued)

Current Regulation	Proposed Change	Rationale
200 KAR 14:081 Repurchase Agreements. The state's custodial banking contract mandates weekly valuation of the sufficiency of repurchase agreement collateral	• Change the section to require daily valuation of collateral sufficiency.	• The State requires that collateral have a value of 102% of the repurchase agreement. Market volatility can easily cause the value of longer term securities to drop by more than 2% in a single week. This would leave the State undercollateralized. Daily valuation is considered a best practice.
200 KAR 14:091 Guidelines for money market instruments. Section 1(3) allows the State to invest in bankers acceptances rated in any one of the three highest categories	• If the recommended statutory change is made to specify that bankers' acceptances should have a short-term rating, update the Regulations to change the minimum credit rating to "the highest short-term category".	• Since bankers acceptances mature in less than one year, the short-term credit rating is applicable.
200 KAR 14:091 Guidelines for money market instruments. Section 1(4) allows the State to invest in commercial paper rated in the highest category	• Change the minimum credit rating to "the highest short-term category".	• Since commercial paper matures in less than one year, the short-term credit rating is applicable.
200 KAR 14:091 Guidelines for money market instruments. Sections 2(a)(a), 3(2)(a) and 4(2)(a) require that security transactions be made on a payment versus delivery basis	• Change these sections to say "delivery versus payment".	• Delivery versus payment is the industry standard terminology.

An edited version of KAR 14:011, 14:081 and 14:091, which incorporates the specific recommendations is provided in the Appendix.

Regulations (continued)

Current Regulation	Proposed Change	Rationale
200 KAR 14:091 Guidelines for money market instruments. Section 4(2) allows the State to invest in both collateralized and uncollateralized CDs. The same minimum credit rating applies to both types of CDs. The issuer must be rated in one of the three highest rating categories	• Set different credit standards for collateralized and uncollateralized CDs. • Uncollateralized CDs should be limited to banks rated in one of the two highest ratings.	• Since an uncollateralized CD subjects the State to a higher degree of credit risk than a collateralized CD, it is appropriate to set a higher credit standard for those deposits.
Overall Impressions	• Restructure the Regulations to be more consistent with best practices for governmental investment policies. • Typically, detailed guidance to investment staff is provided in the following areas: – Purpose – Scope of the Investment Policy – Investment Objectives – Delegation of Authority – Investment Oversight /Committee – Limits of Liability – Standard of Prudence – Ethics and Conflict of Interest – Authorized Investments – Portfolio Diversification – Prohibited Investments and Investment Practices – Selection, Approval of Brokers, Qualified Financial Institutions – Competitive Selection of Investment Instruments – Investment of Bond Proceeds – Safekeeping and Custody – Performance Standards – Reporting	• The regulatory guidelines for the management of the State's portfolios are detailed, but not comprehensive. Further, some of the policies are confusing and may be subject to misinterpretation. • Although the State's regulations include many of the components generally recommended for a governmental investment policy, the arrangement and organization of information makes it difficult to determine exactly what is permitted and what is not. It is also difficult to tie the guidelines back to the statute (i.e. Eurodollar deposits).

Short-Term Pool Prospectus

Issue	Proposed Change	Rationale
Document name	• Change the document name from Prospectus to Information Statement.	• The term "prospectus" is reserved for use by registered mutual funds. • The offering document for government investment pools is typically called an Information Statement.
Overview	• If the Limited Term Pools will be managed in accordance with SEC Rule 2a-7 and the Short-Term Pool will not, the Prospectus will need to describe the differences. • Alternatively, separate Information Statements could be developed.	• Operating the Limited Term Pool in accordance with SEC Rule 2a-7 provides significant benefits to investors and is recommended. • Because of current portfolio holdings and regular periods of negative balances, it is not feasible to operate the Short-Term Fund in the same manner.
Expenses	• The section on expenses should be updated to reflect current expenses on institutional mutual funds. The average fee for institutional money market funds is .20%.	• The fees shown in the current prospectus for "traditional money market funds" are for retail funds. Investors in the Short-Term Pool have balances that would qualify them for lower cost institutional funds.
Accounting	• Add a section to the paragraph that describes the Pool's investment income to also include the calculation of net realized gains/losses.	• The income distributed to money market fund investors includes both net investment income (the total of dividends and interest received less fund expenses) and net realized gains (gains less losses on securities sales).
Safekeeping	• Change the safekeeping agent from U.S. Bank to State Street Bank.	• State Street Bank is the State's new safekeeping agent.

Short-Term Pool Prospectus (continued)

Issue	Proposed Change	Rationale
Investment Policies – STRIPS and CUBES	• Delete the sentence that restricts Treasury STRIPS and CUBES to 10% of the pool.	• Treasury STRIPS are full faith and credit obligations of the U.S. Government and are appropriate investments for the pool; there is no need to restrict these securities. • The last CUBE matured or was refunded in 2006.
Investment Policies – Repo Collateral	• The Prospectus states that "Qualifying mortgages" are acceptable collateral for repurchase agreements. This term needs to be defined.	• The Prospectus states that "treasuries, agencies and qualifying mortgages" may be used to collateralize repurchase agreements. Given the broad range of mortgage backed securities and the significant difference in quality and liquidity, it is important to clearly document which types are acceptable. Given the difficulty in pricing some mortgage backed obligations, a margin of greater than 102% may be appropriate. • We suggest limiting mortgages to those insured by GSE. Further, given the difficulty in pricing some mortgage backed obligations, a margin of greater than 102% may be appropriate.
Other Limitations	• Prohibit the use of mortgage backed securities (MBS), collateralized mortgage obligations (CMOs), non-US sovereign debt in the Limited Term Pool.	• If the Limited Term Pool follows SEC Rule 2a-7, it will not be feasible to include MBS, CMOs and sovereign debt in the portfolio. These securities would generally not meet maturity and liquidity guidelines of the Rule.
Risk Management	• The Prospectus notes that "the State Investment Commission expressly prohibits the use of leverage or the posting of margin." This statement should be qualified to note that the Pool may engage in securities lending and reverse repurchase agreements.	• The Prospectus states that the Pool may engage in securities lending. Although the Prospectus is silent on the topic of reverse repurchase agreements, KAR 14:011 does permit the use of this investment tool. The Prospectus needs to fully disclose that the Pool may use leverage in certain circumstances.

Short-Term Pool Prospectus (continued)

Issue	Proposed Change	Rationale
Securities Lending	• Change the securities lending agent from Credit Suisse/First Boston to Deutsche Bank.	• Deutsche Bank is the State's new securities lending agent.
Overall Impression	• Edit the Prospectus to provide more information for Pool investors. • Typically, information on the following topics is provided to investors in a governmental investment pool that follows SEC Rule 2a-7: − Oversight Board − Investment Policies − Detailed Description of Permitted Investments − Investment Practices including Use of Leverage − Disclosure of Holdings and Transactions − Yield Information − Performance Benchmarking − Valuation of Shares − Dividends and Distributions − Operational Details (Opening an Account, Buying Shares and Redeeming Shares) − Trade Execution − Emergency Operation	• The Short-Term Prospectus includes many of the components generally included in a government pool information statement, but more information about the operation of the Pool will be helpful. This is particularly important if the SIC decides to manage the Pool in accordance with SEC Rule 2a-7.

Intermediate-Term Pool Prospectus

Issue	Proposed Change	Rationale
Document name	• Change the document name from Prospectus to Information Statement.	• The term “prospectus” is reserved for use by registered mutual funds. • The offering document for government investment pools is typically called an Information Statement.
Objective	• Provide more information about the “prescribed maturity and quality standards” under which the Pool is operated.	• Although maturity and quality standards are defined for the Pools in State statutes and regulations, there is limited information provided in the Prospectus. The Prospectus should provide a complete description of the Pool’s investment policies and practices.
Expenses	• The section on expenses should be updated to reflect the expenses on institutional mutual funds. The average fee on institutional bond funds is 0.40 – 0.50%.	• The fees shown in the current Prospectus for “traditional intermediate bond funds” are 0.30 – 1.00%. Average expenses for institutional funds are at the lower end of that range.
Accounting	• The Prospectus should fully disclose that investment income for a month may be negative.	• Because the State distributes investment income on a cash basis, the income distributed each month for the Intermediate-Term Fund can vary significantly from the calculated return in a given month. The variability of income distribution and very real possibility that there will be no income distributed in some months should be fully disclosed.
Investment Policies – STRIPS and CUBES	• Delete the sentence that restricts Treasury STRIPS and CUBES to 20% of the pool.	• Treasury STRIPS are full faith and credit obligations of the U.S. Government and are appropriate investments for the pool; there is no need to restrict these securities. • The last CUBE matured or was refunded in 2006.

Intermediate-Term Pool Prospectus (continued)

Issue	Proposed Change	Rationale
Investment Policies – Money Market Securities	• The Prospectus limits money market securities to 20% of the portfolio. Money market securities are defined as Commercial Paper, CDs and Time Deposits. The definition of money market securities should be expanded to include Bankers' Acceptances.	• Bankers' Acceptances are clearly money market securities and are treated as such in State Statute and Regulation.
Safekeeping	• Change the safekeeping agent from U.S. Bank to State Street Bank.	• State Street Bank is the State's new safekeeping agent.
Risk Management	• The Prospectus says that "the State Investment Commission expressly prohibits the use of leverage or the posting of margin." This statement should be qualified to note that the Pool may engage in securities lending and reverse repurchase agreements.	• The Prospectus states that the Pool may engage in securities lending. Although the Prospectus is silent on the topic of reverse repurchase agreements, KAR 14:011 does permits the use of this investment tool. The Prospectus needs to fully disclose that the Pool may use leverage in certain circumstances.
Securities Lending	• Change the securities lending agent from Credit Suisse/First Boston to Deutsche Bank.	• Deutsche Bank is the State's new securities lending agent.

Intermediate-Term Pool Prospectus (continued)

Issue	Proposed Change	Rationale
Overall Impression	• Edit the Prospectus to provide more information to Pool investors • Typically, information on the following topics is provided to investors in an extended term governmental investment pool: − Investment Policies − Detailed Description of Permitted Investments − Investment Practices including Use of Leverage and Securities Lending − Return Information − Performance Benchmarking − Valuation of Shares − Dividends and Distributions − Operational Details (Opening an Account, Buying Shares and Redeeming Shares)	• The Intermediate-Term Prospectus includes many of the components generally included in an extended term government pool information statement, but more specifics about the operation of the Pool would be helpful. This is particularly important because of the additional risk characteristics and return volatility of longer duration funds.

Summary of Recommendations

Investment Type	Permitted Investments		Credit Quality Requirements		Maturity Limitations	
	Statute	Regulation	Statute	Regulation	Statute	Regulation
U.S. Treasury Obligations	100%	100%				7 years or with a put of <3 years
U.S. Gov't Corporation /GSE	100%	100%				7 years or with a put of <3 years
Certificates of Deposit	100%	$25,000,000 per issuer	A	~~A~~ A-1		9 months
Bankers' Acceptances	100%	$10,000,000 per issuer	A	~~A~~ A-1		6 months
Commercial Paper	100%	$25,000,000 per issuer	A -1	A -1		9 months
Municipal Obligations	100%	100%	A	~~A~~ AA		5 years
Corporate, Yankee, Eurodollar Securities	100%	$25,000,000 per issuer	A	~~A~~ AA		5 years or with a put of < 3 years
U.S. dollar denominated Sovereign Debt	100%	5% or $25,000,000 whichever is less	A	~~A-1~~ AAA		5 years
Asset-backed Securities (ABS)	100%	20%	AAA	AAA		Average life < 4 years
Mutual Funds	~~10%~~ 100%	~~10%~~ 20% per mutual fund	~~90%~~ 100% of holdings in KY permitted investments and AAA rating	~~90%~~ 100% of holdings in KY permitted investments and AAA rating		
Repurchase Agreements and Reverse Repurchase Agreements	100%	100%				1 year/ 3 years for the Kentucky Bank Repurchase Program
Mortgage pass-through securities		25%				Average life < 4 years
Real estate mortgage investment conduit obligations (CMO)		25%		~~A~~ AAA		Average life < 4 years
~~Eurodollars Deposits~~		~~100%~~		~~A-1~~		~~9 months~~
Securities Lending Agreements		100%				
Corporate/Yankee/CP/BA/CDs		25%				
Floating Rate Security						~~No limit~~ 5 Years

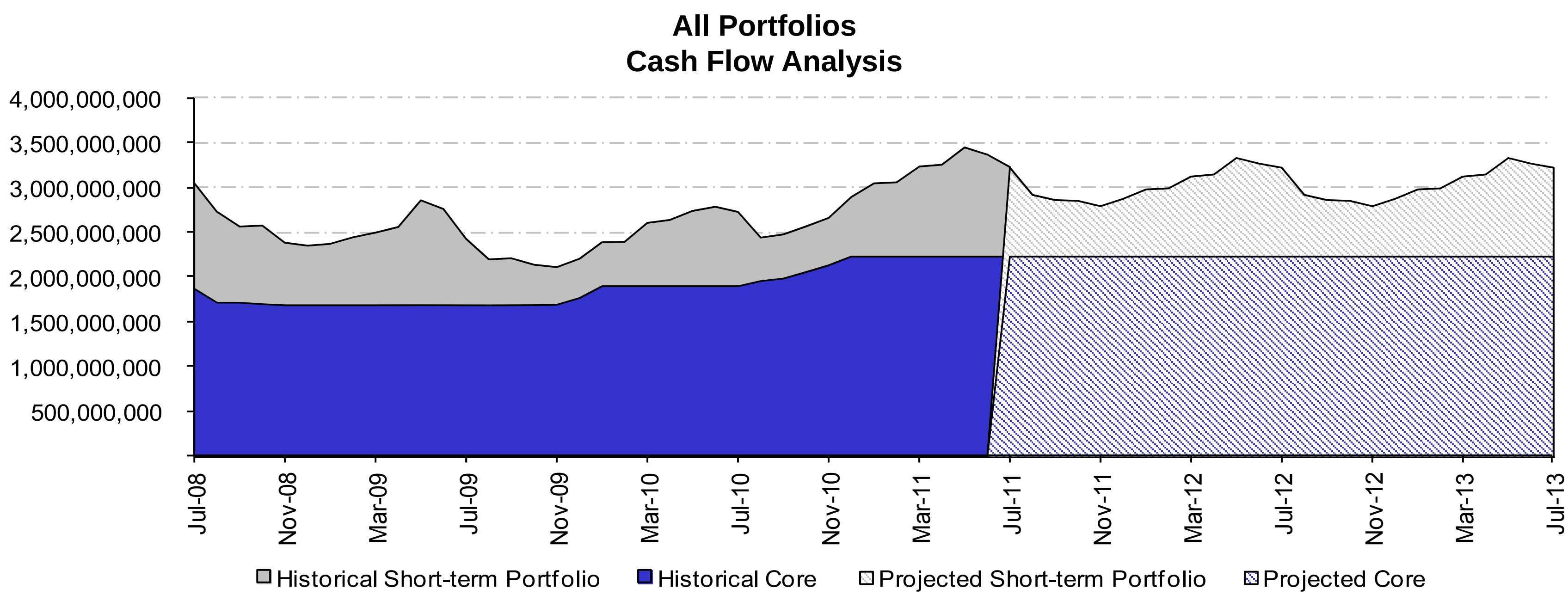
Use of Securities Lending

Topic	Observations	Recommendations
Securities Lending	• Statute permits the State to engage in securities lending on securities held in the portfolio. • 63% of all States allow securities lending. • Kentucky recently selected Deutsche Bank as its new securities lending agent through a competitive procurement process. • The State does not have a written securities lending policy. • During the financial crisis of 2008, many public entities found that their securities lending programs were not as secure as they believed. Cash collateral had been invested in securities that became illiquid (or defaulted) and the lending agent's indemnification did not cover the losses.	• Securities lending can add incremental return, but it also subjects a portfolio to several types of risk. In order to properly control the use of securities lending, the State should develop detailed written policies describing how and when securities lending will be used. It is not sufficient to set limits only on the lending of securities. To control risk, it is necessary to also establish limits on the investment of cash collateral. The securities lending policy should include: 1. Written Agreements a. Lending Agent Agreement b. Master Securities Loan Agreement with Borrowers 2. Cash Collateral Management a. Coverage b. Responsibility for Monitoring Collateral Sufficiency c. Standard of Prudence d. Custodial Agent e. Segregated or Commingled Pool f. Loan/Cash Collateral Mismatch 3. Cash Collateral Investment a. Permitted Investments b. Diversification by Asset Type and Issuer c. Maximum Maturity Limitations d. Average Maturity/Duration Limitations e. Minimum Liquidity f. Credit Quality g. Prohibited Investments 4. Eligible Borrowers a. Credit Quality b. Diversification 5. Reporting a. Activity b. Notice of Credit or Other Problems c. Income 6. Indemnification

Investment Approach

Cash Flow Forecast – Total Portfolio

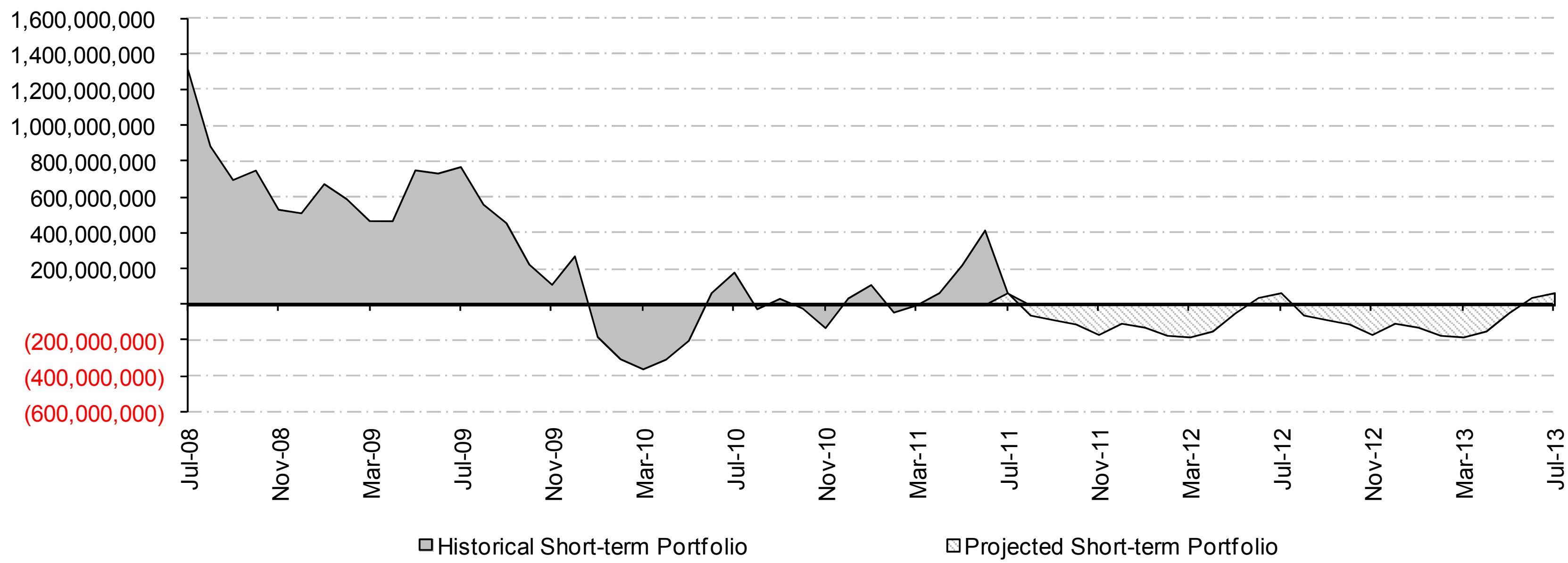
Topic	Observations	Recommendations
Total Fund	• The State's cash flows show strong seasonality with balances peaking in May and dropping to an annual low in November. • There was annual growth of 8.1% during the period from July 2008 through June 2011. • Using average monthly balances and assuming a 20% excess liquidity cushion, it appears that the State has a core balance of $2.2 billion.	• A formal cash flow projection would help the State to determine how much of each fund must remain liquid and how much is available for longer term investment. Further, it could help the OFM to structure the Intermediate Term Pool in an optimal way to potentially increase investment earnings. • The current balance in the Short-Term Pool appears to be consistent with the amount (across all accounts) that requires a high degree of liquidity.



Cash Flow Forecast – Short Term Pool

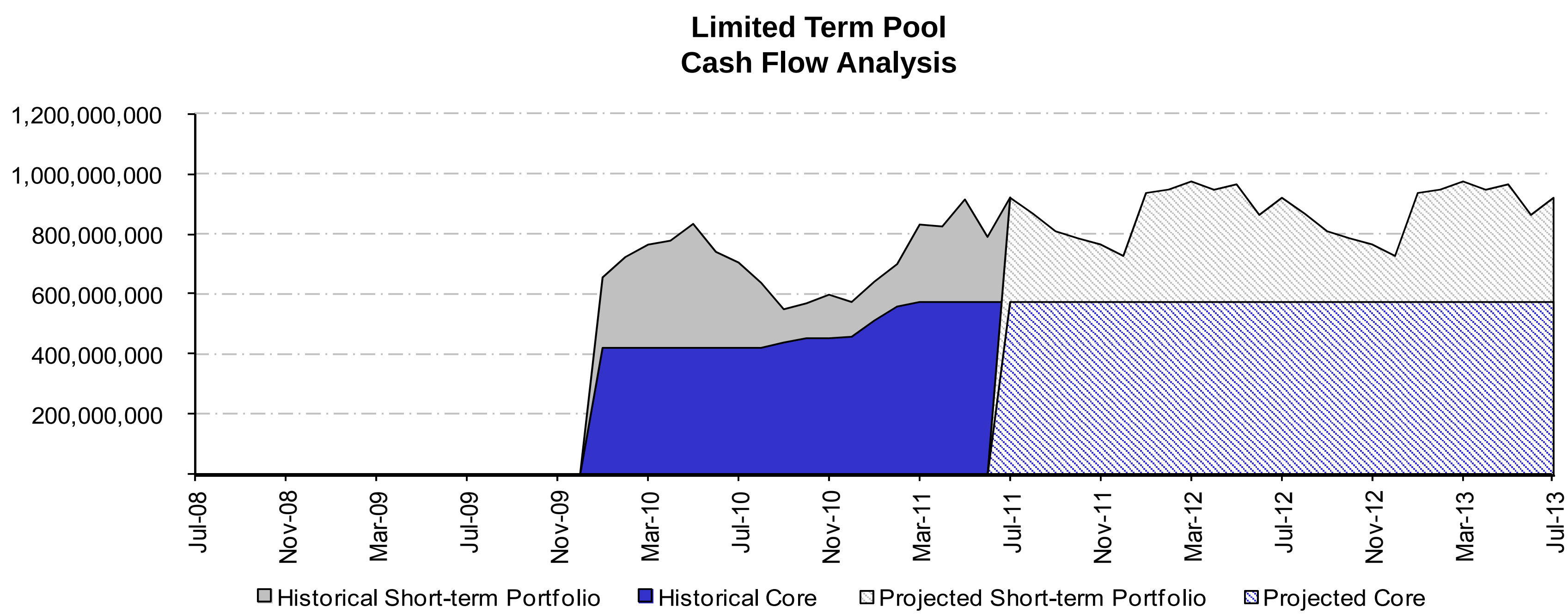
Topic	Observations	Recommendations
Short Term Portfolio	• The Short-Term Pool was divided into the Short-Term and Limited Term Pools in January 2010. This change has created balance stability in the Limited Term Pool and shifted the major balance fluctuations to the Short-Term Pool. • The Pool contains monies belonging to the General Fund and any agency account that is not entitled to retain income. • Inter-fund borrowing by the General Fund from the Short-Term Pool creates negative balances. • Given the variability in balances since January 2010, it is difficult to use historic cash flows to predict future balances.	• Consider short-term borrowing options such as tax and revenue anticipation notes (TRANS), tax-exempt commercial paper, and bank credit lines as an alternative to inter-fund borrowing. • In certain market conditions, borrowing in the tax-exempt market may be less costly than borrowing from the Pool. Of course, debt capacity and current credit ratings will need to be considered.

Short Term Pool
Cash Flow Analysis



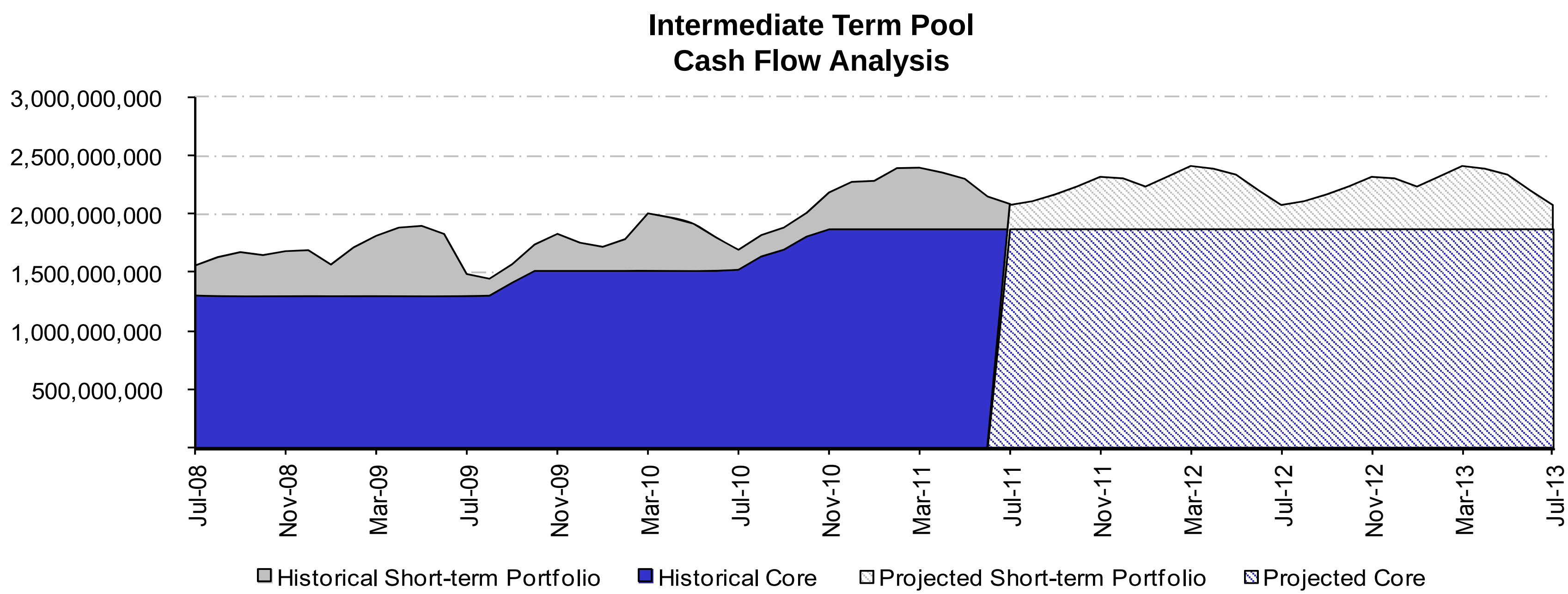
Cash Flow Forecast – Limited Term Pool

Topic	Observations	Recommendations
Limited Term Portfolio	• The Limited Term Pool is for accounts that are entitled to retain income and need a high degree of liquidity and/or funds that can not afford to have negative earnings. • The Limited Term Pool cash flows show strong seasonality with balances peaking in May and dropping to an annual low in July. • There was 7.1% annual growth in the Limited Term Pool during the period from January 2010 through June 2011. • The Limited Term Fund is managed to provide daily liquidity and to maintain a constant net asset value of $1.00 per share.	• Operate the Limited Term Pool in accordance with the SEC's 2a-7 Rule, which specifies that a constant net asset value of $1.00 be maintained to facilitate the provision of liquidity to meet investor needs.



Cash Flow Forecast – Intermediate Term Pool

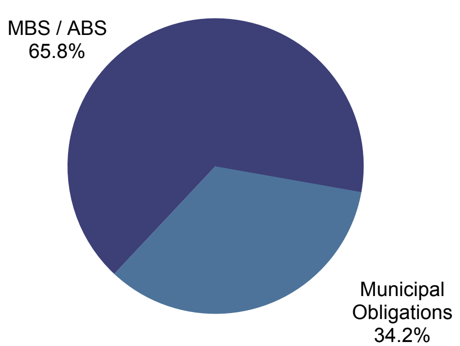
Topic	Observations	Recommendations
Intermediate Term Portfolio	• The Intermediate Term Pool contains all funds not held in either the Short Term Pool or the Limited Term Pool, including bond proceeds. • The Intermediate Term cash flows show modest seasonal fluctuations with balances peaking in March and dropping to an annual low in July. • There was 13.3% annual growth in the Intermediate Term Pool during the period from July 2008 through June 2011. • The balances in the Intermediate Term Pool have been fairly constant, but fluctuations of $700 million (from annual highs to lows) suggest that the Pool must maintain a liquid balance of at least $700 million. Historically, liquidity and duration have been a function of seasonal cash flows for this fund.	• In conjunction with the overall cash flow forecast for all State funds, monitor balances in the intermediate term pool to adjust liquidity to meet investor needs.



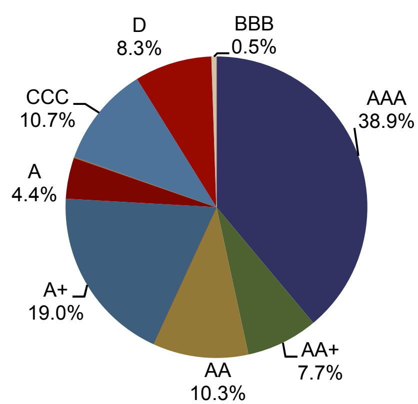
Portfolio Structure – Short Term Pool (10/20/11)

Topic	Observations	Recommendations
Asset Allocation	• The Short-Term Pool has the highest concentration of distressed securities. • Over 65% of the Pool is invested in asset backed securities, some of which are illiquid.	• PFM's security specific recommendations can be found on page 45 of this report.
Credit Quality	• The credit quality of pool holdings varies from D to AAA. The average credit quality is single-A. • 19% of this portfolio is below investment grade.	
Maturity Distribution	• The maturity of portfolio holdings range from overnight to 30 years; 62% of the securities this portfolio have final maturities of longer than 10 years. • The effective duration for the Pool is 1.24 years.	

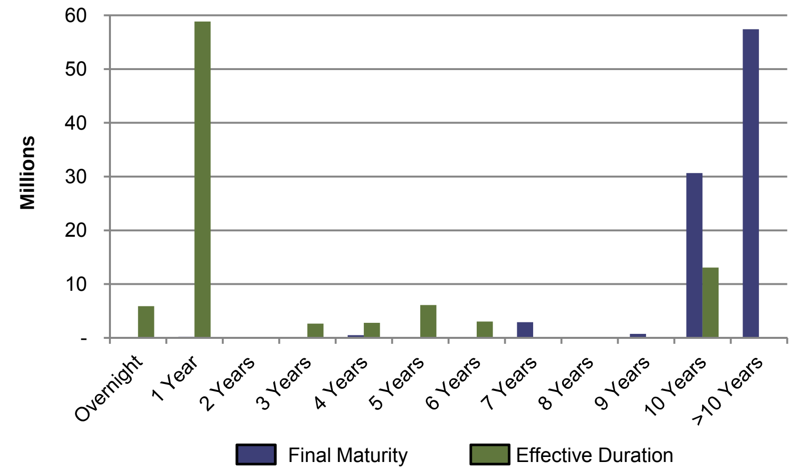
Short-Term Portfolio Holdings



Short-Term S&P Credit Quality



Short-Term Maturity Distribution (Final Maturity vs. Effective Duration)

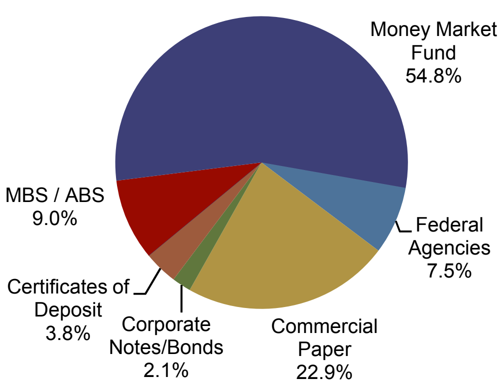


MBS/ABS – Mortgage Backed Securities/ Asset Backed Securities

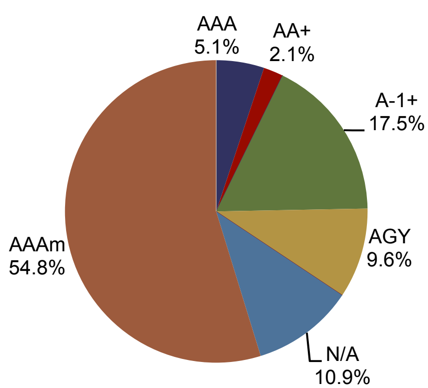
Portfolio Structure – Limited Term Pool (10/20/11)

Topic	Observations	Recommendations
Asset Allocation	• This portfolio is well diversified among certificates of deposit, corporate notes, commercial paper, federal agencies, mortgage backed securities and money market funds.	• The mortgage backed securities have relatively long final maturities for a 2a-like fund. These securities should be liquidated or transferred to one of the longer-term pools.
Credit Quality	• The credit of this portfolio is high, with an average credit quality of AAA.	• No recommendations.
Maturity Distribution	• 91% of the securities in the Limited Term Pool mature in one year or less. The remaining securities mature in 1 to 24 years. • The duration of the Pool is approximately 45 days. • The weighted average maturity of the Pool is 235 days.	• PFM recommends formally adopting the maturity restrictions from SEC Rule 2a-7. This would require limiting the final maturity of Pool holdings to 397 days and maintaining a weighted average maturity of less than 60 days.

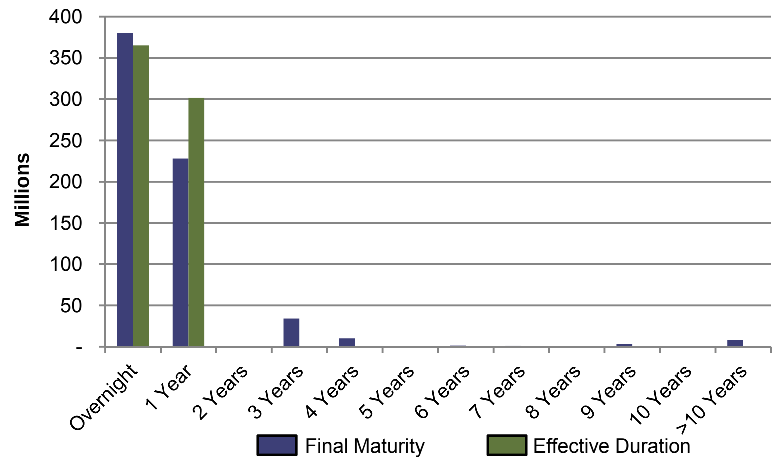
Limited Term Portfolio Holdings



Limited Term S&P Credit Quality



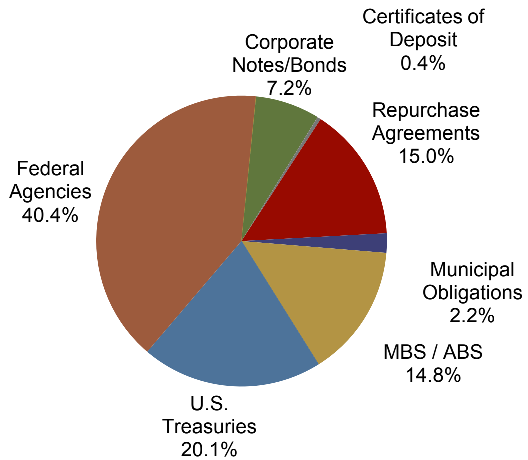
Limited Term Maturity Distribution (Final Maturity vs. Effective Duration)



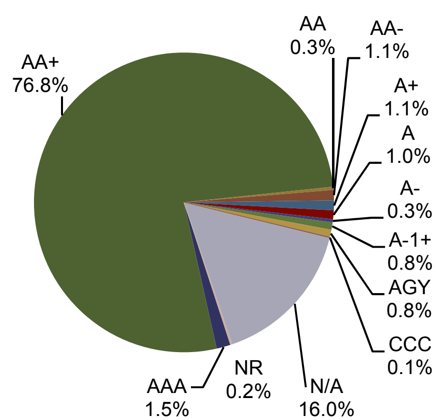
Portfolio Structure – Intermediate Term Pool (10/20/11)

Topic	Observations	Recommendations
Asset Allocation	• This portfolio is well diversified among repurchase agreements, federal agency securities, corporate notes, certificates of deposit, municipal obligations, asset backed securities, and U.S. Treasury notes.	• The allocation to short-term repurchase agreements seems high for an extended term fund with limited liquidity needs. Consider shifting a portion of these monies to longer-term securities to enhance return.
Credit Quality	• The credit quality of pool holdings varies from CCC to AAA. The average credit quality is AA.	• PFM's security specific recommendations on the distressed and 144A holdings in this portfolio can be found on page 45 of this report.
Maturity Distribution	• The maturity of portfolio holdings range from overnight to 30 years. • The effective duration for the Pool is 1.18 years	• The duration of the portfolio is significantly short of the benchmark duration. Consider extending the duration to better match the targeted investment approach and to enhance returns.

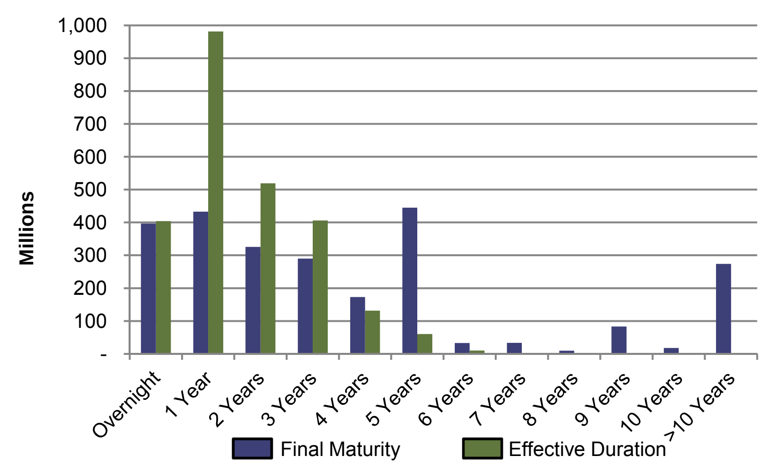
Intermediate-Term Portfolio Holdings



Intermediate-Term S&P Credit Quality



Intermediate-Term Maturity Distribution (Final Maturity vs. Effective Duration)



Credit Analysis

Topic	Observations	Recommendations
Credit Assessment	• Investment staff relies on credit work performed by Nationally Recognized Statistical Rating Organizations (NRSROs). • The Office of Financial Management (OFM) does not conduct independent credit research on securities it is considering buying or on existing portfolio holdings.	• The NRSROs provide a valuable service, but their track record in recent years suggests that the ratings provided by NRSROs should not be the sole source of information used to evaluate credit sensitive securities. PFM recommends that the State perform its own independent credit assessment to augment the work of the NRSROs. • Continuing education in this area is suggested for the investment staff. Training is available from a number of sources including the rating agencies, professional associations and the CFA Institute. • Given the limited number of staff members assigned to managing the State's assets, it could be a challenge for them to find time to undertake this important credit task. It may be necessary to add additional staff or transition some current responsibilities to others.
Approved Issuer List	• The State does not currently maintain a list of issuers that meet its statutory, regulatory and internal credit criteria.	• The State should develop an "approved issuer list" that shows those issuers that meet statutory and regulatory minimum credit ratings and that have been deemed creditworthy by OFM staff. A regular, proactive review of this list – in light of current conditions – should be performed. Documentation of the credit work done on these issuers should be maintained. • The approved credit list should be provided to the SIC periodically.

Management of the Short-Term Pool

Topic	Observations	Recommendations
Background	• The Prospectus for the Short-Term Pool states that the pools (Short and Limited Term) operate in a manner designed to maintain a constant net asset value. This means that the price at which pool 'shares' are bought and sold is managed to remain at $1.00. This simplifies the accounting for pool shares for investors. • GASB Statement 31 allows governmental investors to report investment pool shares at $1.00 (instead of a price that reflects the market value of underlying investments) as long as the pool meets the requirements of a "2a-7 Like Fund". In order to qualify as a 2a-7 Like Fund, the investment pool must generally follow SEC Rule 2a-7 (the regulations for registered money market mutual funds). • GASB 59 has recently amended Statement 31. Now, to qualify as a 2a-7-Like Fund, a pool must satisfy ALL requirements of Rule 2a-7. In recent years, many governments had been selective about which rules they followed. • GASB 59 applies to financial statements for periods beginning after June 15, 2010. • Rule 2a-7 was modified in 2010 to tighten liquidity, credit, diversification and reporting standards.	• Operating guidelines for the Limited Term Pool should be updated to reflect changes to Rule 2a-7. • Because of current portfolio holdings and regular periods of negative balances, it is not feasible to operate the Short-Term Pool in accordance with Rule 2a-7.

A complete copy of Rule 2a-7 is provided in the Appendix.

Management of the Limited-Term Pool

Topic	2a-7 Requirement	Recommendations
Board of Directors	• A group must fulfill the functions of a Board of Directors. • Investment policies must be set by the Board. • The Board must have the authority to suspend redemptions in emergency situations.	• The State Investment Commission currently fulfills most of the requirements of a money market fund Board and can continue to serve in this capacity. • Additional reporting and oversight responsibilities will need to be added with regard to approval of approved credit lists and review of periodic stress tests.
Net Asset Value (NAV)	• The fund may sell shares at a constant price of $1.00 as long as the shadow (market value) NAV is within 0.05% of 1.00. This is referred to as the "amortized cost method." • The fund must report a shadow (market value) NAV to investors. • The fund must have the technical capability of selling/redeeming shares at a price other than $1.00.	• The State does not currently calculate the net asset value (NAV) per share; a constant NAV of $1.00 is assumed. Procedures for computing the NAV using the amortized cost of the portfolio will need to be implemented. • The shadow NAV using the market value of portfolio holdings in lieu of amortized cost will need to be computed periodically. • The shadow NAV must be made available to the Board and to investors. • The Board will need to adopt procedures for how the pool will operate in the event that the shadow NAV varies by more than 0.05% from the NAV.
Maturity	• The maximum weighted average maturity ("WAM") for the pool may not exceed 60 days. • The maximum weighted average life ("WAL") of the pool may not exceed 120 days. • The maximum maturity of any security with a fixed maturity is 397 days. Variable rate securities may have a longer final maturity.	• The current maximum weighted average maturity of 90 days should be shortened to 60 days. • A maximum weighted average life limit of 120 days should be adopted. • The current maximum maturity of one year can be extended to 397 days.

Management of the Limited-Term Pool (continued)

Topic	2a-7 Requirement	Recommendations
Quality	• No more than 5% of a pool may be invested in the obligations of a single issuer, except government obligations. • No more than 3% of the pool may be invested in second tier securities. • No more than 0.5% of the pool may be invested in a single second tier issuer. • The maximum maturity of a second tier security must be limited to 45 days.	• The State's current diversification standards are primarily set as a dollar value of the portfolio. In most cases, these limits are more restrictive than the 5% limit imposed by Rule 2a-7. The investment parameters for the Pool should be amended to limit investments by issuer to no more than 5% or the specified maximum dollar amount, whichever is less. • There is currently no limit on the investment of funds in second tier securities so appropriate limits should be established. The portfolio did not hold any Tier 2 securities as of October 20, 2011.
Repurchase Agreements	• Collateral on repurchase agreements must be limited to cash or government securities. • The Board must set counterparty credit quality standards.	• The proposed changes to limit collateral on repurchase agreements to U.S. Treasury and Federal Agency obligations will address the Rule's collateral requirements for repurchase agreements. • The Short-Term Prospectus currently sets counterparty credit standards. No additional action will be needed.
Stress Test	• Periodic stress testing of the NAV is required to calculate market value NAV fluctuations in the event interest rates move up sharply, the credit quality of portfolio holdings deteriorate and/or there are large deposits/redemptions from the pool. • Reporting of stress test results must be made to the Board no less than quarterly. • The pool must identify any investors whose redemptions may pose risk to the fund (typically, large investors).	• The State will need to develop a methodology for stress testing the Pool and then implement a process for performing the test each quarter.
Reporting	• A list of portfolio holdings must be published to a website each month. The report must remain on the website for 6 months. • Comprehensive reports must be provided to the Board.	• The State's website will need to be updated to allow the Pool's holdings be posted in a timely manner each month. • A report showing 2a-7 required information should be developed for the Board.

Staffing

Topic	Observations	Recommendations
Current Staffing	• OFM portfolio management staff is experienced and knowledgeable about the sectors of the fixed-income market in which they operate. • There appears to be limited time or resources for continuing investment education. • The Commonwealth has a relatively small investment staff given the size and complexity of its portfolio.	• Although staff is experienced and knowledgeable, the investment markets are constantly changing and providing new challenges. Brokers/dealers can provide useful information, but they can be conflicted. Regular contact and communication with peers and industry experts is critical to staying abreast of market conditions. • The State should provide investment staff with opportunities for advanced and ongoing training on investment topics and strategies. Training is available from the CFA Institute, American Institute of CPAs, the rating agencies and at various industry conferences. At least 10 continuing professional education credits in relevant coursework (credit analysis and other investment topics) should be targeted for each key member of the State's investment staff each year. SIC members may also find some investment training to be of value in helping them to fulfill their oversight responsibilities. • Consider either adding additional staff resources, limiting the portfolio approach to less complex securities or delegating some responsibilities of senior portfolio managers to others. This would give those managers more time to focus on the portfolio and credit analysis.

Portfolio Challenges

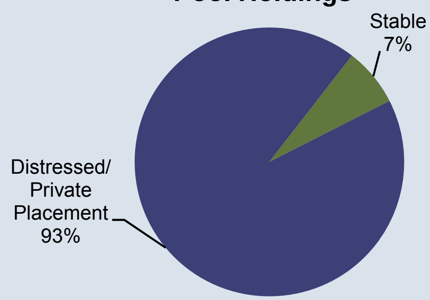
Distressed Securities (10/20/2011)

Topic	Observations	Recommendations
Distressed Securities	• For purposes of this report, PFM has categorized a security as "distressed" if is: – Illiquid – Has a market value of less than 95% of its book value – Has been downgraded below investment grade • Twenty-three securities, with a book value of $113 million were deemed to be distressed.	• The decision to hold or sell a distressed security can be a difficult one. – In many cases, the market value of these securities has fallen well below the book value and a sale would result in the realization of a loss. Since the State has not yet written down the value of the distressed securities, the sale (and realization of losses) could create a budget problem for some funds. – A least one of the distressed securities is simply illiquid and it would be difficult to sell at any price. • An argument can be made that it is better to hold some of the distressed securities and continue to receive the cash flows than to realize large losses. PFM has assessed possible future cash flows for distressed securities in the portfolio to determine the theoretical value and compared that number to the price that an investor would pay in this market. Our recommendations consider this analysis.
Private Placements	• The SEC allows issuers to sell certain equity and debt securities without registration to investors that meet the requirements of a "Qualified Institutional Buyer" or QIB. These securities are referred to as private placements. • In the secondary market these restricted securities can only be sold to another QIB. • Thirteen of the obligations in the State's portfolio, with a book value of $94 million, were issued under SEC Rule 144A and may only be sold to a QIB.	• Based on legal analysis performed by other public entities, PFM does not believe that the Commonwealth of Kentucky qualifies as a QIB. Therefore, it should not have been sold, nor should it have purchased, securities issued under Rule 144A. The Commonwealth should consult competent legal counsel to determine if it agrees with this assessment. • If the State's legal counsel concurs with this assessment, it is our recommendation that the 144A securities by sold. • The State may be able to recover any lost value from the broker . At least one other State has been able to recover its initial investment on a defaulted private placement security.

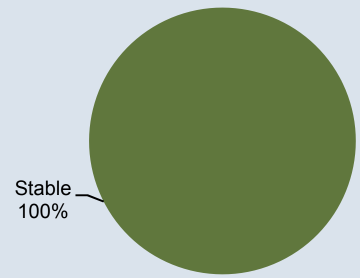
A copy of Rule 144A of the Securities Act of 1933, which includes the definition of a Qualified Institutional Buyer is provided in the Appendix.

Holdings of Distressed and Private Placement Securities

Short-Term Pool Holdings



Limited-Term Pool Holdings



Intermediate-Term Pool Holdings

Topic	Observations	Recommendations
Affected Portfolios	• PFM identified 29 securities as "distressed" or 144A Private Placement • The majority of these securities are held in the Short-Term Pool.	• When liquidating a distressed or thinly traded security, a liquidity premium of 5% is considered to be a fair market premium. • If the bid price differs from the theoretical value (using cash flow analysis), it may make sense to hold the security until better pricing is available • PFM recommends selling 22of the distressed and 144A securities and holding 7 if good pricing can be realized.

	Sell			Hold		
	Book Value		Gain / Loss	Book Value		Gain / Loss
Distressed						
Mortgages	$ 28,038,364	7	$ (14,505,532)	$ 18,674,695.06	7	$ (6,818,565.76)
Municipal	$ 4,175,000	1	$ (626,250)	$ -	-	$ -
Private Placement	$ 58,016,344	7	$ (3,673,194)	$ -	-	$ -
Other	$ 4,100,000	1	$ (1,312,000)	$ -	-	$ -
	$ 94,329,708	16	$ (20,116,976)	$ 18,674,695.06	7	$ (6,818,565.76)
Non-Distressed						
Private Placement	$ 35,940,607	6	$ (311,987)			
	$ 35,940,607	6	$ (311,987)			

Sell/Hold Recommendations by Security

Issuer	Description	Book Value	Market Values from Pricings Sources: State Street October 2011	Market Values from Pricings Sources: Bloomberg November 2011	Market Values from Pricings Sources: IDC October 2011	Market Values from Pricings Sources: Broker November 2011	Greatest Difference in Price	Recommendation
Indymac Indx Mortgage Loan Trust	CMO	3,249,380.35	81.03	75.37	81.03	mid 70s	(787,764.54)	Hold
JP Morgan Mortgage Trust	CMO	2,067,474.27	99.12	96.00	99.12	mid 90s	(157,956.57)	Hold
Countrywide Alternative Loan Trust	CMO	10,609,750.29	57.38	67.03	67.84	low 60s	(4,530,551.19)	Sell
Battery Park City NY Author	MUNI	4,175,000.00	100.00	n/a	n/a	mid 80's	(626,250.00)	Sell
Countrywide Asset-Backed Certificate	ABS	2,391,558.54	62.31	64.10	60.62	mid 50s	(946,465.95)	Sell
Countrywide Home Equity Loan Trust	ABS	4,442,329.40	34.88	n/a	34.88	hi 30s	(2,868,548.31)	Sell
Education Loan Co Trust+	MUNI	9,200,000.00	100.00	n/a	n/a	n/a	n/a	Sell
Greenpoint Home Equity Loan Trust	ABS	109,410.92	74.94	n/a	73.27	mid-hi 70s	(33,945.50)	Hold
Residential Asset Securitization	CMO	4,341,738.96	60.92	47.45	49.07	mid 30s	(2,824,488.96)	Sell
Morgan Stanley Mortgage Loan Trust	CMO	5,774,034.26	52.33	51.92	48.98	low 50s	(2,970,731.45)	Hold
Morgan Stanley Mortgage Loan Trust	ABS	4,919,360.66	56.53	38.82	52.11	mid 40s	(3,062,839.21)	Sell
Residential Funding Mortgage Security	ABS	570,130.06	85.75	91.17	85.75	low 90s	(121,643.44)	Hold
RTP Student Loan Trust+	MUNI	8,250,000.00	100.00	n/a	n/a	n/a	n/a	Sell
SLM Student Loan Trust	ABS	4,100,000.00	100.00	n/a	n/a	hi 60's	(1,312,000.00)	Sell
US Education Loan Trust+	MUNI	10,000,000.00	100.00	n/a	n/a	n/a	n/a	Sell
Wachovia Bank Commercial Mortgage+	CMBS	10,003,296.60	88.16	n/a	88.16	n/a	(1,187,146.60)	Sell
Wachovia Bank Commercial Mortgage+	CMBS	9,999,550.50	88.16	n/a	88.16	n/a	(1,183,400.50)	Sell
Merrill Lynch Mortgage Investor	ABS	545,521.42	87.75	88.05	87.75	low 60s	(72,533.83)	Sell
Bear Stearns Alt-A Trust	ABS	5,040,858.22	69.84	56.44	69.84	low 50s	(2,495,978.22)	Hold
Structured Asset Mortgage Investment	CMO	1,863,406.98	80.72	79.77	80.72	low 80s	(250,546.04)	Hold
Saco I Trust+	ABS	559,238.71	38.03	48.08	38.03	mid 20s	(419,488.71)	Sell
Countrywide Alternative Loan Trust	ABS	788,104.63	93.18	n/a	93.18	mid 70s	(200,104.63)	Sell
Commercial Mortgage Pass-Through+	CMBS	10,004,258.00	91.21	n/a	91.21	n/a	(883,158.00)	Sell
Kentucky Utilities+	ABS	4,787,014.50	97.46	n/a	n/a	n/a	85,785.50	Sell
Morgan Stanley+	ABS	15,000,000.00	100.00	n/a	n/a	n/a	n/a	Sell
New York Life Global Fdg+	CORP	7,500,000.00	99.98	99.90	99.98	n/a	(7,650.00)	Sell
Kingdom of Sweden+	SOVG	2,993,975.10	99.27	101.10	99.27	ct3+37 area	(15,791.10)	Sell
USAA Capital Corp+	CORP	1,998,038.40	100.09	98.69	100.09	n/a	(24,178.40)	Sell
Commercial Mortgage Pass-Through+	CMBS	3,661,578.92	97.71	n/a	97.71	n/a	(350,153.13)	Sell
Total		**148,945,009.69**					**(27,247,528.78)**	

+ 144A Private Placement

Securities identified as distressed

Securities identified as non-distressed

An detailed description of each security and PFM's assessment is provided in the Appendix.

Accounting

Unrealized Loses

Topic	Observations	Recommendations
Income Distribution	• The investment income of the Short-Term Pool (both Short- and Limited Term) is declared daily as income to each qualifying account at the close of the business day. • Net income consists of: (i) interest accrued and discount earned (ii) less amortization of premium and expenses. Cash income is distributed monthly. Any realized gains/losses are also included in the investment income calculation. • Investment income is distributed to investors in the Pool to the extent that cash has been received. In other words, income is calculated on an accrual basis, but distributed on a cash basis. Theoretically, total cash distributed will equal the total calculated investment income figure only at the termination of the Pool or if all investment securities mature on the last day of the month. OFM staff explained that the methodology for paying the investment income in this manner is the result of limitations in the State accounting policies.	• For the Short-Term Pools, the State distributes investment income when received in cash. GAAP standards would suggest that investment income should be distributed on an accrual basis. Most government investment pools and all money market mutual funds distribute income on an accrual basis. Using a full accrual approach allows investors to receive the complete amount of investment income earned each month. • At minimum, the State should prepare a monthly reconciliation to confirm that the amount of earned but unpaid investment income is equal to the expected future cash flows from the portfolio. • A balance sheet should be developed for the Limited Term Fund to aid in calculation of the net asset value and shadow (market value) net asset value. The balance sheet can also be used to reconcile income distributed and income accrued but not yet distributed.
Unrealized Losses	• As of November 2011, the distressed and 144A securities in the portfolio had unrealized losses of $20 to $27 million. Approximately, 96% of the losses relate to securities in the Short-Term Pool with the remainder attributable to the Intermediate-Term Pool. Based on the current size of the Short-Term Pool, the unrealized losses represent 17- 23% of the book value. • There has been a reluctance to recognize losses because of budgetary concerns.	• GASB Statement 31 requires that portfolio securities be valued at "fair value" as of fiscal year end. Any difference between the holding value and fair value of portfolio securities is supposed to be reflected on the income statement as either an increase or reduction to income. • PFM recommends that the State begin to write down the affected securities so that the financial statements better reflect the true value of the asset. This process can be done gradually to minimize the budgetary impact. It may also be appropriate to net the realized losses against current period earnings to avoid having to post "negative earnings." • For securities that are sold at a loss, it may be possible to offset some or all of that loss by selling securities at a gain.

Net Asset Value Calculation

Topic	Observations	Recommendations
Maintaining Stable $1.00 Pool Share Price (NAV)	• A 2a-7 Fund may sell shares at a constant price of $1.00 as long as the shadow (market value) NAV is within 0.05% of 1.00. This is referred to as the "amortized cost method." • The fund must report a shadow (market value) NAV to investors.	• The State does not currently calculate the net asset value (NAV) per share; a constant NAV of $1.00 is assumed. Procedures for computing the NAV using the amortized cost of the portfolio will need to be implemented. • The shadow NAV using the market value of portfolio holdings in lieu of amortized cost will need to be computed periodically. • A sample NAV and Shadow NAV calculation is provided below.

Sample Net Asset Value (NAV) Calculation

	NAV	Shadow NAV
+ Amortized Cost	$ 2,257,415,346	
+ Market Value of Pool's Securities		$ 2,259,661,921
+ Other Assets - Cash, Accrued Interest, etc.	$ 8,459,116	$ 8,459,116
– Liabilities - Dividends Payable, Accrued Expenses, etc.	$ 135,583,533	$ 135,583,533
Total Assets	$ 2,130,290,929	$ 2,132,537,504
÷ Shares Outstanding	$ 2,130,290,929	$ 2,130,290,929
= Net Asset Value Per Share	**$1.00**	**$ 1.00105**

Amortized Cost Method of valuation means the method of calculating an investment company's net asset value whereby portfolio securities are valued at the fund's acquisition cost as adjusted for amortization of premium or accretion of discount rather than at their value based on current market factors

Performance

Intermediate-Term Pool Performance – Trailing Periods

Topic	Observations	Analysis
Cumulative Performance *For periods ended 9/30/11*	• The Intermediate-Term Pool equaled its benchmark for the trailing 10 year period. It underperformed the benchmark for the 1, 3, 5, and 7 year trailing periods. • The average duration of the Pool was 1.27 years versus 1.48 for the benchmark, which is likely to account for some of the underperformance during the recent bull market.	• The table below compares the Pool's performance to two alternative benchmarks: – **A blend of the 75% Merrill Lynch 1-3 year Agency Index and 25% the ML 0-3 month Treasury Index.** This benchmark has a duration to the State's current duration and eliminates the mortgage component. The Pool outperformed this benchmark over the full 10 year period, but has underperformed in recent years. – **The Merrill Lynch1-3 Year Agency benchmark.** This is the highest performing of the three benchmarks in all but the most recent 12 month period. The Pool underperformed this benchmark. Much of the underperformance is likely to have been caused by the relatively short duration of the State's portfolio in recent years.

Intermediate-Term Pool
Total Return Performance (Annualized)
For Trailing Periods Ending September 30, 2011

	Average Duration[3]	1 Year	3 Year	5 Year	7 Year	10 Year
Kentucky Performance[1]	1.27 years	1.21%	2.38%	3.48%	3.34%	3.35%
Custom Benchmark [2]	1.48 years	1.43%	2.70%	3.82%	3.50%	3.35%
75% 1 - 3 Year ML Agency & 25% 0 to 3 ML Month Tsy	1.23 years	0.99%	2.46%	3.49%	3.31%	3.18%
1 - 3 Year ML Agency Index	1.64 ears	1.29%	3.23%	4.13%	3.69%	3.60%

(1) Annualized Yields converted to periodic total returns by multiplying by 1 / 12. Data provided by KY Office of Financial Management
(2) Custom benchmark is 70% of the 1 to 3 Year Merrill Lynch Government Index, 15% 0 to 3 Month Merrill Lynch Treasury Bill Index, and 15% Merrill Lynch Mortgage Backed Securities with a 0 to 3 year weighted average life.
(3) For the 10 year period ending September 30, 2011.

Highest performing

Intermediate-Term Pool Performance – By Year

Topic	Observations	Analysis
Annual Performance *For periods ended 9/30*	• The Pool outperformed the benchmarks in 2004, 2005 and 2009. • The mortgage component of the portfolio appears to have helped performance during 2004 and 2005.	• During much of the decade, corporate and mortgage holdings did little to enhance performance and were a drag on returns (compared to government only benchmarks). • This analysis suggests that the current benchmark may not be appropriate given the investment strategy (asset allocation and duration) employed by the OFM during the past decade.

Intermediate-Term Pool
Total Return Performance (Annualized)
Calendar Year Data

	2011 YTD	2010	2009	2008	2007	2006	2005	2004	2003	2002
Kentucky Performance[1]	1.21%	1.38%	2.95%	4.52%	6.06%	4.52%	2.32%	2.04%	2.13%	5.92%
Custom Benchmark [2]	1.43%	2.46%	1.77%	5.77%	6.76%	4.32%	1.96%	1.31%	1.84%	5.47%
75% 1 - 3 Year ML Agency & 25% 0 to 3 ML Month Tsy	1.36%	1.77%	1.66%	5.72%	6.25%	4.59%	2.07%	1.20%	1.90%	5.00%
1 - 3 Year Agency Index	1.29%	2.32%	2.17%	7.05%	6.73%	4.52%	1.77%	1.18%	2.19%	6.11%

(1) Annualized Yields converted to periodic total returns by multiplying by 1 / 12. Data provided by KY Office of Financial Management

(2) Custom benchmark is 70% of the 1 to 3 Year Merrill Lynch Government Index, 15% 0 to 3 Month Merrill Lynch Treasury Bill Index, and 15% Merrill Lynch Mortgage Backed Securities with a 0 to 3 year weighted average life.

(3) For the 10 year period ending September 30, 2011.

Highest performing

Performance

Topic	Observations	Recommendations
Portfolio Strategy Implications	• The inclusion of mortgage backed securities, private placements obligations and other complex security structures does not appear to have enhanced portfolio performance in the Intermediate-Term Fund during the past decade. • Over the full 10 year period, a Federal Agency strategy may have improved return by 0.25% (based on a comparison of the Pool's performance to the Merrill Lynch 1 – 3 Year Agency benchmark.) • The underweighting of Treasury obligations (relative to the benchmark) has had a detrimental effect on performance during the last 9 months.	• Because the inclusion mortgage backed securities, private placements obligations and other complex security structures has not enhanced the performance of the Pool compared to a strategy that invests primarily in Federal Agency obligations, the State should consider if it wishes to continue the current investment approach. Given the modestly sized investment staff, a simpler more conservative investment approach may be warranted for the Intermediate Term Fund. • The considerable volatility of Treasury benchmarks during the past year, as investors sought the safety of U.S. Treasury obligations, makes a Treasury only benchmark less desirable as a performance gauge.
Benchmark Recommendation – Short-Term and Limited-Term Pools	• The State did not provide detailed performance data for the Short-Term Pool. Therefore, PFM is not able to provide a performance assessment.	• PFM recommends that the State use two benchmarks to assess the performance of the Limited Term Pool. − The iMoneyNet First Tier Institutional Money Fund Index, a composite of registered money market mutual funds. − The Standard & Poor's Rated Government Investment Pool Index/General Purpose Taxable Index, a compilation of the returns on government investment pools rated AAAm by Standard & Poor's. • These indices report the performance of a basket of funds that comply with Rule 2a-7 and are widely used as performance benchmarks for government investment pools.

Performance

Topic	Observations	Recommendations
Benchmark Recommendation – Intermediate Term Pool	• The State currently uses a blended benchmark, made up of 70% of the 1 to 3 Year Merrill Lynch Government Index, 15% 0 to 3 Month Merrill Lynch Treasury Bill Index, and 15% Merrill Lynch Mortgage Backed Securities with a 0 to 3 year weighted average life to assess the performance of the Intermediate Term Pool. • Although the Intermediate-Term Pool has held securities that roughly matched the benchmark the Pool's performance has lagged. This may be a result of security selection, poor market conditions and/or a shorter duration.	• PFM recommends that the State use the BofA Merrill Lynch 1 – 3 Year Agency Index. This benchmark is an unmanaged index that tracks the performance of the direct sovereign debt of the U.S. Government having a maturity of at least one year and less than three years. Although there is no universally appropriate benchmark for governmental funds, the 1 – 3 Year Agency Index is commonly used for operating fund accounts that must be conservatively managed, but do not need regular liquidity. • During our review of the Commonwealth's investment strategy, there was discussion about the appropriate target duration for the Intermediate Term Pool. The 1 – 3 Year Agency benchmark recommended by PFM currently has a duration of 1.6 years. Because the Intermediate-Term Pool has significant cash flow fluctuations, the SIC may determine that a shorter duration approach is warranted. In this case, we would suggest a blended benchmark, containing 75% of the BofA Merrill Lynch 1 – 3 Year Agency Index and 25% of the BofA Merrill Lynch 0 – 3 Month U.S. Treasury Index. The duration of the blended benchmark is currently 1.23 years. • Because the current investment approach includes securities not included in the Agency benchmark, the OFM may wish to establish a shadow benchmark for the Intermediate Term Pool to more closely match the actual portfolio allocation. This internal management tool could be helpful in determining how much value is being added by including non-Government securities in the portfolio.

Appendix – Table of Contents

A. State Investments, Authorized and Asset Allocation

B. 42.500 State Investment Commission Powers *(Edited)*

C. Rule 2a-7 of the Investment Company Act of 1940

D. KAR 14:011 Qualified Investments *(Edited)*

E. KAR 14:081 Repurchase Agreements *(Edited)*

F. KAR 14:091 Guidelines for money market instruments *(Edited)*

G. Rule 144A, Private Resales of Securities to Institutions *(Qualified Institutional Buyer Requirements)*

H. Kentucky Distressed and 144A Security Analysis

State Investments, Authorized and Asset Allocation

Comparison of State Investment Policies

	CDs within state	CDs Nationally	State and Local Gov't Obligations	U.S. Treasury Obligations	U.S. Agency Obligations	Other time deposits	Bankers' acceptances	Commercial paper	Corporate notes/bonds	Mortgage backed securities	Mutual/Money Market funds	Eurodollars - CDs or TDs	Derivatives	Real estate	Repurchase agreements	Venture capital/ Private equity	Corporate stocks (foreign)	Corporate stocks (domestic)	Other
Alabama	y			y	y					y					y				
Alaska				y	y			y							y				
Arizona	y	y	y	y	y	y	y	y	y	y	y				y			y	
Arkansas	y		y	y	y	y	y	y	y	y	y				y			y	
California	y	y	y	y	y	y	y	y	y	y					y				(a)
Colorado	y		y	y	y		y	y	y						y			y	(b)
Connecticut	y	y		y	y	y	y	y	y		y				y				
Delaware	y	y	y	y	y	y	y	y	y	y	y				y				
Florida	y		y	y	y	y	y	y	y	y	y	y	y		y				(c)
Georgia	y			y	y		y	y	y	y					y				
Hawaii	y	y	y	y	y		y	y		y	y				y				
Idaho	y		y	y	y		y	y	y	y	y		y		y				
Illinois	y			y	y			y			y				y	y			
Indiana	y		y	y	y			y			y				y				
Iowa	y		y	y	y	y	y	y	y	y	y				y				
Kansas	y			y	y			y							y				
Kentucky	y	y	y	y	y	y	y	y	y	y	y	y	y		y				(d)
Louisiana	y		y	y	y			y	y	y	y				y				
Maine	y	y	y	y	y		y	y	y	y	y				y				
Maryland	y		y	y	y	y	y	y			y				y				
Massachusetts	y	y	y	y	y		y	y							y				(e)
Michigan	y	y	y	y	y	y	y	y	y		y				y			y	(f)
Minnesota				y	y		y	y	y	y							y	y	
Mississippi	y		y	y	y	y		y	y	y	y				y		y	y	
Missouri				y	y		y	y		y					y				(g)
Montana	y	y	y	y	y	y									y				
Nebraska	y	y	y	y	y	y	y	y	y	y	y	y	y	y	y		y	y	
Nevada	y	y		y	y	y	y	y	y	y	y				y				
New Hampshire	y		y	y	y		y	y	y	y	y				y			y	
New Jersey	y	y		y	y		y	y	y	y	y			y	y		y	y	
New Mexico	y		y	y	y	y		y	y	y	y				y				
New York	y		y	y	y	y	y	y		y					y				
North Carolina	y		y	y	y	y	y	y	y	y	y				y				
North Dakota	y	y		y	y	y	y	y	y	y	y	y	y	y	y		y	y	
Ohio	y		y	y	y	y	y	y		y					y				
Oklahoma	y	y	y	y	y		y	y			y				y				
Oregon	y		y	y	y	y	y	y	y	y			y		y				(h)
Pennsylvania	y	y	y	y	y	y	y	y	y	y					y				
Rhode Island	y	y		y	y	y		y	y					y	y	y			
South Carolina	y		y	y	y			y	y	y					y				
South Dakota	y	y	y	y	y	y	y	y	y	y			y	y	y		y	y	
Tennessee	y			y	y		y	y							y				
Texas				y	y	y	y	y	y	y	y		y	y	y	y	y	y	(i)
Utah	y	y	y	y	y		y	y	y	y	y				y			y	
Vermont	y	y	y	y	y	y	y	y		y	y				y				(j)
Virginia	y	y	y	y	y		y	y	y	y	y				y				
Washington	y		y	y	y		y	y							y				
West Virginia	y	y	y	y	y			y	y	y	y		y		y		y	y	(k)
Wisconsin	y	y	y	y	y			y									y	y	
Wyoming	y	y	y	y	y	y	y	y	y	y	y	y	y	y	y	y	y	y	
DC	y	y	y	y	y		y	y	y	y	y				y				

(a) Small Business Administration guaranteed loans
(b) Aset backed securities
(c) Convertible Bonds
(d) Collateralized Mortgage Obligation's & Other Mortgages; Asset Banking
(e) Massachusetts Municipal Depository Trust; Chapter 29 Section 38A
(f) Emergency loans to municipalities within the state.
(g) Time deposits within state.
(h) Reverse repurchase agreements.
(i) Private Equity
(j) For certain non pension trust funds identified by statute, equities and corporate bonds/notes are permitted investments.
(k) Economic Development Loans.

Source: National Association of State Treasurers, State Treasury Activities Functions, Seventh Edition, Fiscal year end 2004

	CDs within State	CDs Nationally	Cash	Time Deposits	Demand Deposits	Treasury Bills	Treasury Notes/Bonds	Federal Land Bank Securities	Banks for Co-ops	Federal Intermediate Credit Banks	FNMA Securities	Federal Home Loan Bank Securities	Collateralized Mortgage Obligations	Commercial Paper	Money Market Fund	Banker's Acceptances	Repurchase Agreements	Reverse Repos	Total
Alabama	50%				1%												49%		
Alaska			3%	1%	2%	25%							2%	67%					
Arizona		0%					23%				11%	23%	7%	27%	1%		7%		
Arkansas	35%		1%		9%						5%	11%	1%	0%	38%				
California	1%	25%		16%	4%	7%	15%						1%	31%					
Colorado							20%				30%	9%		36%	5%				
Connecticut					100%														
Delaware							18%							25%	38%		18%		
Florida	17%		3%		1%	4%	17%				7%	9%	8%	24%	2%	3%	2%	4%	
Georgia	8%						9%				13%	44%	2%				24%		
Hawaii				14%	0%		9%										77%		
Idaho	7%		3%							2%	10%	16%		17%	46%				
Illinois				12%	1%						2%	2%		29%	21%		33%		
Indiana	19%					17%									64%				
Iowa	9%						4%							22%	65%				
Kansas	7%				2%									43%			48%		
Kentucky	0%						24%						9%	13%	5%		49%		
Louisiana	8%						38%				28%	6%					19%		
Maine	3%		22%				11%				26%			37%					
Maryland						1%	3%				13%	7%					75%		
Massachusetts															(a)				
Michigan	0%				33%									67%					
Minnesota							1%				6%	3%		72%			18%		
Mississippi	55%				11%										3%		30%		
Missouri				14%			19%				16%	14%		21%			15%		
Montana											28%	72%							
Nebraska							47%				15%	16%		15%	6%				
Nevada		6%		0%		4%	16%	1%		19%	15%	21%	1%	10%	4%		3%		
New Hampshire	5%						3%								88%		3%		
New Jersey		30%	2%			27%					12%	7%		22%					
New Mexico	8%										23%	28%		1%			40%		
New York	5%													95%			0%		
North Carolina	3%						92%										5%		
North Dakota	50%	50%													0%				
Ohio	8%						11%				31%	25%		20%	5%				
Oklahoma	17%						36%					0%			20%		26%		
Oregon	2%										26%	25%		47%					
Pennsylvania	0%		1%	1%		3%	18%	0%			18%	12%		5%	5%		36%		
Rhode Island	1%													8%	79%		12%		
South Carolina	14%						6%						0%	10%			70%		
South Dakota																			
Tennessee	53%										18%	20%					8%		
Texas				4%			20%				24%	6%	2%	25%	1%		3%	15%	
Utah							47%								53%				
Vermont				0%	2%						29%	20%		11%	20%		18%		
Virginia	3%	13%					18%							38%	2%		27%		
Washington	17%				11%	5%	29%										38%		
West Virginia	0%				1%	22%	12%				25%	12%			4%		23%		
Wisconsin	10%	3%					3%				34%	6%		14%			29%		
Wyoming			15%	0%	0%		13%				36%	26%	3%	1%	1%		5%		

(a) All Massachusetts investments are placed in a state run local government investment pool.

Source: National Association of State Treasurers, State Treasury Activities Functions, Seventh Edition, Fiscal year end 2004

42.500 State Investment Commission Powers
(Edited)

42.500 State Investment Commission -- Powers.

1) There shall be a State Investment Commission composed of the Governor who shall be chairman; the State Treasurer who shall be vice chairman and serve as chairman in the absence of the Governor; the secretary of the Finance and Administration Cabinet; and two (2) persons appointed by the Governor.
2) The individuals appointed by the Governor shall be selected as follows: one (1) to be selected from a list of five (5) submitted to the Governor by the Kentucky Bankers Association, and one (1) to be selected from a list of five (5) submitted to the Governor by the Independent Community Bankers Association.
3) The State Investment Commission shall meet at least quarterly to review investment performance and conduct other business. This provision shall not prohibit the commission from meeting more frequently as the need arises.
4) The Governor, State Treasurer, and secretary of the Finance and Administration Cabinet shall each have the authority to designate, by an instrument in writing over his or her signature and filed with the secretary of the commission as a public record of the commission, an alternate with full authority to:
   a) Attend in the member's absence, for any reason, any properly convened meeting of the commission; and
   b) Participate in the consideration of, and vote upon, business and transactions of the commission.

   Each alternate shall be a person on the staff of the appointing member or in the employ of the appointing member's state agency or department.
5) Any designation of an alternate may, at the appointing member's direction:
   a) Be limited upon the face of the appointing instrument to be effective for only a specific meeting or specified business;
   b) Be shown on the face of the appointing instrument to be a continuing designation, for a period of no more than four (4) years, whenever the appointing member is unable to attend; or
   c) Be revoked at any time by the appointing member in an instrument in writing, over his or her signature, filed with the secretary of the commission as a public record of the commission.
6) Any person transacting business with, or materially affected by, the business of the commission may accept and rely upon a joint certificate of the secretary of the commission and any member of the commission concerning the designation of any alternate, the time and scope of the designation, and, if it is of a continuing nature, whether and when the designation has been revoked. The joint certificate shall be made and delivered to the person requesting it within a reasonable time after it has been requested in writing, with acceptable identification of the business or transaction to which it refers and the requesting person's interest in the business or transaction.
7) Any three (3) persons who are members of the commission or alternates authorized under subsections (4) and (5) of this section shall constitute a quorum and may, by majority vote, transact any business of the commission. Any three (3) members of the commission may call a meeting.

8) The provisions of KRS 61.070 shall not apply to members of the commission.
9) The commission shall have authority and may, if in its opinion the cash in the State Treasury is in excess of the amount required to meet current expenditures, invest any and all of the excess cash in:
   a) Obligations and contracts for future delivery of obligations backed by the full faith and credit of the United States or a United States government agency, including but not limited to:
      1. United States Treasury;
      2. Export-Import Bank of the United States;
      3. Farmers Home Administration;
      4. Government National Mortgage Corporation; and
      5. Merchant Marine bonds;
   (b) Obligations of any corporation of the United States government or government sponsored enterprise, including but not limited to:
      1. Federal Home Loan Mortgage Corporation;
      2. Federal Farm Credit Banks;
         a. Bank for Cooperatives;
         b. Federal Intermediate Credit Banks; and
         c. Federal Land Banks;
      3. Federal Home Loan Banks;
      4. Federal National Mortgage Association; and
      5. Tennessee Valley Authority obligations;
   (c) Collateralized or uncollateralized certificates of deposit, issued by banks rated in one (1) of the three (3) highest categories by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization or other interest-bearing accounts in depository institutions chartered by this state or by the United States, except for shares in mutual savings banks;
   (d) Bankers acceptances for banks rated in ~~one (1) of the three (3)~~ the highest categor~~ies~~y by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization;
   (e) Commercial paper rated in the highest category by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization;
   (f) Securities issued by a state or local government, or any instrumentality or agency thereof, in the United States, and rated in one (1) of the three (3) highest categories by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization;
   (g) United States denominated corporate, Yankee, and Eurodollar securities, excluding corporate stocks, issued by foreign and domestic issuers, including sovereign and supranational governments, rated in one (1) of the three (3) highest categories by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization;
   (h) Asset-backed securities rated in the highest category by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization; and
   (i) Shares of mutual funds, ~~not to exceed ten percent (10%) of the total funds available for investment as described in subsection (9) of this section, each of~~ which shall have the following characteristics:

1. The mutual fund shall be an open-end diversified investment company registered under Federal Investment Company Act of 1940, as amended;
2. The management company of the investment company shall have been in operation for at least five (5) years;
~~2.~~3. The mutual fund shall be rated in the highest category by a nationally recognized statistical rating organization;
~~3.~~4. ~~At least ninety percent (90%)~~All of the securities in the mutual fund shall be eligible investments pursuant to this section; and

(j) State and local delinquent property tax claims which upon purchase shall become certificates of delinquency secured by interests in real property not to exceed twenty-five million dollars ($25,000,000) in the aggregate. For any certificates of delinquency that have been exonerated pursuant to KRS 132.220(5), the Department of Revenue shall offset the loss suffered by the Finance and Administration Cabinet against subsequent local distributions to the affected taxing districts as shown on the certificate of delinquency.

~~(j)~~

~~10) The State Investment Commission shall promulgate administrative regulations for the investment and reinvestment of state funds in shares of mutual funds, and the regulations shall specify:~~

~~a) The long and short term goals of any investment;~~

~~b) The specification of moneys to be invested;~~

~~c) The amount of funds which may be invested per instrument;~~

~~d) The qualifications of instruments; and~~

~~e) The acceptable maturity of investments.~~

~~11)~~10) Any investment in obligations and securities pursuant to subsection (9)(a) and (9)(b) of this section shall satisfy this section if these obligations are subject to repurchase agreements, provided that delivery of these obligations is taken either directly or through an authorized custodian.

~~12)~~11)

(a) Income earned from investments made pursuant to this section shall accrue to the credit of the investment income account of the general fund, except that interest from investments of excess cash in the road fund shall be credited to the surplus account of the road fund and interest from investments of excess cash in the game and fish fund shall be credited to the game and fish fund, interest earned from investments of imprest cash funds and funds in the trust and revolving fund for each state public university shall be credited to the appropriate institutional account, and interest earned from the investment of funds accumulated solely by means of contributions and gifts shall not be diverted to any purpose other than that stipulated by the donor, when the donor shall have designated the use to which the interest shall be placed.

(b) Except as otherwise provided by law, or by the obligations and covenants contained in resolutions and trust indentures adopted or entered into for state bond issues, interest earned from the investment of moneys appropriated to the capital construction accounts, trust and agency accounts, and trust and agency revolving accounts shall accrue to the capital construction investment income account.

(c) If there is a revenue shortfall, as defined in KRS 48.010, of five percent (5%) or less, the secretary of the Finance and Administration Cabinet, upon the recommendation of the state budget director, may direct the transfer of excess unappropriated capital construction investment income to the general fund investment income account. The amount of the transfer shall not exceed the amount of the shortfall in general fund revenues.

(d) If the capital construction investment income is less than that amount appropriated by the General Assembly, the secretary of the Finance and Administration Cabinet may, upon recommendation of the state budget director, direct the transfer of excess unappropriated general fund investment income to the capital construction investment income account. The transfer of general fund investment income revenues to the capital construction investment income account shall be made only when the actual general fund revenues are in excess of the enacted estimates under KRS 48.120 and shall be limited to the amount of the excess general fund revenues. The amount of the transfer shall not exceed the amount of the shortfall in the capital construction fund revenues.

~~13)~~12) The authority granted by this section to the State Investment Commission shall not extend to any funds that are specifically provided by law to be invested by some other officer or agency of the state government.

~~14)~~13) The authority granted by this section to the State Investment Commission shall only be exercised pursuant to the administrative regulations mandated by KRS 42.525.

~~15)~~14) Each member of the State Investment Commission, with the exception of the Governor, shall post bond for his acts or omissions as a member thereof identical in amount and kind to that posted by the State Treasurer.

Effective: June 25, 2009

History: Amended 2009 Ky. Acts ch. 78, sec. 28, effective June 25, 2009. -- Amended 2005 Ky. Acts ch. 85, sec. 54, effective June 20, 2005. -- Amended 1998 Ky. Acts ch. 209, sec. 19, effective March 30, 1998. -- Amended 1997 (1st Extra. Sess.) Ky. Acts ch. 4, sec. 36, effective May 30, 1997. -- Amended 1996 Ky. Acts ch. 101, sec. 1, effective July 15, 1996. -- Amended 1990 Ky. Acts ch. 277, sec. 1, effective July 13, 1990; ch. 291, sec. 1, effective July 13, 1990; and ch. 294, sec. 1, effective July 13, 1990. -- Amended 1988 Ky. Acts ch. 368, sec. 2, effective July 15, 1988. -- Amended 1986 Ky. Acts ch. 408, sec. 1, effective July 15, 1986. -- Amended 1984 Ky. Acts ch. 324, sec. 60, effective July 13, 1984. -- Amended 1982 Ky. Acts ch. 300, sec. 5, effective July 15, 1982; repealed, reenacted and amended as KRS 42.500, ch. 382, sec. 6, effective July 15, 1982; and amended ch. 450, sec. 58, effective July 1, 1983. -- Amended 1980 Ky. Acts ch. 295, sec. 11, effective July 15, 1980; and ch. 347, sec. 1, effective January 1, 1982. -- Amended 1954 Ky. Acts ch. 245, sec. 1, effective June 17, 1954. -- Created 1952 Ky. Acts ch. 86, sec. 1.

Formerly codified as KRS 41.380.

Rule 2a-7 of the Investment Company Act of 1940

Rules and Regulations promulgated under the Investment Company Act of 1940

Rule 2a-7 -- Money Market Funds

Definitions.

- *Acquisition* (or *Acquire*) means any purchase or subsequent rollover (but does not include the failure to exercise a Demand Feature).
- *Amortized Cost Method of valuation means the method of calculating an investment company's net asset value whereby portfolio securities are valued at the fund's Acquisition cost as adjusted for amortization of premium or accretion of discount rather than at their value based on current market factors.,br.*
- *Asset Backed Security means a fixed income security (other than a Government Security) issued by a Special Purpose Entity (as defined in this paragraph), substantially all of the assets of which consist of Qualifying Assets (as defined in this paragraph). Special Purpose Entity means a trust, corporation, partnership or other entity organized for the sole purpose of issuing securities that entitle their holders to receive payments that depend primarily on the cash flow from Qualifying Assets, but does not include a registered investment company. Qualifying Assets means financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders.*
- *Business Day means any day, other than Saturday, Sunday, or any customary business holiday.*
- *Collateralized Fully means "Collateralized Fully" as defined in Rule 270.5b-3(c)(1) except that Rule* 270.5b-3(c)(1)(iv)(C) and (D) shall not apply.

- *Conditional Demand Feature* means a Demand Feature that is not an Unconditional Demand Feature. A Conditional Demand Feature is not a Guarantee.

- *Conduit Security* means a security issued by a Municipal Issuer (as defined in this paragraph) involving an arrangement or agreement entered into, directly or indirectly, with a person other than a Municipal Issuer, which arrangement or agreement provides for or secures repayment of the security. Municipal Issuer means a State or territory of the United States (including the District of Columbia), or any political subdivision or public instrumentality of a State or territory of the United States. A Conduit Security does not include a security that is:

    - Fully and unconditionally guaranteed by a Municipal Issuer;

    - Payable from the general revenues of the Municipal Issuer or other Municipal Issuers (other than those revenues derived from an agreement or arrangement with a person who is not a Municipal Issuer that provides for or secures repayment of the security issued by the Municipal Issuer);

    - Related to a project owned and operated by a Municipal Issuer; or

    - Related to a facility leased to and under the control of an industrial or commercial enterprise that is part of a public project which, as a whole, is owned and under the control of a Municipal Issuer.

- *Daily Liquid Assets* means:

    - Cash;

    - Direct obligations of the U.S. Government; or

    - Securities that will mature or are subject to a Demand Feature that is exercisable and payable within one Business Day.

- *Demand Feature means*:

    - A feature permitting the holder of a security to sell the security at an exercise price equal to the approximate amortized cost of the security plus accrued interest, if any, at the time of exercise. A Demand Feature must be exercisable either:

        - At any time on no more than 30 calendar days' notice; or

        - At specified intervals not exceeding 397 calendar days and upon no more than 30 calendar days' notice; or

    - A feature permitting the holder of an Asset Backed Security unconditionally to receive principal and interest within 397 calendar days of making demand.

- *Demand Feature Issued By A Non-Controlled Person* means a Demand Feature issued by:

    - A person that, directly or indirectly, does not control, and is not controlled by or under common control with the issuer of the security subject to the Demand Feature (control means "control" as defined in section 2(a)(9) of the Act) (15 U.S.C. 80a-2(a)(9)); or

    - A sponsor of a Special Purpose Entity with respect to an Asset Backed Security.

- Designated NRSRO means any one of at least four nationally recognized statistical rating organizations, as that term is defined in section 3(a)(62) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(62)), that:

    - The money market fund's board of directors:

        - Has designated as an NRSRO whose credit ratings with respect to any obligor or security or particular obligors or securities will be used by the fund to determine whether a security is an Eligible Security; and

        - Determines at least once each calendar year issues credit ratings that are sufficiently reliable for such use;

    - Is not an "affiliated person," as defined in section 2(a)(3)(C) of the Act (15 U.S.C. 80a-2(a)(3)(C)), of the issuer of, or any insurer or provider of credit support for, the security; and

    - The fund discloses in its statement of additional information is a Designated NRSRO, including any limitations with respect to the fund's use of such designation.

- *Eligible Security* means:

    - A Rated Security with a remaining maturity of 397 calendar days or less that has received a rating from the Requisite NRSROs in one of the two highest short-term rating categories (within which there may be sub-categories or gradations indicating relative standing); or

    - An Unrated Security that is of comparable quality to a security meeting the requirements for a Rated Security in paragraph (a)(12)(i) of this section, as determined by the money market fund's board of directors; provided, however, that: a security that at the time of issuance had a remaining maturity of more than 397 calendar days but that has a remaining maturity of 397 calendar days or less and that is an Unrated Security is not an Eligible Security if the security has received a long-term rating from any Designated NRSRO that is not within the Designated NRSRO's three highest long-term ratings categories (within which there may be sub-categories or gradations indicating relative standing), unless the security has received a long-term rating from the Requisite NRSROs in one of the three highest rating categories.

    - In addition, in the case of a security that is subject to a Demand Feature or Guarantee:

    - The Guarantee has received a rating from a Designated NRSRO or the Guarantee is issued by a guarantor that has received a rating from a Designated NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security to the Guarantee, unless:

        - The Guarantee is issued by a person that, directly or indirectly, controls, is controlled by or is under common control with the issuer of the security subject to the Guarantee (other than a sponsor of a Special Purpose Entity with respect to an Asset Backed Security);

        - The security subject to the Guarantee is a repurchase agreement that is Collateralized Fully; or

    - The Guarantee is itself a Government Security; and
  - The issuer of the Demand Feature or Guarantee, or another institution, has undertaken promptly to notify the holder of the security in the event the Demand Feature or Guarantee is substituted with another Demand Feature or Guarantee (if such substitution is permissible under the terms of the Demand Feature or Guarantee).

- *Event of Insolvency* means "Event of Insolvency" as defined in Rule 270.5b-3(c)(2).

- *First Tier Security* means any Eligible Security that:

  - Is a Rated Security that has received a short-term rating from the Requisite NRSROs in the highest short-term rating category for debt obligations (within which there may be sub-categories or gradations indicating relative standing);

  - Is an Unrated Security that is of comparable quality to a security meeting the requirements for a Rated Security in paragraph (a)(14)(i) of this section, as determined by the fund's board of directors;

  - Is a security issued by a registered investment company that is a money market fund; or

  - Is a Government Security.

- *Floating Rate Security* means a security the terms of which provide for the adjustment of its interest rate whenever a specified interest rate changes and that, at any time until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost.

- *Government Security* means any "Government security" as defined in section 2(a)(16) of the Act (15 U.S.C. 80a-2(a)(16)).

- *Guarantee* means an unconditional obligation of a person other than the issuer of the security to undertake to pay, upon presentment by the holder of the Guarantee (if required), the principal amount of the underlying security plus accrued interest when due or upon default, or, in the case of an Unconditional Demand Feature, an obligation that entitles the holder to receive upon exercise the approximate amortized cost of the underlying security or securities, plus accrued interest, if any. A Guarantee includes a letter of credit, financial guaranty (bond) insurance, and an Unconditional Demand Feature (other than an Unconditional Demand Feature provided by the issuer of the security).

- *Guarantee Issued By A Non-Controlled Person* means a Guarantee issued by:

  - A person that, directly or indirectly, does not control, and is not controlled by or under common control with the issuer of the security subject to the Guarantee (control means "control" as defined in section 2(a)(9) of the Act) (15 U.S.C. 80a-2(a)(9)); or

  - A sponsor of a Special Purpose Entity with respect to an Asset Backed Security.

- *Illiquid Security* means a security that cannot be sold or disposed of in the ordinary course of business within seven calendar days at approximately the value ascribed to it by the fund.

- *Penny-Rounding Method of pricing* means the method of computing an investment company's price per share for purposes of distribution, redemption and repurchase whereby the current net asset value per share is rounded to the nearest one percent.

- *Rated Security* means a security that meets the requirements of paragraphs (a)(21)(i) or (ii) of this section, in each case subject to paragraph (a)(21)(iii) of this section:

  - The security has received a short-term rating from a Designated NRSRO, or has been issued by an issuer that has received a short-term rating from a Designated NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security with the security; or

  - The security is subject to a Guarantee that has received a short-term rating from a Designated NRSRO, or a Guarantee issued by a guarantor that has received a short-term rating from a Designated NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security with the Guarantee; but

  - A security is not a Rated Security if it is subject to an external credit support agreement (including an arrangement by which the security has become a Refunded Security) that was not in effect when the security was assigned its rating, unless the security has received a short-term rating reflecting the existence of the credit support agreement as provided in paragraph (a)(21)(i) of this section, or the credit support agreement with respect to the security has received a short-term rating as provided in paragraph (a)(21)(ii) of this section.

- *Refunded Security* means "Refunded Security" as defined in Rule 270.5b-3(c)(4)

- *Requisite NRSROs* means:

  - Any two Designated NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer; or

  - If only one Designated NRSRO has issued a rating with respect to such security or class of debt obligations of an issuer at the time the fund acquires the security, that Designated NRSRO.

- *Second Tier Security* means any Eligible Security that is not a First Tier Security.

- *Single State Fund* means a Tax Exempt Fund that holds itself out as seeking to maximize the amount of its distributed income that is exempt from the income taxes or other taxes on investments of a particular State and, where applicable, subdivisions thereof.

- *Tax Exempt Fund* means any money market fund that holds itself out as distributing income exempt from regular Federal income tax.

- *Total Assets* means, with respect to a money market fund using the Amortized Cost Method, the total amortized cost of its assets and, with respect to any other money market fund, the total market-based value of its assets.

- *Unconditional Demand Feature* means a Demand Feature that by its terms would be readily exercisable in the event of a default in payment of principal or interest on the underlying security or securities.

- *United States Dollar-Denominated* means, with reference to a security, that all principal and interest payments on such security are payable to security holders in United States dollars under all circumstances and that the interest rate of, the principal amount to be repaid, and the timing of payments related to such security do not vary or float with the value of a foreign currency, the rate of interest payable on foreign currency borrowings, or with any other interest rate or index expressed in a currency other than United States dollars.

- *Unrated Security* means a security that is not a Rated Security.

- *Variable Rate Security* means a security the terms of which provide for the adjustment of its interest rate on set dates (such as the last day of a month or calendar quarter) and that, upon each adjustment until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost.

- *Weekly Liquid Assets* means:

    - Cash;

    - Direct obligations of the U.S. Government;

    - Government Securities that are issued by a person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States that:

        - Are issued at a discount to the principal amount to be repaid at maturity; and

        - Have a remaining maturity date of 60 days or less; or

    - Securities that will mature or are subject to a Demand Feature that is exercisable and payable within five Business Days.

- Holding Out and Use of Names and Titles.

    - It shall be an untrue statement of material fact within the meaning of section 34(b) of the Act (15 U.S.C. 80a-33(b)) for a registered investment company, in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to the Act, including any advertisement, pamphlet, circular, form letter, or other sa les literature addressed to or intended for distribution to prospective investors that is required to be filed with the Commission by section 24(b) of the Act (15 U.S.C. 80a-24(b)), to hold itself out to investors as a money market fund or the equivalent of a money market fund, unless such registered investment company meets the conditions of paragraphs (c)(2), (c)(3), (c)(4), and (c)(5) of this section.

    - It shall constitute the use of a materially deceptive or misleading name or title within the meaning of section 35(d) of the Act (15 U.S.C. 80a-34(d)) for a registered investment company to adopt the term "money market" as part of its name or title or the name or title of any redeemable securities of which it is the issuer, or to adopt a name that suggests that it is a money market fund or the equivalent of a money market fund, unless such registered investment company meets the conditions of paragraphs (c)(2), (c)(3), (c)(4), and (c)(5) of this section.

    - For purposes of this paragraph, a name that suggests that a registered investment company is a money market fund or the equivalent thereof shall include one that uses such terms as "cash," "liquid," "money," "ready assets" or similar terms.

- *Share Price Calculations.* The current price per share, for purposes of distribution, redemption and repurchase, of any redeemable security issued by any registered investment company ("money market fund" or "fund"), notwithstanding the requirements of section 2 (a)(41) of the Act (15 U.S.C. 80a-2(a)(41)) and of Rules 270.2a-4 and 270.22c-1 thereunder, may be computed by use of the Amortized Cost Method or the Penny-Rounding Method; provided, however, that:

    - *Board Findings.* The board of directors of the money market fund shall determine, in good faith, that it is in the best interests of the fund and its shareholders to maintain a stable net asset value per share or stable price per share, by virtue of either the Amortized Cost Method or the Penny-Rounding Method, and that the money market fund will continue to use such method only so long as the board of directors believes that it fairly reflects the market-based net asset value per share.

    - *Portfolio Maturity.* The money market fund shall maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable net asset value per share or price per share; provided, however, that the money market fund will not:

        - Acquire any instrument with a remaining maturity of greater than 397 calendar days;

        - Maintain a dollar-weighted average portfolio maturity that exceeds 60 calendar days; or

        - Maintain a dollar-weighted average portfolio maturity that exceeds 120 calendar days, determined without reference to the exceptions in paragraph (d) of this section regarding interest rate readjustments.

    - Portfolio Quality

        - General. The money market fund shall limit its portfolio investments to those United States Dollar-Denominated securities that the fund's board of directors determines present minimal credit risks (which determination must be based on factors pertaining to credit quality in addition to any rating assigned to such securities by a Designated NRSRO) and that are at the time of Acquisition Eligible Securities.

        - Second Tier Securities. No money market fund shall Acquire a Second Tier Security with a remaining maturity of greater than 45 calendar days. Immediately after the Acquisition of any Second Tier Security, a money market fund shall not have invested more than three percent of its Total Assets in Second Tier Securities.

        - Securities Subject to Guarantees. A security that is subject to a Guarantee may be determined to be an Eligible Security or a First Tier Security based solely on whether the Guarantee is an Eligible Security or First Tier Security, as the case may be.

        - Securities Subject to Conditional Demand Features. A security that is subject to a Conditional Demand Feature ("Underlying Security") may be determined to be an Eligible Security or a First Tier Security only if:

            - The Conditional Demand Feature is an Eligible Security or First Tier Security, as the case may be;

            - At the time of the Acquisition of the Underlying Security, the money market fund's board of directors has determined that there is minimal risk that the circumstances that would result in the Conditional Demand Feature not being exercisable will occur; and

        - The conditions limiting exercise either can be monitored readily by the fund, or relate to the taxability, under Federal, State or local law, of the interest payments on the security; or

        - The terms of the Conditional Demand Feature require that the fund will receive notice of the occurrence of the condition and the opportunity to exercise the Demand Feature in accordance with its terms; and

    - The Underlying Security or any Guarantee of such security (or the debt securities of the issuer of the Underlying Security or Guarantee that are comparable in priority and security with the Underlying Security or Guarantee) has received either a short-term rating or a long-term rating, as the case may be, from the Requisite NRSROs within the NRSROs' two highest short-term or long-term rating categories (within which there may be sub-categories or gradations indicating relative standing) or, if unrated, is determined to be of comparable quality by the money market fund's board of directors to a security that has received a rating from the Requisite NRSROs within the NRSROs' two highest short-term or long-term rating categories, as the case may be.

- Portfolio Diversification

  - Issuer Diversification. The money market fund shall be diversified with respect to issuers of securities Acquired by the fund as provided in paragraphs (c)(4)(i) and (c)(4)(ii) of this section, other than with respect to Government Securities and securities subject to a Guarantee Issued By A Non-Controlled Person.

    - Taxable and National Funds. Immediately after the Acquisition of any security, a money market fund other than a Single State Fund shall not have invested more than five percent of its Total Assets in securities issued by the issuer of the security; provided, however, that such a fund may invest up to twenty-five percent of its Total Assets in the First Tier Securities of a single issuer for a period of up to three Business Days after the Acquisition thereof; provided , further, that the fund may not invest in the securities of more than one issuer in accordance with the foregoing proviso in this paragraph at any time.

    - Single State Funds. With respect to seventy-five percent of its Total Assets, immediately after the Acquisition of any security, a Single State Fund shall not have invested more than five percent of its Total Assets in securities issued by the issuer of the security.

    - Second Tier Securities. Immediately after the Acquisition of any Second Tier Security, a money market fund shall not have invested more than one half of one percent of its Total Assets in the Second Tier Securities of any single issuer.

  - Issuer Diversification Calculations. For purposes of making calculations under paragraph (c)(4)(i) of this section:

    - Repurchase Agreements. The Acquisition of a repurchase agreement may be deemed to be an Acquisition of the underlying securities, provided the obligation of the seller to repurchase the securities from the money market fund is Collateralized Fully and the fund's board of directors has evaluated the seller's creditworthiness.

    - Refunded Securities. The Acquisition of a Refunded Security shall be deemed to be an Acquisition of the escrowed Government Securities.

- Conduit Securities. A Conduit Security shall be deemed to be issued by the person (other than the Municipal Issuer) ultimately responsible for payments of interest and principal on the security.

- Asset Backed Securities

  - General. An Asset Backed Security Acquired by a fund ("Primary ABS") shall be deemed to be issued by the Special Purpose Entity that issued the Asset Backed Security, provided, however:

    - Holdings of Primary ABS. Any person whose obligations constitute ten percent or more of the principal amount of the Qualifying Assets of the Primary ABS ("Ten Percent Obligor") shall be deemed to be an issuer of the portion of the Primary ABS such obligations represent; and

    - Holdings of Secondary ABS. If a Ten Percent Obligor of a Primary ABS is itself a Special Purpose Entity issuing Asset Backed Securities ("Secondary ABS"), any Ten Percent Obligor of such Secondary ABS also shall be deemed to be an issuer of the portion of the Primary ABS that such Ten Percent Obligor represents.

  - Restricted Special Purpose Entities. A Ten Percent Obligor with respect to a Primary or Secondary ABS shall not be deemed to have issued any portion of the assets of a Primary ABS as provided in paragraph (c)(4)(ii)(D)(1) of this section if that Ten Percent Obligor is itself a Special Purpose Entity issuing Asset Backed Securities ("Restricted Special Purpose Entity"), and the securities that it issues (other than securities issued to a company that controls, or is controlled by or under common control with, the Restricted Special Purpose Entity and which is not itself a Special Purpose Entity issuing Asset Backed Securities) are held by only one other Special Purpose Entity.

  - Demand Features and Guarantees. In the case of a Ten Percent Obligor deemed to be an issuer, the fund shall satisfy the diversification requirements of paragraph (c)(4)(iii) of this section with respect to any Demand Feature or Guarantee to which the Ten Percent Obligor's obligations are subject.

- Shares of Other Money Market Funds. A money market fund that Acquires shares issued by another money market fund in an amount that would otherwise be prohibited by paragraph (c)(4)(i) of this section shall nonetheless be deemed in compliance with this section if the board of directors of the Acquiring money market fund reasonably believes that the fund in which it has invested is in compliance with this section.

- Diversification Rules for Demand Features and Guarantees. The money market fund shall be diversified with respect to Demand Features and Guarantees Acquired by the fund as provided in paragraphs (c)(4)(iii) and (c)(4)(iv) of this section, other than with respect to a Demand Feature issued by the same institution that issued the underlying security, or with respect to a Guarantee or Demand Feature that is itself a Government Security.

  - General. Immediately after the Acquisition of any Demand Feature or Guarantee or security subject to a Demand Feature or Guarantee, a money market fund, with respect to seventy-five percent of its Total Assets, shall not have invested more than ten percent of its Total Assets in securities issued by or subject to Demand Features or Guarantees from the institution that issued the Demand Feature or Guarantee, subject to paragraphs (c)(4)(iii)(B) and (C) of this section.

        - Second Tier Demand Features or Guarantees. Immediately after the Acquisition of any Demand Feature or Guarantee (or a security after giving effect to the Demand Feature or Guarantee) that is a Second Tier Security, a money market fund shall not have invested more than 2.5 percent of its Total Assets in securities issued by or subject to Demand Features or Guarantees from the institution that issued the Demand Feature or Guarantee.

        - Demand Features or Guarantees Issued by Non-Controlled Persons. Immediately after the Acquisition of any security subject to a Demand Feature or Guarantee, a money market fund shall not have invested more than ten percent of its Total Assets in securities issued by, or subject to Demand Features or Guarantees from the institution that issued the Demand Feature or Guarantee, unless, with respect to any security subject to Demand Features or Guarantees from that institution (other than securities issued by such institution), the Demand Feature or Guarantee is a Demand Feature or Guarantee Issued By A Non-Controlled Person.

    - Demand Feature and Guarantee Diversification Calculations

        - Fractional Demand Features or Guarantees. In the case of a security subject to a Demand Feature or Guarantee from an institution by which the institution guarantees a specified portion of the value of the security, the institution shall be deemed to guarantee the specified portion thereof.

        - Layered Demand Features or Guarantees. In the case of a security subject to Demand Features or Guarantees from multiple institutions that have not limited the extent of their obligations as described in paragraph (c)(4)(iv)(A) of this section, each institution shall be deemed to have provided the Demand Feature or Guarantee with respect to the entire principal amount of the security.

    - Diversification Safe Harbor. A money market fund that satisfies the applicable diversification requirements of paragraphs (c)(4) and (c)(6) of this section shall be deemed to have satisfied the diversification requirements of section 5(b)(1) of the Act (15 U.S.C. 80a-5(b)(1)) and the rules adopted thereunder.

- Portfolio Liquidity. The money market fund shall hold securities that are sufficiently liquid to meet reasonably foreseeable shareholder redemptions in light of the fund's obligations under section 22 (e) of the Act (15 U.S.C. 80a-22(e)) and any commitments the fund has made to shareholders; provided, however, that:

    - Illiquid Securities. The money market fund shall not Acquire any Illiquid Security if, immediately after the Acquisition, the money market fund would have invested more than five percent of its Total Assets in Illiquid Securities.

    - Minimum Daily Liquidity Requirement. The money market fund shall not Acquire any security other than a Daily Liquid Asset if, immediately after the Acquisition, the fund would have invested less than ten percent of its Total Assets in Daily Liquid Assets. This provision shall not apply to Tax Exempt Funds.

    - Minimum Weekly Liquidity Requirement. The money market fund shall not Acquire any security other than a Weekly Liquid Asset if, immediately after the Acquisition, the fund would have invested less than thirty percent of its Total Assets in Weekly Liquid Assets.

- Demand Features and Guarantees Not Relied Upon. If the fund's board of directors has determined that the fund is not relying on a Demand Feature or Guarantee to determine the quality (pursuant to paragraph (c)(3) of this section), or maturity (pursuant to paragraph (d) of this section), or liquidity of a portfolio security, and maintains a record of this determination (pursuant to paragraphs (c)(10)(ii) and (c)(11)(vi) of this section), then the fund may disregard such Demand Feature or Guarantee for all purposes of this section.

- Downgrades, Defaults and Other Events

    - Downgrades

        - General. Upon the occurrence of either of the events specified in paragraphs (c)(7)(i)(A)(1) and (2) of this section with respect to a portfolio security, the board of directors of the money market fund shall reassess promptly whether such security continues to present minimal credit risks and shall cause the fund to take such action as the board of directors determines is in the best interests of the money market fund and its shareholders:

            - A portfolio security of a money market fund ceases to be a First Tier Security (either because it no longer has the highest rating from the Requisite NRSROs or, in the case of an Unrated Security, the board of directors of the money market fund determines that it is no longer of comparable quality to a First Tier Security); and

            - The money market fund's investment adviser (or any person to whom the fund's board of directors has delegated portfolio management responsibilities) becomes aware that any Unrated Security or Second Tier Security held by the money market fund has, since the security was Acquired by the fund, been given a rating by a Designated NRSRO below the Designated NRSRO's second highest short-term rating category.

        - Securities To Be Disposed Of. The reassessments required by paragraph (c)(7)(i)(A) of this section shall not be required if the fund disposes of the security (or it matures) within five Business Days of the specified event and, in the case of events specified in paragraph (c)(7)(i)(A)(2) of this section, the board is subsequently notified of the adviser's actions.

        - Special Rule for Certain Securities Subject to Demand Features. In the event that after giving effect to a rating downgrade, more than 2.5 percent of the fund's Total Assets are invested in securities issued by or subject to Demand Features from a single institution that are Second Tier Securities, the fund shall reduce its investment in securities issued by or subject to Demand Features from that institution to no more than 2.5 percent of its Total Assets by exercising the Demand Features at the next succeeding exercise date(s), absent a finding by the board of directors that disposal of the portfolio security would not be in the best interests of the money market fund.

    - Defaults and Other Events. Upon the occurrence of any of the events specified in paragraphs (c)(7)(ii)(A) through (D) of this section with respect to a portfolio security, the money market fund shall dispose of such security as soon as practicable consistent with achieving an orderly disposition of the security, by sale, exercise of any Demand Feature or otherwise, absent a finding by the board of directors that disposal of the portfolio security would not be in the best interests of the money market fund (which determination may take into account, among other factors, market conditions that could affect the orderly disposition of the portfolio security):

        - The default with respect to a portfolio security (other than an immaterial default unrelated to the financial condition of the issuer);
        - A portfolio security ceases to be an Eligible Security;
        - A portfolio security has been determined to no longer present minimal credit risks; or
        - An Event of Insolvency occurs with respect to the issuer of a portfolio security or the provider of any Demand Feature or Guarantee.
    - Notice to the Commission. The money market fund shall promptly notify the Commission by electronic mail directed to the Director of Investment Management or the Director's designee, of any:
        - Default or Event of Insolvency with respect to the issuer of one or more portfolio securities (other than an immaterial default unrelated to the financial condition of the issuer) or any issuer of a Demand Feature or Guarantee to which one or more portfolio securities is subject, and the actions the money market fund intends to take in response to such event, where immediately before default the securities (or the securities subject to the Demand Feature or Guarantee) accounted for 1/2 of 1 percent or more of the money market fund's Total Assets; or
        - Purchase of a security from the fund by an affiliated person, promoter, or principal underwriter of the fund, or an affiliated person of such a person, in reliance on Rule 270.17a-9, including identification of the security, its amortized cost, the sale price, and the reasons for such purchase.
    - Defaults for Purposes of Paragraphs (c)(7)(ii) and (iii). For purposes of paragraphs (c)(7)(ii) and (iii) of this section, an instrument subject to a Demand Feature or Guarantee shall not be deemed to be in default (and an Event of Insolvency with respect to the security shall not be deemed to have occurred) if:
        - In the case of an instrument subject to a Demand Feature, the Demand Feature has been exercised and the fund has recovered either the principal amount or the amortized cost of the instrument, plus accrued interest; or
        - The provider of the Guarantee is continuing, without protest, to make payments as due on the instrument.
- Required Procedures: Amortized Cost Method. In the case of a money market fund using the Amortized Cost Method:
    - General. In supervising the money market fund's operations and delegating special responsibilities involving portfolio management to the money market fund's investment adviser, the money market fund's board of directors, as a particular responsibility within the overall duty of care owed to its shareholders, shall establish written procedures reasonably designed, taking into account current market conditions and the money market fund's investment objectives, to stabilize the money market fund's net asset value per share, as computed for the purpose of distribution, redemption and repurchase, at a single value.

- Specific Procedures. Included within the procedures adopted by the board of directors shall be the following:
  - Shadow Pricing. Written procedures shall provide:
    - That the extent of deviation, if any, of the current net asset value per share calculated using available market quotations (or an appropriate substitute that reflects current market conditions) from the money market fund's amortized cost price per share, shall be calculated at such intervals as the board of directors determines appropriate and reasonable in light of current market conditions;
    - For the periodic review by the board of directors of the amount of the deviation as well as the methods used to calculate the deviation; and
    - For the maintenance of records of the determination of deviation and the board's review thereof.
  - Prompt Consideration of Deviation. In the event such deviation from the money market fund's amortized cost price per share exceeds 1/2 of 1 percent, the board of directors shall promptly consider what action, if any, should be initiated by the board of directors.
  - Material Dilution or Unfair Results. Where the board of directors believes the extent of any deviation from the money market fund's amortized cost price per share may result in material dilution or other unfair results to investors or existing shareholders, it shall cause the fund to take such action as it deems appropriate to eliminate or reduce to the extent reasonably practicable such dilution or unfair results.

- Required Procedures: Penny-Rounding Method. In the case of a money market fund using the Penny -Rounding Method, in supervising the money market fund's operations and delegating special responsibilities involving portfolio management to the money market fund's investment adviser, the money market fund's board of directors undertakes, as a particular responsibility within the overall duty of care owed to its shareholders, to assure to the extent reasonably practicable, taking into account current market conditions affecting the money market fund's investment objectives, that the money market fund's price per share as computed for the purpose of distribution, redemption and repurchase, rounded to the nearest one percent, will not deviate from the single price established by the board of directors.

- Specific Procedures: Amortized Cost and Penny-Rounding Methods. Included within the procedures adopted by the board of directors for money market funds using either the Amortized Cost or Penny-Rounding Methods shall be the following:
  - Securities for Which Maturity is Determined by Reference to Demand Features. In the case of a security for which maturity is determined by reference to a Demand Feature, written procedures shall require ongoing review of the security's continued minimal credit risks, and that review must be based on, among other things, financial data for the most recent fiscal year of the issuer of the Demand Feature and, in the case of a security subject to a Conditional Demand Feature, the issuer of the security whose financial condition must be monitored under paragraph (c)(3)(iv) of this section, whether such data is publicly available or provided under the terms of the security's governing documentation.
  - Securities Subject to Demand Features or Guarantees. In the case of a security subject to one or more Demand Features or Guarantees that the fund's board of directors has determined

that the fund is not relying on to determine the quality (pursuant to paragraph (c)(3) of this section), maturity (pursuant to paragraph (d) of this section) or liquidity (pursuant to paragraph (c)(5) of this section) of the security subject to the Demand Feature or Guarantee, written procedures shall require periodic evaluation of such determination.

    - Adjustable Rate Securities Without Demand Features. In the case of a Variable Rate or Floating Rate Security that is not subject to a Demand Feature and for which maturity is determined pursuant to paragraphs (d)(1), (d)(2) or (d)(4) of this section, written procedures shall require periodic review of whether the interest rate formula, upon readjustment of its interest rate, can reasonably be expected to cause the security to have a market value that approximates its amortized cost value.
    - Asset Backed Securities. In the case of an Asset Backed Security, written procedures shall require the fund to periodically determine the number of Ten Percent Obligors (as that term is used in paragraph (c)(4)(ii)(D) of this section) deemed to be the issuers of all or a portion of the Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section; provided, however, written procedures need not require periodic determinations with respect to any Asset Backed Security that a fund's board of directors has determined, at the time of Acquisition, will not have, or is unlikely to have, Ten Percent Obligors that are deemed to be issuers of all or a portion of that Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section, and maintains a record of this determination.
    - Stress Testing. Written procedures shall provide for:
        - The periodic testing, at such intervals as the board of directors determines appropriate and reasonable in light of current market conditions, of the money market fund's ability to maintain a stable net asset value per share based upon specified hypothetical events that include, but are not limited to, a change in short-term interest rates, an increase in shareholder redemptions, a downgrade of or default on portfolio securities, and the widening or narrowing of spreads between yields on an appropriate benchmark the fund has selected for overnight interest rates and commercial paper and other types of securities held by the fund.
        - A report on the results of such testing to be provided to the board of directors at its next regularly scheduled meeting (or sooner, if appropriate in light of the results), which report shall include:
            - The date(s) on which the testing was performed and the magnitude of each hypothetical event that would cause the deviation of the money market fund's net asset value calculated using available market quotations (or appropriate substitutes which reflect current market conditions) from its net asset value per share calculated using amortized cost to exceed 1/2 of 1 percent; and
            - An assessment by the fund's adviser of the fund's ability to withstand the events (and concurrent occurrences of those events) that are reasonably likely to occur within the following year.
- Record Keeping and Reporting
    - Written Procedures. For a period of not less than six years following the replacement of such procedures with new procedures (the first two years in an easily accessible place), a written copy of the procedures (and any modifications thereto) described in paragraphs (c)(7) through (c)(10) and (e) of this section shall be maintained and preserved.

- Board Considerations and Actions. For a period of not less than six years (the first two years in an easily accessible place) a written record shall be maintained and preserved of the board of directors' considerations and actions taken in connection with the discharge of its responsibilities, as set forth in this section, to be included in the minutes of the board of directors' meetings.

- Credit Risk Analysis. For a period of not less than three years from the date that the credit risks of a portfolio security were most recently reviewed, a written record of the determination that a portfolio security presents minimal credit risks and the Designated NRSRO ratings (if any) used to determine the status of the security as an Eligible Security, First Tier Security or Second Tier Security shall be maintained and preserved in an easily accessible place.

- Determinations With Respect to Adjustable Rate Securities. For a period of not less than three years from the date when the determination was most recently made, a written record shall be preserved and maintained, in an easily accessible place, of the determination required by paragraph (c)(10)(iii) of this section (that a Variable Rate or Floating Rate Security that is not subject to a Demand Feature and for which maturity is determined pursuant to paragraphs (d)(1), (d)(2) or (d)(4) of this section can reasonably be expected, upon readjustment of its interest rate at all times during the life of the instrument, to have a market value that approximates its amortized cost).

- Determinations with Respect to Asset Backed Securities. For a period of not less than three years from the date when the determination was most recently made, a written record shall be preserved and maintained, in an easily accessible place, of the determinations required by paragraph (c)(10)(iv) of this section (the number of Ten Percent Obligors (as that term is used in paragraph (c)(4)(ii)(D) of this section) deemed to be the issuers of all or a portion of the Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section). The written record shall include:

  - The identities of the Ten Percent Obligors (as that term is used in paragraph (c)(4)(ii)(D) of this section), the percentage of the Qualifying Assets constituted by the securities of each Ten Percent Obligor and the percentage of the fund's Total Assets that are invested in securities of each Ten Percent Obligor; and

  - Any determination that an Asset Backed Security will not have, or is unlikely to have, Ten Percent Obligors deemed to be issuers of all or a portion of that Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section.

- Evaluations with Respect to Securities Subject to Demand Features or Guarantees. For a period of not less than three years from the date when the evaluation was most recently made, a written record shall be preserved and maintained, in an easily accessible place, of the evaluation required by paragraph (c)(10)(ii) (regarding securities subject to one or more Demand Features or Guarantees) of this section.

- Reports with Respect to Stress Testing. For a period of not less than six years (the first two years in an easily accessible place), a written copy of the report required under paragraph (c)(10)(v)(B) of this section shall be maintained and preserved.

- Inspection of Records. The documents preserved pursuant to this paragraph (c)(11) shall be subject to inspection by the Commission in accordance with section 31(b) of the Act (15 U.S.C. 80a-30(b)) as if such documents were records required to be maintained pursuant to rules adopted under section 31(a) of the Act (15 U.S.C. 80a-30(a)). If any action was taken under paragraphs (c)(7)(ii) (with respect to defaulted securities and events of insolvency) or (c)(8)(ii) (with respect to a deviation from the fund's share price of more than 1/2 of 1 percent) of this section, the money market fund will file an exhibit to the Form N-SAR (17 CFR 274.101) filed for the period in which the action was taken describing with specificity the nature and circumstances of such action. The money market fund will report in an exhibit to such Form any securities it holds on the final day of the reporting period that are not Eligible Securities.

- Web Site Disclosure of Portfolio Holdings. The money market fund shall post on its Web site, for a period of not less than six months, beginning no later than the fifth Business Day of the month, a schedule of its investments, as of the last Business Day of the prior month, that includes the following information:
  - With respect to the money market fund and each class thereof:
    - The dollar-weighted average portfolio maturity; and
    - The dollar-weighted average portfolio maturity determined without reference to the exceptions in paragraph (d) of this section regarding interest rate readjustments;
  - With respect to each security held by the money market fund:
    - Name of the issuer;
    - Category of investment (indicate the category that most closely identifies the instrument from among the following: Treasury Debt; Government Agency Debt; Variable Rate Demand Note; Other Municipal Debt; Financial Company Commercial Paper; Asset Backed Commercial Paper; Other Commercial Paper; Certificate of Deposit; Structured Investment Vehicle Note; Other Note; Treasury Repurchase Agreement; Government Agency Repurchase Agreement; Other Repurchase Agreement; Insurance Company Funding Agreement; Investment Company; Other Instrument);
    - CUSIP number (if any);
    - Principal amount;
    - Maturity date as determined under this section;
    - Final legal maturity date (taking into account any maturity date extensions that may be effected at the option of the issuer), if different from the maturity date as determined under this section;
    - Coupon or yield; and
    - Amortized cost value; and
  - A link to a Web site of the Securities and Exchange Commission where a user may obtain the most recent 12 months of publicly available information filed by the money market fund pursuant to Rule 270.30b1-7.
- Processing of Transactions. The money market fund (or its transfer agent) shall have the capacity to redeem and sell securities issued by the fund at a price based on the current net asset value per

share pursuant to Rule 270.22c-1. Such capacity shall include the ability to redeem and sell securities at prices that do not correspond to a stable net asset value or price per share.

- Maturity of Portfolio Securities. For purposes of this section, the maturity of a portfolio security shall be deemed to be the period remaining (calculated from the trade date or such other date on which the fund's interest in the security is subject to market action) until the date on which, in accordance with the terms of the security, the principal amount must unconditionally be paid, or in the case of a security called for redemption, the date on which the redemption payment must be made, except as provided in paragraphs (d)(1) through (d)(8) of this section:

    - Adjustable Rate Government Securities. A Government Security that is a Variable Rate Security where the variable rate of interest is readjusted no less frequently than every 397 calendar days shall be deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate. A Government Security that is a Floating Rate Security shall be deemed to have a remaining maturity of one day.

    - Short-Term Variable Rate Securities. A Variable Rate Security, the principal amount of which, in accordance with the terms of the security, must unconditionally be paid in 397 calendar days or less shall be deemed to have a maturity equal to the earlier of the period remaining until the next readjustment of the interest rate or the period remaining until the principal amount can be recovered through demand.

    - Long-Term Variable Rate Securities. A Variable Rate Security, the principal amount of which is scheduled to be paid in more than 397 calendar days, that is subject to a Demand Feature, shall be deemed to have a maturity equal to the longer of the period remaining until the next readjustment of the interest rate or the period remaining until the principal amount can be recovered through demand.

    - Short-Term Floating Rate Securities. A Floating Rate Security, the principal amount of which, in accordance with the terms of the security, must unconditionally be paid in 397 calendar days or less shall be deemed to have a maturity of one day.

    - Long-Term Floating Rate Securities. A Floating Rate Security, the principal amount of which is scheduled to be paid in more than 397 calendar days, that is subject to a Demand Feature, shall be deemed to have a maturity equal to the period remaining until the principal amount can be recovered through demand.

    - Repurchase Agreements. A repurchase agreement shall be deemed to have a maturity equal to the period remaining until the date on which the repurchase of the underlying securities is scheduled to occur, or, where the agreement is subject to demand, the notice period applicable to a demand for the repurchase of the securities.

    - Portfolio Lending Agreements. A portfolio lending agreement shall be treated as having a maturity equal to the period remaining until the date on which the loaned securities are scheduled to be returned, or where the agreement is subject to demand, the notice period applicable to a demand for the return of the loaned securities.

    - Money Market Fund Securities. An investment in a money market fund shall be treated as having a maturity equal to the period of time within which the Acquired money market fund is required to make payment upon redemption, unless the Acquired money market fund has agreed in writing to provide redemption proceeds to the investing money market fund within a shorter time period, in which case the maturity of such investment shall be deemed to be the shorter period.

- Delegation. The money market fund's board of directors may delegate to the fund's investment adviser or officers the responsibility to make any determination required to be made by the board of directors under this section (other than the determinations required by paragraphs (a)(11)(i) (designation of NRSROs); (c)(1) (board findings); (c)(7)(ii) (defaults and other events); (c)(8)(i) (general required procedures: Amortized Cost Method); (c)(8)(ii)(A) (shadow pricing), (B) (prompt consideration of deviation), (C) (material dilution or unfair results); (c)(9) (required procedures: Penny Rounding Method); and (c)(10)(v)(A) (stress testing procedures) of this section; provided that:

    - Written Guidelines. The Board shall establish and periodically review written guidelines (including guidelines for determining whether securities present minimal credit risks as required in paragraph (c)(3) of this section) and procedures under which the delegate makes such determinations.

    - Oversight. The Board shall take any measures reasonably necessary (through periodic reviews of fund investments and the delegate's procedures in connection with investment decisions and prompt review of the adviser's actions in the event of the default of a security or Event of Insolvency with respect to the issuer of the security or any Guarantee to which it is subject that requires notification of the Commission under paragraph (c)(7)(iii) of this section) to assure that the guidelines and procedures are being followed.

Regulatory History

61 FR 13956, 13976, March 28, 1996; 62 FR 64968, 64978, Dec. 9, 1997; 66 FR 36156, 36161, July 11, 2001; 75 FR 10060, 10109, Mar. 4, 2010

KAR 14:011 Qualified Investments

(Edited)

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) means a credit rating agency that provides its opinion on the creditworthiness of an entity and the financial obligations issues by that entity, which is ~~as designated~~registered with ~~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, but may engage in securities lending and may borrow money to meet the short-term liquidity needs to 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, and 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~~in the highest category by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization 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~~nationally recognized statistical rating organization 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 AA or higher by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization, 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~~ in the highest category ~~or higher~~ by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization, 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~~Time deposits with banks having~~rated in~~ the highest short-term rating ~~with~~ and assets in excess of one (1) billion dollars and bankers' acceptances issued by banks ~~rated A or higher~~having the highest short-term rating.

(d) 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~~ agency mortgage backed 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 AA or higher by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization, with a maturity not to exceed five (5) years. The maturity and credit 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, provided that the pool is rated in the highest category by a nationally recognized statistical rating organization.

(11) ~~Any f~~Floating rate securities which would otherwise qualify under this section except for maturity or average life ~~restrictions~~restrictions provided the maximum maturity does not exceed five (5) years.

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~~thirty-five (~~25~~35) 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) No more than 20% of total pool assets shall be invested in a single mutual fund.

(6) For purposes of meeting the minimum credit rating requirements herein, the lowest rating assigned by a nationally recognized statistical rating organization shall apply.

(7) Privately offered securities issued pursuant to Rule 144A of the Securities Act of 1933 or other securities where the buyer must be a qualified institutional buyer will not be purchased.

(~~5~~8) 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 be divided into the short-term pool and the limited term pool.

(c) The short-term pool will not purchase a security with a final maturity exceeding 397 days and the weighted average maturity shall not exceed ninety (90) days.

(d) The limited term pool will be managed to meet the requirements of Section 2a.7 of the Investment Company Act of 1940. Terms used in this section will have the definition prescribed in the Investment Company Act of 1940.

(i) The pool will not purchase a security with a ~~duration~~ final maturity exceeding 397 days~~one (1) year~~.

(ii) The

~~(c) The duration~~ weighted average maturity ~~of the short-term pool~~ shall not exceed ~~ninety~~ sixty (60~~90~~) days and the weighted average life shall not exceed one-hundred and twenty (120) days.

(iii) At least 10% of the pool will be invested in liquid securities and at least 30% of the pool will be invested in assets maturing in seven (7) days or less.

(iv) No more than 5% of the pool will be invested in illiquid securities.

(v) No more than 3% of the pool will be invested in second tier securities and no more than 0.05% of the pool will be invested in a second tier security issuer.

(vi) The net asset value of pool shares will be computed using the amortized cost method

(vii) The shadow net asset value using the market value of pool holdings will be computed no less than monthly and made public within 60 days of the calculation date.

(viii) Stress testing of the pool based on redemptions and changes in market value will be performed no less than quarterly and reported to the SIC.

(ix) Monthly portfolio listings will be published to a public website and will remain available for no less than 6 months.

(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~~limited-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~~nationally recognized statistical rating organization;

(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~~nationally recognized statistical rating organization; 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~~nationally recognized statistical rating organization;

(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 third-party custodial agreement or Custodial ~~undertaking~~ Undertaking in ~~Connection~~ connection with Master Repurchase Agreement for tri-party repurchase agreements; and

(d) Be primary dealer of the Federal Reserve who is rated A1-P1 or higher by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization.

(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~~nationally recognized statistical rating organization;

(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.

(7) Notwithstanding the broker-dealer requirements described in this section, the state may purchase securities directly from the issuer.

(8)(a) All securities purchases and sales will be transacted through a formal and competitive process requiring the solicitation and evaluation of at least three bids/offers, taking into consideration current market conditions. Electronic bids will be accepted.

(b) Primary fixed price offerings may be purchased from broker-dealers without competitive solicitation if it is determined that no comparable security is available in the secondary market at a higher yield.

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.)

KAR 14:081 Repurchase Agreements
(Edited)

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)(a) or (b), 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)(a) and (b) 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~~daily for all repurchase agreements maturing in greater than one business day.

(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.)

KAR 14:091 Guidelines for money market instruments
(Edited)

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~~ short-term rating category by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization.
(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 short-term rating category by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization.

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 short-term rating category~~ies~~ by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization and which are eligible for purchase by the Federal Reserve System.
(2) The purchase of these instruments shall be:
(a) Made on a delivery versus 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 short-term rating category by a ~~nationally recognized rating agency~~nationally recognized statistical rating organization.
(2) The purchase of these instruments shall be:
(a) Made on a delivery versus 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~~nationally recognized statistical rating organization.
(2) The office may purchase uncollateralized negotiable certificates of deposit if issued by banks rated in one (1) of the two (2) highest categories by a nationally recognized statistical rating organization.
(3) The purchase of these instruments shall be:
(a) Made on a delivery versus 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~~ thirty-five (~~20~~35) 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.)

Rule 144A, Private Resales of Securities to Institutions

(Qualified Institutional Buyer Requirements)

Qualified Institutional Buyer Requirements

General Rules and Regulations
Promulgated under the Securities Act of 1933

Rule 144A -- Private Resales of Securities to Institutions

Preliminary Notes

1. This section relates solely to the application of section 5 of the Act and not to antifraud or other provisions of the federal securities laws.

2. Attempted compliance with this section does not act as an exclusive election; any seller hereunder may also claim the availability of any other applicable exemption from the registration requirements of the Act.

3. In view of the objective of this section and the policies underlying the Act, this section is not available with respect to any transaction or series of transactions that, although in technical compliance with this section, is part of a plan or scheme to evade the registration provisions of the Act. In such cases, registration under the Act is required.

4. Nothing in this section obviates the need for any issuer or any other person to comply with the securities registration or broker-dealer registration requirements of the Securities Exchange Act of 1934 (the *Exchange Act)*, whenever such requirements are applicable.

5. Nothing in this section obviates the need for any person to comply with any applicable state law relating to the offer or sale of securities.

6. Securities acquired in a transaction made pursuant to the provisions of this section are deemed to be *restricted securities* within the meaning of Rule 144(a)(3).

7. The fact that purchasers of securities from the issuer thereof may purchase such securities with a view to reselling such securities pursuant to this section will not affect the availability to such issuer of an exemption under section 4(2) of the Act, or Regulation D under the Act, from the registration requirements of the Act.

a. *Definitions.*

    1. For purposes of this section, *qualified institutional buyer* shall mean:

        i. Any of the following entities, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the entity:

            A. Any *insurance company* as defined in section 2(a)(13) of the Act ;

            Note: A purchase by an insurance company for one or more of its separate accounts, as defined by section 2(a)(37) of the Investment Company Act of 1940 (the "Investment Company Act"), which are neither registered under section 8 of the Investment Company Act nor required to be so registered, shall be deemed to be a purchase for the account of such insurance company.

B. Any *investment company* registered under the Investment Company Act or any *business development company* as defined in section 2(a)(48) of that Act;

C. Any *Small Business Investment Company* licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958;

D. Any *plan* established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees;

E. Any *employee benefit plan* within the meaning of title I of the Employee Retirement Income Security Act of 1974;

F. Any trust fund whose trustee is a bank or trust company and whose participants are exclusively plans of the types identified in paragraph (a)(1)(i)(D) or (E) of this section, except trust funds that include as participants individual retirement accounts or H.R. 10 plans.

G. Any *business development company* as defined in section 202(a)(22) of the Investment Advisers Act of 1940;

H. Any organization described in section 501(c) (3) of the Internal Revenue Code, corporation (other than a bank as defined in section 3(a)(2) of the Act or a savings and loan association or other institution referenced in section 3(a)(5)(A) of the Act or a foreign bank or savings and loan association or equivalent institution), partnership, or Massachusetts or similar business trust; and

I. Any *investment adviser* registered under the Investment Advisers Act.

ii. Any *dealer* registered pursuant to section 15 of the Exchange Act, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least $10 million of securities of issuers that are not affiliated with the dealer, *Provided,* That securities constituting the whole or a part of an unsold allotment to or subscription by a dealer as a participant in a public offering shall not be deemed to be owned by such dealer;

iii. Any *dealer* registered pursuant to section 15 of the Exchange Act acting in a riskless principal transaction on behalf of a qualified institutional buyer;

Note: A registered dealer may act as agent, on a non-discretionary basis, in a transaction with a qualified institutional buyer without itself having to be a qualified institutional buyer.

iv. Any investment company registered under the Investment Company Act, acting for its own account or for the accounts of other qualified institutional buyers, that is part of a family of investment companies which own in the aggregate at least $100 million in securities of issuers, other than issuers that are affiliated with the investment company or are part of such family of investment companies. *Family of investment companies* means any two or more investment companies registered under the Investment Company Act, except for a unit investment trust whose assets consist solely of shares of one or more registered investment companies, that have the same investment adviser (or, in the case of unit investment trusts, the same depositor), Provided That, for purposes of this section:

A. Each series of a series company (as defined in Rule 18f-2 under the Investment Company Act) shall be deemed to be a separate investment company; and

B. Investment companies shall be deemed to have the same adviser (or depositor) if their advisers (or depositors) are majority-owned subsidiaries of the same parent, or if one investment company's adviser (or depositor) is a majority-owned subsidiary of the other investment company's adviser (or depositor);

v. Any entity, all of the equity owners of which are qualified institutional buyers, acting for its own account or the accounts of other qualified institutional buyers; and

vi. Any *bank* as defined in section 3(a)(2) of the Act, any savings and loan association or other institution as referenced in section 3(a)(5)(A) of the Act, or any foreign bank or savings and loan association or equivalent institution, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with it and that has an audited net worth of at least $25 million as demonstrated in its latest annual financial statements, as of a date not more than 16 months preceding the date of sale under the Rule in the case of a U.S. bank or savings and loan association, and not more than 18 months preceding such date of sale for a foreign bank or savings and loan association or equivalent institution.

2. In determining the aggregate amount of securities owned and invested on a discretionary basis by an entity, the following instruments and interests shall be excluded: bank deposit notes and certificates of deposit; loan participations; repurchase agreements; securities owned but subject to a repurchase agreement; and currency, interest rate and commodity swaps.

3. The aggregate value of securities owned and invested on a discretionary basis by an entity shall be the cost of such securities, except where the entity reports its securities holdings in its financial statements on the basis of their market value, and no current information with respect to the cost of those securities has been published. In the latter event, the securities may be valued at market for purposes of this section.

4. In determining the aggregate amount of securities owned by an entity and invested on a discretionary basis, securities owned by subsidiaries of the entity that are consolidated with the entity in its financial statements prepared in accordance with generally accepted accounting principles may be included if the investments of such subsidiaries are managed under the direction of the entity, except that, unless the entity is a reporting company under section 13 or 15(d) of the Exchange Act,

securities owned by such subsidiaries may not be included if the entity itself is a majority-owned subsidiary that would be included in the consolidated financial statements of another enterprise.

5. For purposes of this section, *riskless principal transaction* means a transaction in which a dealer buys a security from any person and makes a simultaneous offsetting sale of such security to a qualified institutional buyer, including another dealer acting as riskless principal for a qualified institutional buyer.

6. For purposes of this section, *effective conversion premium* means the amount, expressed as a percentage of the security's conversion value, by which the price at issuance of a convertible security exceeds its conversion value.

7. For purposes of this section, *effective exercise premium* means the amount, expressed as a percentage of the warrant's exercise value, by which the sum of the price at issuance and the exercise price of a warrant exceeds its exercise value.

b. *Sales by persons other than issuers or dealers.* Any person, other than the issuer or a dealer, who offers or sells securities in compliance with the conditions set forth in paragraph (d) of this section shall be deemed not to be engaged in a distribution of such securities and therefore not to be an underwriter of such securities within the meaning of sections 2(a)(11) and 4(1) of the Act.

c. *Sales by Dealers.* Any dealer who offers or sells securities in compliance with the conditions set forth in paragraph (d) of this section shall be deemed not to be a participant in a distribution of such securities within the meaning of section 4(3)(C) of the Act and not to be an underwriter of such securities within the meaning of section 2 (11) of the Act, and such securities shall be deemed not to have been offered to the public within the meaning of section 4(3)(A) of the Act.

d. *Conditions to be met.* To qualify for exemption under this section, an offer or sale must meet the following conditions:

1. The securities are offered or sold only to a qualified institutional buyer or to an offeree or purchaser that the seller and any person acting on behalf of the seller reasonably believe is a qualified institutional buyer. In determining whether a prospective purchaser is a qualified institutional buyer, the seller and any person acting on its behalf shall be entitled to rely upon the following non-exclusive methods of establishing the prospective purchaser's ownership and discretionary investments of securities:

   i. The prospective purchaser's most recent publicly available financial statements, *Provided* That such statements present the information as of a date within 16 months preceding the date of sale of securities under this section in the case of a U.S. purchaser and within 18 months preceding such date of sale for a foreign purchaser;

   ii. The most recent publicly available information appearing in documents filed by the prospective purchaser with the Commission or another United States federal, state, or local governmental agency or self-regulatory organization, or with a foreign governmental agency or self-regulatory organization, *Provided* That any such information is as of a date within 16 months preceding the date of sale of securities under this section in the case of a U.S. purchaser and within 18 months preceding such date of sale for a foreign purchaser;

iii. The most recent publicly available information appearing in a recognized securities manual, *Provided* That such information is as of a date within 16 months preceding the date of sale of securities under this section in the case of a U.S. purchaser and within 18 months preceding such date of sale for a foreign purchaser; or

iv. A certification by the chief financial officer, a person fulfilling an equivalent function, or other executive officer of the purchaser, specifying the amount of securities owned and invested on a discretionary basis by the purchaser as of a specific date on or since the close of the purchaser's most recent fiscal year, or, in the case of a purchaser that is a member of a family of investment companies, a certification by an executive officer of the investment adviser specifying the amount of securities owned by the family of investment companies as of a specific date on or since the close of the purchaser's most recent fiscal year;

2. The seller and any person acting on its behalf takes reasonable steps to ensure that the purchaser is aware that the seller may rely on the exemption from the provisions of section 5 of the Act provided by this section;

3. The securities offered or sold:

    i. Were not, when issued, of the same class as securities listed on a national securities exchange registered under section 6 of the Exchange Act or quoted in a U.S. automated inter-dealer quotation system; *Provided*, That securities that are convertible or exchangeable into securities so listed or quoted at the time of issuance and that had an effective conversion premium of less than 10 percent, shall be treated as securities of the class into which they are convertible or exchangeable; and that warrants that may be exercised for securities so listed or quoted at the time of issuance, for a period of less than 3 years from the date of issuance, or that had an effective exercise premium of less than 10 percent, shall be treated as securities of the class to be issued upon exercise; and *Provided further,* That the Commission may from time to time, taking into account then-existing market practices, designate additional securities and classes of securities that will not be deemed of the same class as securities listed on a national securities exchange or quoted in a U.S. automated inter-dealer quotation system; and

    ii. Are not securities of an open-end investment company, unit investment trust or face-amount certificate company that is or is required to be registered under section 8 of the Investment Company Act; and

4.

    i. In the case of securities of an issuer that is neither subject to section 13 or 15(d) of the Exchange Act, nor exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act, nor a foreign government as defined in Rule 405 eligible to register securities under Schedule B of the Act, the holder and a prospective purchaser designated by the holder have the right to obtain from the issuer, upon request of the holder, and the prospective purchaser has received from the issuer, the seller, or a person acting on either of their behalf, at or prior to the time of sale, upon such prospective purchaser's request to the holder or the issuer, the following information (which shall be reasonably current in relation to the date of resale under this section): a very brief statement of the nature of the business of the issuer and the products and services it offers; and the issuer's most recent balance sheet and profit and loss and retained earnings statements, and similar financial statements for such part of the two preceding fiscal years as the issuer has been in operation (the financial statements should be audited to the extent reasonably available).

ii. The requirement that the information be *reasonably current* will be presumed to be satisfied if:

A. The balance sheet is as of a date less than 16 months before the date of resale, the statements of profit and loss and retained earnings are for the 12 months preceding the date of such balance sheet, and if such balance sheet is not as of a date less than 6 months before the date of resale, it shall be accompanied by additional statements of profit and loss and retained earnings for the period from the date of such balance sheet to a date less than 6 months before the date of resale; and

B. The statement of the nature of the issuer's business and its products and services offered is as of a date within 12 months prior to the date of resale; or

C. With regard to foreign private issuers, the required information meets the timing requirements of the issuer's home country or principal trading markets.

e. Offers and sales of securities pursuant to this section shall be deemed not to affect the availability of any exemption or safe harbor relating to any previous or subsequent offer or sale of such securities by the issuer or any prior or subsequent holder thereof.

55 FR 17945, Apr. 30, 1990, as amended at 57 FR 48722, Oct. 28, 1992

Kentucky Distressed and 144A Security Analysis

Indymac Index Mortgage Loan Trust – August 2034

CUSIP	**45660NQ40**
Issuer	Indymac Indx Mortgage Loan Trust
Description	CMO
Portfolio	INTERMED
Par Value	3,266,000.00
Book Value	3,249,380.35
Market Value	2,654,038.75
Effective Duration	7.36
Mortgage Prepay Speed	4.00
Original Face	17,031,000.00
Original Cost	3,244,306.96
Mortgage Factor	0.19
Remaining Face Value	3,275,010.15
Loss Adjusted Yield	9.78%
Maturity Date	8/25/2034
Credit Quality	
S&P Rating	AA-
Moody's Rating	B3
Fitch Rating	-
Collateral Type	WHARM2.5
Trade Date	4/20/2007
Settlement Date	4/23/2007
Weighted Average Life	5.56
Unrealized Gain/Loss	(595,341.60)
Loss Write Downs	-
Bloomberg Projected Loses	2.6%

Pricing		
Price Source 1	Kentucky	81.03
Price Source 2	Bloomberg	75.37
Price Source 3	IDC	81.03
Price Source 4	Broker	mid 70s

Recommendation

Hold

Troubled Security Characteristics

	Private Placement
X	>5% MV Loses
	Illiquid
	Downgraded

Comments: This security is the third highest tranche, but no lower tranches remain. Mortgages originated in 2004, which is near the peak of the housing bubble. Current market price on the security reflects a significant impairment. This security is currently projected to incur at least 2.6% in losses by May 2015. Collateral has experienced 1.35% cumulative losses. cumulative 90+ day delinquency is 12.7%, collateral is over 50% California loans. This is a poor geographic vintage and delinquency history indicate that collateral will perform poorly.

JP Morgan Mortgage Trust – August 2036

CUSIP	46629AAH4
Issuer	JP Morgan Mortgage Trust
Description	CMO
Portfolio	INTERMED
Par Value	1,989,000.00
Book Value	2,067,474.27
Market Value	2,052,398.35
Effective Duration	0.54
Mortgage Prepay Speed	225.00
Original Face	10,000,000.00
Original Cost	2,069,035.08
Mortgage Factor	0.20
Remaining Face Value	2,060,022.49
Loss Adjusted Yield	5.46%
Maturity Date	8/25/2036
Credit Quality	
S&P Rating	CCC
Moody's Rating	B3
Fitch Rating	C
Collateral Type	WH30 5.9
Trade Date	8/8/2006
Settlement Date	8/11/2006
Weighted Average Life	2.07
Unrealized Gain/Loss	(15,075.92)
Loss Write Downs	-
Bloomberg Projected Loses	4.6%

Pricing		
Price Source 1	Kentucky	99.12
Price Source 2	Bloomberg	96.00
Price Source 3	IDC	99.12
Price Source 4	Broker	mid 90s

Recommendation
Hold

Troubled Security Characteristics

	Private Placement
	>5% MV Loses
	Illiquid
X	Downgraded

Comments: Security represents the 8th senior tranche of 31 tranches. Underlying mortgages are owner occupied fixed-rate mortgages with 34% representing California loans. Vintage is 2006. Underlying borrower's had an initial credit score of 739, which is fairly high. 9.6% 90+ day delinquent. Geographic and vintage point to poor collateral performance , but since the security has a short remaining life of approximately 1/4 year, we would recommend holding the security.

Countrywide Alternative Loan Trust – August 2036

CUSIP	021464AD4
Issuer	Countrywide Alternative Loan Trust
Description	CMO
Portfolio	SHRT TRM
Par Value	10,595,000.00
Book Value	10,609,750.29
Market Value	6,100,648.61
Effective Duration	4.89
Mortgage Prepay Speed	15.00
Original Face	17,000,000.00
Original Cost	10,607,609.36
Mortgage Factor	0.62
Remaining Face Value	10,632,382.81
Loss Adjusted Yield	12.62%
Maturity Date	4/25/2036
Credit Quality	
S&P Rating	D
Moody's Rating	Caa2
Fitch Rating	-
Collateral Type	AltAA4.1
Trade Date	6/25/2009
Settlement Date	6/25/2009
Weighted Average Life	1.56
Unrealized Gain/Loss	(4,509,101.68)
Loss Write Downs	1,237,654.08
Bloomberg Projected Loses	20.7%

Pricing		
Price Source 1	Kentucky	57.38
Price Source 2	Bloomberg	67.03
Price Source 3	IDC	67.84
Price Source 4	Broker	low 60s

Recommendation
Sell

Troubled Security Characteristics

	Private Placement
X	>5% MV Loses
X	Illiquid
X	Downgraded

Comments: 3rd of 4 tranches. Underlying mortgages originated in 2006. A high percentage of loans are adjustable rate mortgages (76%) with 18% of mortgages used to purchase vacation or investment properties. A high percentage of loans originated in states with highly impaired housing markets: California (40%), Florida (14%), and Nevada (7%). Average credit score of 694. Cumulative losses 18.1% are already high with $1.2 million of the $4.5 million unrealized loss already being written down. Geographic and vintage of this issue suggest this may continue, we would recommend selling this security.

Battery Park City -- November 2031

CUSIP	07133AEZ1
Issuer	Battery Park City Ny Auth
Description	MUNI
Portfolio	SHRT TRM
Par Value	4,175,000.00
Book Value	4,175,000.00
Market Value	4,175,000.00
Effective Duration	0.07
Original Face	4,175,000.00
Original Cost	4,175,000.00
Remaining Face Value	4,175,000.00
Loss Adjusted Yield	-
Maturity Date	11/1/2031
Credit Quality	
S&P Rating	AA+
Moody's Rating	Aa3
Fitch Rating	AA
Trade Date	2/21/2008
Settlement Date	2/22/2008
Unrealized Gain/Loss	-
Loss Write Downs	-
Bloomberg Projected Loses	

Pricing		
Price Source 1	Kentucky	100.00
Price Source 2	Bloomberg	n/a
Price Source 3	IDC	n/a
Price Source 4	Broker	mid 80's

Recommendation
Sell

Troubled Security Characteristics

- [ ] Private Placement
- [ ] >5% MV Loses
- [ ] Illiquid
- [ ] Downgraded

Comments: This auction rate security was purchased in February 2008. The interest rate resets monthly and is currently yielding 0.496%. There have been no successful auctions since August 2008 resulting in a lack of liquidity. This security is not eligible for 2a-7 like funds. We have no concerns of the underlying credit quality of the issuer, but view the security having little to no liquidity .

If the Commonwealth is able to obtain a price near par, we would recommend selling the security.

Countrywide Asset-Backed Certificates – August 2032

CUSIP	126671PE0
Issuer	Countrywide Asset-Backed Certificate
Description	ABS
Portfolio	SHRT TRM
Par Value	2,384,000.00
Book Value	2,391,558.54
Market Value	1,489,704.88
Effective Duration	0.28
Mortgage Prepay Speed	2.00
Original Face	82,800,000.00
Original Cost	2,391,733.30
Mortgage Factor	0.03
Remaining Face Value	2,390,872.57
Loss Adjusted Yield	12.40%
Maturity Date	8/25/2032
Credit Quality	
S&P Rating	CCC
Moody's Rating	Caa3
Fitch Rating	-
Collateral Type	RESB/7.5
Trade Date	6/26/2006
Settlement Date	6/28/2006
Weighted Average Life	5.78
Unrealized Gain/Loss	(901,853.66)
Loss Write Downs	-
Bloomberg Projected Loses	7.2%

Pricing		
Price Source 1	Kentucky	62.31
Price Source 2	Bloomberg	64.10
Price Source 3	IDC	60.62
Price Source 4	Broker	mid 50s

Recommendation
Sell

Troubled Security Characteristics

	Private Placement
X	>5% MV Loses
X	Illiquid
X	Downgraded

Comments: This security represents the most senior tranche. 71% of the underlying mortgages are fixed-rate, with the remaining adjustable-rate. Mortgages were originated in 2001 & 2002. The issue is more seasoned, potentially suggesting the initial wave of delinquencies and foreclosures have been absorbed. 41% of the underlying mortgages are 90+ day delinquent, with 24% of the underlying mortgages in foreclosure. Collateral is performing very poorly but subordination may reduce losses on this tranche.

Countrywide Home Equity Loan Trust – April 2032

CUSIP	**126685CE4**
Issuer	Countrywide Home Equity Loan Trust
Description	ABS
Portfolio	SHRT TRM
Par Value	4,512,000.00
Book Value	4,442,329.40
Market Value	1,570,805.05
Effective Duration	(1.25)
Mortgage Prepay Speed	-
Original Face	18,000,000.00
Original Cost	4,428,028.52
Mortgage Factor	0.25
Remaining Face Value	4,512,640.54
Loss Adjusted Yield	n/a
Maturity Date	4/15/2032
Credit Quality	
S&P Rating	D
Moody's Rating	Ca
Fitch Rating	-
Collateral Type	HELOC7.7
Trade Date	8/15/2007
Settlement Date	8/20/2007
Weighted Average Life	n/a
Unrealized Gain/Loss	(2,871,524.35)
Loss Write Downs	327,469.14
Bloomberg Projected Loses	

Pricing		
Price Source 1	Kentucky	34.88
Price Source 2	Bloomberg	n/a
Price Source 3	IDC	34.88
Price Source 4	Broker	hi 30s

Recommendation
Sell

Troubled Security Characteristics

	Private Placement
X	>5% MV Loses
X	Illiquid
X	Downgraded

Comments: This security is in the highest level tranche. The collateral backing the security is home equity lines of credit (secondary liens). This security has already seen huge losses causing the market value of the security to be priced in the mid 30's.

Based upon recent paydowns, it will take over 4 years to recoup the current depressed market value ($1.5 million). During the interim, the interest received is minimal at 0.42%. Although a significant loss would be incurred, we would recommend selling this security.

Education Loan Co Trust – August 2041

CUSIP	**28148VAB1**
Issuer	Education Loan Co Trust
Description	MUNI
Portfolio	SHRT TRM
Par Value	9,200,000.00
Book Value	9,200,000.00
Market Value	9,200,000.00
Effective Duration	0.01
Original Face	9,200,000.00
Original Cost	9,200,000.00
Remaining Face Value	9,200,000.00
Loss Adjusted Yield	n/a
Maturity Date	8/1/2041
Credit Quality	
S&P Rating	AAA /*-
Moody's Rating	-
Fitch Rating	AAA
Collateral Type	SECURED
Trade Date	8/31/2007
Settlement Date	8/31/2007
Weighted Average Life	n/a
Unrealized Gain/Loss	-
Loss Write Downs	-
Bloomberg Projected Loses	

Private Placement

Pricing		
Price Source 1	Kentucky	100.00
Price Source 2	Bloomberg	n/a
Price Source 3	IDC	n/a
Price Source 4	Broker	n/a

Recommendation
Sell

Troubled Security Characteristics

X	Private Placement
	>5% MV Loses
	Illiquid
	Downgraded

Comments: In PFM's opinion, the Commonwealth of Kentucky is not a Qualified Institutional Buyer and therefore not eligible to purchase private placement securities. As a private placement security, there was no pricing data from Bloomberg, IDC, or third-party brokers that PFM contacted. The security has an irregular coupon pattern. In August, the interest rate was 1.37%. In September, the interest rate was 1.39%. In October, the interest rate was 0.61%. In November, the interest rate was 0.00%.

If the Commonwealth can obtain a quote near par, we would recommend selling this security.

Greenpoint Home Equity Loan Trust – July 2029

CUSIP	395385AQ0
Issuer	Greenpoint Home Equity Loan Trust
Description	
Portfolio	SHRT TRM
Par Value	103,000.00
Book Value	109,410.92
Market Value	82,029.89
Effective Duration	17.53
Mortgage Prepay Speed	-
Original Face	5,000,000.00
Original Cost	109,390.89
Mortgage Factor	0.02
Remaining Face Value	109,459.29
Loss Adjusted Yield	-
Maturity Date	7/25/2029
Credit Quality	
S&P Rating	BBB+
Moody's Rating	Caa2
Fitch Rating	-
Collateral Type	HELOC6.3
Trade Date	6/10/2004
Settlement Date	6/10/2004
Weighted Average Life	-
Unrealized Gain/Loss	(27,381.03)
Loss Write Downs	-
Bloomberg Projected Loses	

Pricing		
Price Source 1	Kentucky	74.94
Price Source 2	Bloomberg	n/a
Price Source 3	IDC	73.27
Price Source 4	Broker	nid-hi 70s

Recommendation
Hold

Troubled Security Characteristics

	Private Placement
X	>5% MV Loses
X	Illiquid
	Downgraded

Comments: Based upon the payment received in October, the remaining principal could be recovered in 17 months. Subordinated tranches all paid off. Minimal collateral information is available making proper analysis challenging, but believe the mid-70's pricing is less than fair value.

Residential Asset Securitization – April 2036

PFM

CUSIP	45660L6N4
Issuer	Residential Asset Securitization
Description	CMO
Portfolio	SHRT TRM
Par Value	4,335,000.00
Book Value	4,341,738.96
Market Value	2,642,510.55
Effective Duration	2.49
Mortgage Prepay Speed	50.00
Original Face	10,025,000.00
Original Cost	4,342,110.10
Mortgage Factor	0.43
Remaining Face Value	4,337,815.67
Loss Adjusted Yield	14.59%
Maturity Date	4/25/2036
Credit Quality	
S&P Rating	CCC
Moody's Rating	Caa2
Fitch Rating	-
Collateral Type	AltA35.7
Trade Date	6/25/2009
Settlement Date	6/25/2009
Weighted Average Life	7.27
Unrealized Gain/Loss	(1,699,228.41)
Loss Write Downs	-
Bloomberg Projected Loses	18.3%

Pricing		
Price Source 1	Kentucky	60.92
Price Source 2	Bloomberg	47.45
Price Source 3	IDC	49.07
Price Source 4	Broker	mid 30s

Recommendation
Sell

Troubled Security Characteristics

	Private Placement
X	>5% MV Loses
X	Illiquid
X	Downgraded

Comments: The issue is the 6th of 8 senior tranches. Although no losses have been incurred to date on this tranche, principal is being repaid at a slow pace and losses are expected to be incurred. The issue failed the FFIEC Test making it less desirable and accelerating payments to more senior tranches.

Morgan Stanley Mortgage Loan Trust – February 2047

CUSIP	**61751JAA9**
Issuer	Morgan Stanley Mortgage Loan Trust
Description	CMO
Portfolio	SHRT TRM
Par Value	5,723,000.00
Book Value	5,774,034.26
Market Value	3,021,667.61
Effective Duration	5.87
Mortgage Prepay Speed	50.00
Original Face	10,000,000.00
Original Cost	5,774,034.26
Mortgage Factor	0.57
Remaining Face Value	5,774,034.26
Loss Adjusted Yield	13.04%
Maturity Date	2/25/2047
Credit Quality	
S&P Rating	CCC
Moody's Rating	Caa2
Fitch Rating	-
Collateral Type	WH30 5.2
Trade Date	3/30/2007
Settlement Date	3/30/2007
Weighted Average Life	8.14
Unrealized Gain/Loss	(2,752,366.65)
Loss Write Downs	-
Bloomberg Projected Loses	15.7%

Pricing		
Price Source 1	Kentucky	52.33
Price Source 2	Bloomberg	51.92
Price Source 3	IDC	48.98
Price Source 4	Broker	low 50s

Recommendation
Hold

Troubled Security Characteristics

	Private Placement
X	>5% MV Loses
X	Illiquid
X	Downgraded

Comments: Most senior tranche with no losses incurred to date. Mortgage originated in 2006 (70.3%) and 2007 (29.7%), but are 100% fixed-rate mortgages. A high percentage of mortgages (43%) are with California. 19% currently in foreclosure, 28% are delinquent for more than 90+ days. Yield received on security is adjustable. The current market value (high 40's / low 50's) appear to more greatly impaired than the underlying collateral.

Morgan Stanley Mortgage Loan Trust – January 2047

CUSIP	**61752RAA0**
Issuer	Morgan Stanley Mortgage Loan Trust
Description	ABS
Portfolio	SHRT TRM
Par Value	4,783,000.00
Book Value	4,919,360.66
Market Value	2,780,914.58
Effective Duration	3.61
Mortgage Prepay Speed	75.00
Original Face	10,000,000.00
Original Cost	4,919,360.66
Mortgage Factor	0.48
Remaining Face Value	4,919,360.66
Loss Adjusted Yield	12.92%
Maturity Date	1/25/2047
Credit Quality	
S&P Rating	CCC
Moody's Rating	Caa3
Fitch Rating	-
Collateral Type	HOMEE6.0
Trade Date	2/21/2007
Settlement Date	2/28/2007
Weighted Average Life	10.78
Unrealized Gain/Loss	(2,138,446.08)
Loss Write Downs	-
Bloomberg Projected Loses	32.8%

Pricing		
Price Source 1	Kentucky	56.53
Price Source 2	Bloomberg	38.82
Price Source 3	IDC	52.11
Price Source 4	Broker	mid 40s

Recommendation
Sell

Troubled Security Characteristics

	Private Placement
X	>5% MV Loses
X	Illiquid
X	Downgraded

Comments: Highest senior tranche. Floating rate structure. Over the last 12 months, $868,000 of principal has been repaid (roughly 1/3 of market value). 94.9% owner occupied, 100% 2006 originated, 100% fixed-rate mortgages. 48% of loans originated in California. Currently 21% is in foreclosure and 37% are 90+ days delinquent . Future losses are expected to mount and projected to climb as high as 33%.

Residential Funding Mortgage Security – August 2017

CUSIP	76110VKS6
Issuer	Residential Funding Mortgage Security
Description	ABS
Portfolio	SHRT TRM
Par Value	523,000.00
Book Value	570,130.06
Market Value	485,392.72
Effective Duration	0.53
Mortgage Prepay Speed	50.00
Original Face	10,500,000.00
Original Cost	568,970.27
Mortgage Factor	0.05
Remaining Face Value	571,403.19
Loss Adjusted Yield	10.14%
Maturity Date	8/25/2017
Credit Quality	
S&P Rating	BBB/*-
Moody's Rating	Baa1
Fitch Rating	-
Collateral Type	HOMEE8.2
Trade Date	7/11/2006
Settlement Date	7/14/2006
Weighted Average Life	1.68
Unrealized Gain/Loss	(84,737.34)
Loss Write Downs	-
Bloomberg Projected Loses	0.0%

Pricing		
Price Source 1	Kentucky	85.75
Price Source 2	Bloomberg	91.17
Price Source 3	IDC	85.75
Price Source 4	Broker	low 90s

Recommendation
Hold

Troubled Security Characteristics

	Private Placement
X	>5% MV Loses
	Illiquid
	Downgraded

Comments: Last remaining senior tranche. Other senior tranches did not suffer any losses. The issue is seasoned with a 2002 vintage year. Underlying mortgages are 100% fixed-rate with a modest allocation to California (11.9%). There are no reported 90+ days delinquencies.

With good geographic diversity and the issue expected to be paid off by August 2014 (weighted-average life), we are comfortable holding the security.

RTP Student Loan Trust – August 2047

CUSIP	78108LAA8
Issuer	Rtp Student Loan Trust
Description	MUNI
Portfolio	SHRT TRM
Par Value	8,250,000.00
Book Value	8,250,000.00
Market Value	8,250,000.00
Effective Duration	0.25
Original Face	8,250,000.00
Original Cost	8,250,000.00
Remaining Face Value	8,250,000.00
Loss Adjusted Yield	n/a
Maturity Date	8/1/2047
Credit Quality	
S&P Rating	AAA/*-
Moody's Rating	Aa3
Fitch Rating	-
Collateral Type	STUDNT 0
Trade Date	8/29/2007
Settlement Date	8/30/2007
Weighted Average Life	n/a
Unrealized Gain/Loss	-
Loss Write Downs	-
Bloomberg Projected Loses	

Private Placement

Pricing		
Price Source 1	Kentucky	100.00
Price Source 2	Bloomberg	n/a
Price Source 3	IDC	n/a
Price Source 4	Broker	n/a

Recommendation
Sell

Troubled Security Characteristics

X	Private Placement
	>5% MV Loses
	Illiquid
	Downgraded

Comments: In PFM's opinion, the Commonwealth of Kentucky is not a Qualified Institutional Buyer and therefore is not eligible to hold private placement securities. Information not available on Bloomberg.

If a market price near par can be obtained, we would recommend selling the security.

SLM Student Loan Trust – September 2032

CUSIP	78443CBB9
Issuer	Slm Student Loan Trust
Description	ABS
Portfolio	SHRT TRM
Par Value	4,100,000.00
Book Value	4,100,000.00
Market Value	4,100,000.00
Effective Duration	(0.12)
Original Face	4,100,000.00
Original Cost	4,100,000.00
Remaining Face Value	4,100,000.00
Loss Adjusted Yield	n/a
Maturity Date	9/15/2032
Credit Quality	
S&P Rating	A
Moody's Rating	Baa1
Fitch Rating	AAA
Collateral Type	STUDNT 0
Trade Date	4/27/2006
Settlement Date	4/27/2006
Weighted Average Life	n/a
Unrealized Gain/Loss	-
Loss Write Downs	-
Bloomberg Projected Loses	

Pricing		
Price Source 1	Kentucky	100.00
Price Source 2	Bloomberg	n/a
Price Source 3	IDC	n/a
Price Source 4	Broker	hi 60's

Recommendation
Sell

Troubled Security Characteristics

- [ ] Private Placement
- [ ] >5% MV Loses
- [ ] Illiquid
- [ ] Downgraded

Comments: This auction rate security was purchased in April 2006. All auctions since May 2008 have failed. Interest rates reset every 28 days. Recent yields were as high as 3.25%.

If a market price near par can be obtained, we would recommend selling the security.

US Education Loan Trust Investments – March 2041

CUSIP	90342NAE7
Issuer	Us Education Loan Tr Iv
Description	MUNI
Portfolio	SHRT TRM
Par Value	10,000,000.00
Book Value	10,000,000.00
Market Value	10,000,000.00
Effective Duration	0.33
Original Face	10,000,000.00
Original Cost	10,000,000.00
Remaining Face Value	10,000,000.00
Maturity Date	3/1/2041
Credit Quality	
S&P Rating	AAA /*-
Moody's Rating	-
Fitch Rating	AAA
Collateral Type	SECURED
Trade Date	9/5/2007
Settlement Date	9/6/2007
Weighted Average Life	n/a
Unrealized Gain/Loss	-
Loss Write Downs	-
Bloomberg Projected Loses	

Private Placement

Pricing		
Price Source 1	Kentucky	100.00
Price Source 2	Bloomberg	n/a
Price Source 3	IDC	n/a
Price Source 4	Broker	n/a

Recommendation
Sell

Troubled Security Characteristics

X	Private Placement
	>5% MV Loses
	Illiquid
	Downgraded

Comments: In PFM's opinion, the Commonwealth of Kentucky is not a Qualified Institutional Buyer and therefore is not eligible to hold private placement securities. No information on this security is available on Bloomberg. Pricing is unavailable from Bloomberg, IDC, or third-party brokers.

If a market price near par can be obtained, we would recommend selling the security.

Wachovia Bank Commercial Mortgages – September 2021

CUSIP	92976BHK1
Issuer	Wachovia Bank Commercial Mortg
Description	CMBS
Portfolio	SHRT TRM
Par Value	10,000,000.00
Book Value	10,003,296.60
Market Value	8,792,000.00
Effective Duration	0.01
Original Face	10,000,000.00
Original Cost	10,004,400.00
Remaining Face Value	10,000,000.00
Maturity Date	9/15/2021
Credit Quality	
S&P Rating	A+
Moody's Rating	Baa2
Fitch Rating	A
Collateral Type	CMBS 1.2
Trade Date	6/24/2008
Settlement Date	6/26/2008
Weighted Average Life	n/a
Unrealized Gain/Loss	(1,211,296.60)
Loss Write Downs	-
Bloomberg Projected Loses	

Private Placement

Pricing		
Price Source 1	Kentucky	88.16
Price Source 2	Bloomberg	n/a
Price Source 3	IDC	88.16
Price Source 4	Broker	n/a

Recommendation
Sell

Troubled Security Characteristics

X	Private Placement
X	>5% MV Loses
	Illiquid
	Downgraded

Comments: In PFM's opinion, the Commonwealth of Kentucky is not a Qualified Institutional Buyer and therefore is not eligible to hold private placement securities.

The issue is the 2nd most senior tranche. The security has not yet begun repaying principal, however subordinated tranches have suffered losses. We would recommend selling.

Wachovia Bank Commercial Mortgages – September 2021

CUSIP	**92976BHK1**
Issuer	Wachovia Bank Commercial Mortg
Description	CMBS
Portfolio	SHRT TRM
Par Value	10,000,000.00
Book Value	10,003,296.60
Market Value	8,792,000.00
Effective Duration	0.01
Mortgage Prepay Speed	-
Original Face	10,000,000.00
Original Cost	10,004,400.00
Loss Adjusted Yield	n/a
Remaining Face Value	10,000,000.00
Maturity Date	9/15/2021
Credit Quality	
S&P Rating	A+
Moody's Rating	Baa2
Fitch Rating	A
Collateral Type	CMBS 1.2
Trade Date	6/24/2008
Settlement Date	6/26/2008
Weighted Average Life	n/a
Unrealized Gain/Loss	(1,211,296.60)
Loss Write Downs	-
Bloomberg Projected Loses	

Private Placement

Pricing		
Price Source 1	Kentucky	88.16
Price Source 2	Bloomberg	n/a
Price Source 3	IDC	88.16
Price Source 4	Broker	n/a

Recommendation
Sell

Troubled Security Characteristics

X	Private Placement
X	>5% MV Loses
	Illiquid
	Downgraded

Comments: In PFM's opinion, the Commonwealth of Kentucky is not a Qualified Institutional Buyer and therefore is not eligible to hold private placement securities.

The issue is the 2nd most senior tranche. The security has not yet begun repaying principal, however subordinated tranches have suffered losses. We would recommend selling.

Merrill Lynch Mortgage Investor – July 2034

CUSIP	**5899294S4**
Issuer	Merrill Lynch Mortgage Investor
Description	ABS
Portfolio	SHRT TRM
Par Value	539,000.00
Book Value	545,521.42
Market Value	477,030.89
Effective Duration	0.62
Mortgage Prepay Speed	4.00
Original Face	10,000,000.00
Original Cost	546,155.09
Mortgage Factor	0.05
Remaining Face Value	542,805.94
Loss Adjusted Yield	7.98%
Maturity Date	7/25/2034
Credit Quality	
S&P Rating	AAA
Moody's Rating	A1
Fitch Rating	AA
Collateral Type	HOMEE6.1
Trade Date	6/26/2006
Settlement Date	6/28/2006
Weighted Average Life	2.15
Unrealized Gain/Loss	(68,490.53)
Loss Write Downs	-
Bloomberg Projected Loses	0.0%

Pricing		
Price Source 1	Kentucky	87.75
Price Source 2	Bloomberg	88.05
Price Source 3	IDC	87.75
Price Source 4	Broker	low 60s

Recommendation
Sell

Troubled Security Characteristics

	Private Placement
X	>5% MV Loses
	Illiquid
	Downgraded

Comments: Highest senior tranche. Subordinated tranches have suffered losses. 2003 originated year. 100% low documentation loans. 22% of loans are 90+ days delinquent with 4.86% of loans in foreclosure. Issue is geographically well diversified. The security has a long tail of principal payments, would suggest selling.

Bear Stearns Alt-A Trust – July 2034

CUSIP	**07386HJU6**
Issuer	Bear Stearns Alt-A Trust
Description	ABS
Portfolio	SHRT TRM
Par Value	4,894,000.00
Book Value	5,040,858.22
Market Value	3,528,343.44
Effective Duration	0.66
Mortgage Prepay Speed	10.00
Original Face	30,000,000.00
Original Cost	5,040,050.66
Mortgage Factor	0.16
Remaining Face Value	5,048,785.06
Loss Adjusted Yield	11.88%
Maturity Date	7/25/2034
Credit Quality	
S&P Rating	AAA
Moody's Rating	Baa2
Fitch Rating	-
Collateral Type	AltAA2.6
Trade Date	6/25/2009
Settlement Date	6/25/2009
Weighted Average Life	8.55
Unrealized Gain/Loss	(1,512,514.78)
Loss Write Downs	-
Bloomberg Projected Loses	0.0%

Pricing		
Price Source 1	Kentucky	69.84
Price Source 2	Bloomberg	56.44
Price Source 3	IDC	69.84
Price Source 4	Broker	low 50s

Recommendation
Hold

Troubled Security Characteristics

	Private Placement
X	>5% MV Loses
	Illiquid
	Downgraded

Comments: This security is in the highest level tranche. Currently, no collateral losses have been realized for this tranche or lower tranches. Collateral is "Near Prime" loans with an origination year of 2004. However 72% are low document loans. Loans are concentrated in California (29%) and Florida (16%). Currently, 19.3% of loans are 90 day+ delinquent and 10% foreclosure. Poor performance by the underlying collateral should be buffered by subordination (lower tranches). Tranche is not projected to suffer principal loss. The fair value appears to be higher than the current quoted market prices.

Structured Asset Mortgage Investment – May 2035

CUSIP	**86359LGE3**
Issuer	Structured Asset Mortgage Investment
Description	CMO
Portfolio	INTERMED
Par Value	2,022,000.00
Book Value	1,863,406.98
Market Value	1,640,969.83
Effective Duration	1.48
Mortgage Prepay Speed	10.00
Original Face	30,000,000.00
Original Cost	1,837,585.36
Mortgage Factor	0.07
Remaining Face Value	2,030,481.08
Loss Adjusted Yield	7.38%
Maturity Date	5/19/2035
Credit Quality	
S&P Rating	AAA
Moody's Rating	Aa3
Fitch Rating	-
Collateral Type	WHARM1.9
Trade Date	2/25/2008
Settlement Date	2/27/2008
Weighted Average Life	5.53
Unrealized Gain/Loss	(222,437.15)
Loss Write Downs	-
Bloomberg Projected Loses	0.0%

Pricing		
Price Source 1	Kentucky	80.72
Price Source 2	Bloomberg	79.77
Price Source 3	IDC	80.72
Price Source 4	Broker	low 80s

Recommendation
Hold

Troubled Security Characteristics

	Private Placement
X	>5% MV Loses
	Illiquid
	Downgraded

Comments: Highest senior class. Collateral losses have wiped out subordinated tranches (B4 / B5). 100% of underlying mortgages are adjustable rate. Mortgages were originated in 2004 (80.3%) and 2005 (19.7%).

Subordination of lower tranches should protect the principal value of this issue. We would suggest holding the security because the fair value appears to be higher than quoted market prices.

Saco I Trust – April 2035

CUSIP	**785778EC1**
Issuer	Saco I Trust
Description	ABS
Portfolio	SHRT TRM
Par Value	559,000.00
Book Value	559,238.71
Market Value	212,703.86
Effective Duration	(0.34)
Mortgage Prepay Speed	14.00
Original Face	47,380,000.00
Original Cost	559,237.21
Mortgage Factor	0.01
Remaining Face Value	559,253.98
Loss Adjusted Yield	15.71%
Maturity Date	4/25/2035
Credit Quality	
S&P Rating	-
Moody's Rating	B2
Fitch Rating	AA
Collateral Type	RESB/9.3
Trade Date	6/25/2009
Settlement Date	6/25/2009
Weighted Average Life	5.65
Unrealized Gain/Loss	(346,534.85)
Loss Write Downs	-
Bloomberg Projected Loses	0.0%

Private Placement

Pricing		
Price Source 1	Kentucky	38.03
Price Source 2	Bloomberg	48.08
Price Source 3	IDC	38.03
Price Source 4	Broker	mid 20s

Recommendation
Sell

Troubled Security Characteristics

X	Private Placement
X	>5% MV Loses
X	Illiquid
	Downgraded

Comments: In PFM's opinion, the Commonwealth of Kentucky is not a Qualified Institutional Buyer and therefore is not eligible to hold private placement securities. This security represents the most senior tranche. The underlying collateral have performed poorly with heavy losses incurred in subordinated tranches (M4 / M5) and (B1 - B4). For this issue, there has not been any principal paydown in the last 12 months. Only $2,700 of interest was received over the last 12 months representing a 0.48% return.

Kentucky Utilities – November 2015

CUSIP	491674BB2
Issuer	Kentucky Utilities
Description	
Portfolio	INTERMED
Par Value	5,000,000.00
Book Value	4,787,014.50
Market Value	4,872,800.00
Effective Duration	4.04
Original Cost	4,751,300.00
Remaining Face Value	5,000,000.00
Maturity Date	11/1/2015
Credit Quality	
S&P Rating	-
Moody's Rating	A2
Fitch Rating	A+
Collateral Type	1ST MORTGAGE
Trade Date	2/10/2011
Settlement Date	2/15/2011
Unrealized Gain/Loss	85,785.50
Loss Write Downs	-
Bloomberg Projected Loses	

Private Placement

Pricing		
Price Source 1	Kentucky	97.46
Price Source 2	Bloomberg	n/a
Price Source 3	IDC	n/a
Price Source 4	Broker	n/a

Recommendation

Sell

Troubled Security Characteristics

X	Private Placement
	>5% MV Loses
	Illiquid
	Downgraded

Comments: In PFM's opinion, the Commonwealth of Kentucky is not a Qualified Institutional Buyer and therefore is not eligible to hold private placement securities. At a price of $97.46, this security offers a yield of 2.30%. At this level, we would recommend selling this security.

Morgan Stanley – August 2014

CUSIP	61747YDL6
Issuer	Morgan Stanley
Description	
Portfolio	INTERMED
Par Value	15,000,000.00
Book Value	15,000,000.00
Market Value	15,000,000.00
Effective Duration	2.85
Original Cost	15,000,000.00
Remaining Face Value	15,000,000.00
Maturity Date	8/26/2014
Credit Quality	
S&P Rating	A
Moody's Rating	-
Fitch Rating	-
Collateral Type	SR UNSECURED
Trade Date	8/12/2011
Settlement Date	8/26/2011
Unrealized Gain/Loss	-
Loss Write Downs	-
Bloomberg Projected Loses	

Private Placement

Pricing		
Price Source 1	Kentucky	100.00
Price Source 2	Bloomberg	n/a
Price Source 3	IDC	n/a
Price Source 4	Broker	n/a

Recommendation
Sell

Troubled Security Characteristics

X	Private Placement
	>5% MV Loses
	Illiquid
	Downgraded

Comments: In PFM's opinion, the Commonwealth of Kentucky is not a Qualified Institutional Buyer and therefore is not eligible to hold private placement securities. The security currently offers a 4% coupon rate. The coupon rate will reset on a quarterly basis to the 3 month LIBOR + 2.25% effective August 26, 2012. Depending upon the liquidity of this issue, it should theoretically be priced at a premium.

New York Life Global Funding – April 2012

CUSIP	64952WAY9
Issuer	New York Life Global Fdg
Description	FIN
Portfolio	INTERMED
Par Value	7,500,000.00
Book Value	7,500,000.00
Market Value	7,498,275.00
Effective Duration	0.19
Original Cost	7,500,000.00
Remaining Face Value	7,500,000.00
Maturity Date	4/4/2012
Credit Quality	
S&P Rating	AA+
Moody's Rating	Aaa
Fitch Rating	AAA
Collateral Type	SR SECURED
Trade Date	9/30/2010
Settlement Date	10/4/2010
Unrealized Gain/Loss	(1,725.00)
Loss Write Downs	-
Bloomberg Projected Loses	

Private Placement

Pricing		
Price Source 1	Kentucky	99.98
Price Source 2	Bloomberg	99.90
Price Source 3	IDC	99.98
Price Source 4	Broker	n/a

Recommendation
Sell

Troubled Security Characteristics

X	Private Placement
	>5% MV Loses
	Illiquid
	Downgraded

Comments: In PFM's opinion, the Commonwealth of Kentucky is not a Qualified Institutional Buyer and therefore is not eligible to hold private placement securities and it would be our recommendation to sell. The security has a high credit profile (AA+ / Aaa / AAA) and a short maturity (April 2012).

Kingdom of Sweden – June 2014

CUSIP	87020DAA2
Issuer	Kingdom Of Sweden
Description	SOVG
Portfolio	INTERMED
Par Value	3,000,000.00
Book Value	2,993,975.10
Market Value	2,974,470.00
Effective Duration	2.55
Original Cost	2,993,100.00
Remaining Face Value	3,000,000.00
Maturity Date	6/3/2014
Credit Quality	
S&P Rating	AAA
Moody's Rating	Aaa
Fitch Rating	AAA
Collateral Type	SR UNSECURED
Trade Date	5/26/2011
Settlement Date	6/3/2011
Unrealized Gain/Loss	(19,505.10)
Loss Write Downs	-
Bloomberg Projected Loses	

Private Placement

Pricing		
Price Source 1	Kentucky	99.27
Price Source 2	Bloomberg	101.10
Price Source 3	IDC	99.27
Price Source 4	Broker	3 yr + 0.37%

Recommendation
Sell

Troubled Security Characteristics

X	Private Placement
	>5% MV Loses
	Illiquid
	Downgraded

Comments: In PFM's opinion, the Commonwealth of Kentucky is not a Qualified Institutional Buyer and therefore is not eligible to hold private placement securities and it would be our recommendation to sell. Based upon third-party broker pricing, the security can be sold at a yield comparable to Federal Agencies.

USAA Capital Corp – September 2014

CUSIP	90327QCV9
Issuer	Usaa Capital Corp
Description	FIN
Portfolio	INTERMED
Par Value	2,000,000.00
Book Value	1,998,038.40
Market Value	1,990,620.00
Effective Duration	2.86
Original Cost	1,997,960.00
Remaining Face Value	2,000,000.00
Maturity Date	9/30/2014
Credit Quality	
S&P Rating	AA+
Moody's Rating	Aa1
Fitch Rating	-
Collateral Type	SR UNSECURED
Trade Date	8/30/2011
Settlement Date	9/7/2011
Unrealized Gain/Loss	(7,418.40)
Loss Write Downs	-
Bloomberg Projected Loses	

Private Placement

Pricing		
Price Source 1	Kentucky	100.09
Price Source 2	Bloomberg	98.69
Price Source 3	IDC	100.09
Price Source 4	Broker	n/a

Recommendation
Sell

Troubled Security Characteristics

X	Private Placement
	>5% MV Loses
	Illiquid
	Downgraded

Comments: In PFM's opinion, the Commonwealth of Kentucky is not a Qualified Institutional Buyer and therefore is not eligible to hold private placement securities and it would be our recommendation to sell. At current IDC pricing, the security offers a yield of 1.01%, only 0.30% over Agencies. A comparable corporate note issued by Bank of New York would offer a yield of 1.73%.

Countrywide Alternative Loan – September 2033

CUSIP	12669FJR5
Issuer	Countrywide Alternative Loan T
Description	ABS
Portfolio	SHRT TRM
Par Value	784,000.00
Book Value	788,104.63
Market Value	735,454.04
Effective Duration	8.83
Mortgage Prepay Speed	25.00
Original Face	10,000,000.00
Original Cost	788,674.88
Loss Adjusted Yield	7.84%
Remaining Face Value	787,567.37
Maturity Date	9/25/2033
Credit Quality	
S&P Rating	AAA
Moody's Rating	Aa3
Fitch Rating	-
Collateral Type	AltA35.7
Trade Date	1/28/2004
Settlement Date	2/2/2004
Weighted Average Life	
Unrealized Gain/Loss	(52,650.59)
Loss Write Downs	1.86
Bloomberg Projected Loses	

Pricing

Price Source 1	Kentucky	93.18
Price Source 2	Bloomberg	0.00
Price Source 3	IDC	93.18
Price Source 4	Broker	mid 70s

Recommendation

Sell

Troubled Security Characteristics

	Private Placement
X	>5% MV Loses
	Illiquid
	Downgraded

Comments: Seasoned issue with a long projected tail for principal payments. Failed FFIEC Test. Underlying collateral is 100% fixed-rate mortgages, 100% 2003 vintage year. A high allocation (45%) are mortgages originated in California. Borrowers had an initial average credit score of 673 and 81% are low documentation loans. 18% of mortgages are 90+ days delinquent and 6.8% are in foreclosure. We would recommend considering to sell the security because of the geographic concentration and the long tail.

Commercial Mortgage Pass-Through – December 2020

CUSIP	**20046GAW8**
Issuer	Commercial Mortgage Pass-Throu
Description	
Portfolio	SHRT TRM
Par Value	10,000,000.00
Book Value	10,004,258.00
Market Value	9,501,200.00
Effective Duration	0.50
Mortgage Prepay Speed	-
Original Face	10,000,000.00
Original Cost	10,005,800.00
Loss Adjusted Yield	100.00%
Remaining Face Value	10,000,000.00
Maturity Date	12/15/2020
Credit Quality	
S&P Rating	AA
Moody's Rating	A1
Fitch Rating	AAA
Collateral Type	CMBS 1.7
Trade Date	6/24/2008
Settlement Date	6/26/2008
Weighted Average Life	
Unrealized Gain/Loss	(503,058.00)
Loss Write Downs	-
Bloomberg Projected Loses	

Private Placement

Pricing		
Price Source 1	Kentucky	91.21
Price Source 2	Bloomberg	0.00
Price Source 3	IDC	91.21
Price Source 4	Broker	n/a

Recommendation
Sell

Troubled Security Characteristics

X	Private Placement
X	>5% MV Loses
	Illiquid
	Downgraded

Comments: In PFM's opinion, the Commonwealth of Kentucky is not a Qualified Institutional Buyer and therefore is not eligible to hold private placement securities and it would be our recommendation to sell.

This issue is a private placement of a limited number of commercial real estate properties requiring very specific commercial real estate analysis to properly evaluate the security. Given the complexity of the security, it would be our recommendation to sell.

Commercial Mortgage Pass-Through– December 2020

CUSIP	20046GAC2
Issuer	Commercial Mortgage Pass-Throu
Description	
Portfolio	SHRT TRM
Par Value	3,389,000.00
Book Value	3,661,578.92
Market Value	3,569,535.45
Effective Duration	9.32
Mortgage Prepay Speed	-
Original Face	10,000,000.00
Original Cost	3,661,929.28
Loss Adjusted Yield	-
Remaining Face Value	3,660,611.46
Maturity Date	12/15/2020
Credit Quality	
S&P Rating	AAA
Moody's Rating	Aaa
Fitch Rating	AAA
Collateral Type	CMBS 1.7
Trade Date	6/24/2008
Settlement Date	6/26/2008
Weighted Average Life	
Unrealized Gain/Loss	(92,043.47)
Loss Write Downs	-
Bloomberg Projected Loses	

Private Placement

Pricing		
Price Source 1	Kentucky	97.71
Price Source 2	Bloomberg	n/a
Price Source 3	IDC	97.71
Price Source 4	Broker	n/a

Recommendation
Sell

Troubled Security Characteristics

X	Private Placement
	>5% MV Loses
	Illiquid
	Downgraded

Comments: In PFM's opinion, the Commonwealth of Kentucky is not a Qualified Institutional Buyer and therefore is not eligible to hold private placement securities and it would be our recommendation to sell.

This issue is a private placement of a limited number of commercial real estate properties requiring very specific commercial real estate analysis to properly evaluate the security. Given the complexity of the security, it would be our recommendation to sell.