

State Investment Commission

March 23, 2016

11:00 a.m. ~ Room 182 ~ Capitol Annex
Frankfort, Kentucky

The State Investment Commission (“SIC” or “the Commission”) meeting was called to order on March 23, 2016 at 11:00 a.m. in Room 182 of the Capitol Annex by Allison Ball, Kentucky State Treasurer. The Treasurer asked for a roll call. Other members present were W. Fred Brashear, II, President & CEO, Hyden Citizens Bank, Hyden, Kentucky; William Fallon, President & CEO, The Bankers’ Bank of Kentucky, Frankfort, Kentucky; William M. Landrum III, Secretary of the Finance and Administration Cabinet (“FAC”); and Nate Haney, proxy for Governor Beshear.

Office of Financial Management (“OFM”) Staff Present: Ryan Barrow, Executive Director of OFM and Secretary to the Commission; Steve Jones, Deputy Executive Director; Brian Caldwell, Hannah Hogston, Kim Bechtel, Dwight Price, Denise Pitts and Tammy McCall.

Other Guests: Ed Ross, Controller, Office of the Controller, FAC; Mark Bunning, Office of the Secretary, FAC; and Janet Cuthrell, Kentucky State Treasury.

Treasurer Ball verified that a quorum was present and that the press had been notified of the meeting.

Treasurer Ball called for a motion to approve the minutes from the November 24, 2015, meeting. A motion was made by Mr. Fred Brashear and seconded by Mr. Bill Fallon to approve the minutes as written. Motion **CARRIED**.

Mr. Barrow gave a short introduction and directed the members to handouts that gave a brief overview of the SIC and the statutes and regulations that define the authority of the Commission.

Limited Term Pool Performance – Ms. Bechtel presented the monthly performance of the Limited Term Pool compared to the Local Government Investment Pool benchmark as of February 29, 2016. The monthly performance graph showed that the Limited Term pool has recently been outperforming the benchmark. She explained that in September 2015 there was a dip in the graph due to liquidity issues in which extra cash was held because of the concern of a federal government shutdown in October 2015. The second page of the report listed all the securities held in the Pool as of February 29, 2015. The next page showed a breakdown of the Pool by credit rating and sector distributions. The next page provided a detail on the weighted average maturity and life plus liquidity positions. She explained that the maturity goal is less than 60 days and the weighted average was around 42 days in February 2016. The daily liquidity was at 30% with a minimum goal of 15%. The Net Asset Value graph was steady as it should be. The largest daily withdrawal as of March 24, 2016 was by the University of Kentucky Hospital on December 27, 2015. The largest weekly withdrawals were the same as the largest daily withdrawals. The largest individual account in the portfolio was the Employee Self-Insurance Fund. The daily liquidity requirement as set forth by the Commission is 15% and the weekly liquidity requirement is 30%. Staff recommended maintaining the current liquidity requirements of the Pool requiring no action from the Commission. The Commission took no action. Secretary Landrum asked if staff met with the credit rating agencies for the Commonwealth. Mr. Barrow answered that the Debt team from OFM, along with the Budget Office, meet with and manage relationships with the credit rating agencies for several

entities such as the State Property and Buildings Commission, the Kentucky Asset/Liability Commission, the Turnpike Authority of Kentucky, the Kentucky Infrastructure Authority, and others.

Bridges Pool – Mr. Jones presented the Bridges Pool report as of March 16, 2016. He explained that this portfolio provides cash for the construction of the Downtown Bridges Project in Louisville. Because of federal participation, the Pool is required to be kept in a separate portfolio. The Pool started with approximately \$650 million, the current holdings total approximately \$100 million, and the balance is expected to be zero by the end of 2016. The Current Holdings consist of cash in a State Street Money Market Fund and three Treasury Notes that mature in March, June and December of 2016. The reported Income Generated is approximately \$1.1 million. The Projected New Cash Flow graph showed the excess cash balance available. Mr. Jones noted that the Transportation Cabinet has alternative plans to supplement funds which are not reflected in this report. Treasurer Ball asked about those plans and Mr. Jones answered that funds from the federal government would be redirected into the program. Mr. Barrow added that approximately \$50 million a year for five years was part of the original financing plan, however not all will be needed. There is an agreement with the federal government and the Transportation Cabinet that requires sufficient cash to go into the project for completion.

Intermediate Pool Performance – Mr. Caldwell directed the Commission members to the Intermediate Term Pool report as of February 29, 2016. The Pool market value stood at \$2.4 billion. The Yield to Worst was 0.79% which was slightly under the benchmark. Quality remained high at Aaa. Duration was slightly over 1-year and short of the benchmark half a year as a defensive position for anticipated higher rates at some point in the future. The Portfolio Sector Allocations page gave a snapshot of how the Portfolio is diversified across the different sectors of the fixed income market as of February 29, 2016. The allocations were basically the same as last quarter's report with the only change being a 2% increase in corporates and a 5% increase in treasuries. Mr. Caldwell continued with the Portfolio Performance page, which showed the performance versus the Benchmark as of February 29, 2016. He reported that the Portfolio has produced positive returns for all time periods listed and are very close to the Benchmark returns as well.

Country Bank – Mr. Price gave an introduction to the Kentucky Bank Program and explained its objective was to give some liquidity to Kentucky local banks. There are currently seven banks participating in the Kentucky Bank Program. The banks had to meet the following criteria to be included: 1) their loans to deposits should be greater than 70%; 2) their return on assets should be greater than 0.5%; and 3) their non-performing loans to capital should be less than 25%. The Bank of Jamestown and Farmers Deposit Bank's Loans to Deposits ratios are below the requirement. Mr. Price stated that the banks are well collateralized and there was no risk to the Commonwealth. The Commission took no action.

Credit Considerations – Ms. Hogston stated that since the last meeting no names had been added or removed from the Corporate Credit List Approved for Purchase as of March 23, 2016. There were 28 non-financial companies and 27 financial companies for a total of 55 companies to be approved by the Commission. Ms. Hogston also presented the list for Securities Lending Agent Approved Counterparties as of March 23, 2016. There were no changes to this list from the last meeting. She reported that in order to limit the Commonwealth's exposure, the securities lending agent Deutsche Bank Securities Inc. is not allowed to do repos with the following: BMO Capital Markets Corp., Bank of Nova Scotia, BNP Paribas Prime Brokerage, Inc., BNP Paribas Securities Corp., RBC Capital Markets LLC, and JP Morgan Securities LLC which is the Commonwealth's

depository bank. Treasurer Ball asked about the process for approving companies. Ms. Hogston and Mr. Barrow explained the process involved three steps for a company to be approved: 1) a credit rating of "A" or higher was required from an independent assessment; 2) financials were reviewed; and 3) news headlines were researched. Treasurer Ball called for a motion to approve the Corporate Credit lists. Mr. Bill Fallon made a motion which was seconded by Mr. Fred Brashear. Motion **CARRIED**.

Compliance Reporting – Ms. Hogston reported that since the last SIC meeting, there were three (3) compliance alerts triggered and thirty-seven (37) compliance rule changes. On November 25th, Steve Jones changed 14 trading limit rules by updating Kim Bechtel from Junior Portfolio Manager to Senior Portfolio Manager and added Dwight Price as Senior Portfolio Manager as approved by the Commission in November. On January 25th, Kim Bechtel changed the Senior Treasury trading limit rule from Firm to Group Total so Worker's Compensation trades would not be included in the compliance calculation. On January 26th, three compliance alerts were triggered. The purchase of 3 money market securities by Kim Bechtel totaling \$75 million caused the alerts. The alerts were triggered due to an error within the rule which treated money market securities as ABS, CORP and MBS securities which is limited to \$50 million. It calculated the trades based on a group of traders and not as individuals. On January 27th, the above mentioned errors were corrected in Bloomberg by Kim Bechtel. Two rules were changed from User Group of PM to each trader individually. On February 16th, Kim Bechtel updated 20 rules covering: changed scope assignment from Firm to the group titled TOTAL; included Yankee CD as security type; reflected US Govt rating as Sovereign rating; changed from "less than A2, P2, F2" to "less than A1, P1, F1" for money market securities; and trading limit attributes were changed from User Group PM to list each trader individually. All changes were reflected in the Compliance Rule Change Log.

Other Business – Mr. Barrow stated that the Investment Manual would not be presented for comments at this meeting. Because there were three new members on the Commission, OFM staff will present the manual along with some additional background information at the next quarterly meeting.

With no further business, Treasurer Ball called for a motion to adjourn. Secretary Landrum made a motion which was seconded by Mr. Brashear. The meeting stands adjourned.

Respectfully submitted,



Ryan Barrow
Secretary