

**STATE INVESTMENT COMMISSION
FEBRUARY 6, 2009
MINUTES**

The State Investment Commission Meeting was called to order on Friday, February 6, at 2:00 p.m. in Room 76 of the Capitol Annex by Todd Hollenbach, State Treasurer. Other members present were Greg Haskamp, proxy for Jonathan Miller, Secretary of the Finance and Administration Cabinet; Ed C. Ross, proxy for Governor Steve Beshear; and George Spragens, President, Farmers National Bank in Lebanon, Kentucky.

OFM Staff Present: Tom Howard, Executive Director, and secretary to the Commission, Steve Jones, Dwight Price, Kim Bechtel, Jason Hamilton, Jonathan Eakin, Becky Stevenson and Marcia Adams.

Other Guests: Mary John Celletti, Deputy Treasurer, Kristi Culpepper of LRC and Travis Powell, Office of Legal Services.

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

Treasurer Hollenbach called for a motion to approve the minutes from December 11, 2008. A motion was made by Mr. George Spragens and seconded by Mr. Ed Ross to approve the minutes of the December 11, 2008 meeting as written. Motion **CARRIED**.

Administrative Regulations – Treasurer Hollenbach reminded the commission and guests of the presentation at the last meeting by Credit Suisse involving restructuring the securities lending portfolio. This restructuring requires changes to the Administrative Regulations that govern the SIC actions. Mr. Jones went over the proposed changes to the regulation. With the commission's approval, this document will be presented to the Governor for his execution as an emergency regulation. At the same time, it will also be filed with LRC for approval as a permanent regulation.

Changes noted: **Pg 2, Line 8** Conforms language with the standard Securities and Exchange Commission language for rating agencies; **Page 4, Line 17**, Ratings restriction conforms to KRS 42.500; **Page 5 line 9**, Ratings restriction conforms to KRS 42.500; **Page 6, line 3a**, Under a new FDIC program, banks are able to issue notes guaranteed by the FDIC which carries the full faith and credit of the United States. This change allows the SIC to consider the guarantor, rather than the issuer, when measuring credit exposure; **Page 6, line 3b**, Between February 19, 2009 and March 31, 2009 approximately, the regulatory limit of \$25 million maximum exposure to any one name will be eliminated. This allows staff to execute the Credit Suisse exchange. Credit limits will revert to current restrictions after that time; **Page 6, line 8** Allows the Commission to waive any restrictions in this section of the regulation by unanimous vote in order to respond to any additional new programs announced by the federal government.

Mr. Spragens asked how the federal government will institute programs to support mortgage-backed securities. Mr. Jones answered that they are supporting the agency mortgage market by buying 15 to 26 billion dollars a week. That has pushed the mortgage rates down tremendously. Current discussions are that the Treasury will use some TARP money and Federal Reserve support to "wall off" and guarantee certain assets within selected banks. In the Citibank deal, the Treasury chose a certain portfolio of assets, which the government guaranteed. They are still on the books of the bank, but with that guarantee (full faith and credit), the capital requirements are zero, which frees up capital for the institution. Mr. Spragens asked if that guarantee applies to the institution or to the individual security. Mr. Jones responded that it applies to the specified pool of assets.

Additional changes: **Page 7, line 4** historically, certain bond indentures restrict the reinvestment of new money proceeds from a bond issuance. Most of the older indentures are no longer in use so proceeds from bond issuance may be invested in a wider variety of investments with higher yields; **Line 13 Section 9**, Most of the changes in this Section focus on clarifying language so that the intent is clearer; **Page 8, line 15** Restricts tri-party repo counter-parties to primary dealers only; **Page 9**, Updates the names and dates of some of the documents attached by reference; **Page 10** Recognizes the change of address for OFM.

Treasurer Hollenbach asked about **Page 7, line 23** where word "and" was removed from the regulations. Mr. Price answered that if a broker has an office in Kentucky, they qualify as a broker if their trades are guaranteed by a primary dealer. Treasurer Hollenbach questioned the language further. The Commission changed this and subsequent lines so that they now read "(b) Maintains an office in Kentucky and has twenty-five (25) million dollars in excess net capital or 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;" Page 8, Line 6 now becomes (c).

Mr. Spragens moved to close discussion on the changes and accept the Administrative Regulations with amended changes noted. The motion was seconded by Mr. Ross. **Motion carried** and the amended Regulation approved by the Commission.

TRAN – Mr. Jones discussed the TRAN for Fiscal Year 2009 and performance for the first seven months of the fiscal year. He pointed out that the current cost of funds on this debt is roughly -1%, which represents the arbitrage between tax-exempt borrowing cost and taxable reinvestments. The performance report shows that the year-to-date earnings are in excess of \$4 million dollars. The original projections were for \$5.5 million in income by the end of fiscal year 2009. The program is well ahead of that projection.

Securities Update - Mr. Price discussed the securities lending portfolio. He noted that the securities lending portfolio still holds several securities, which

are below the regulatory guidelines for purchase. Several of these securities will probably be removed from future lists with the restructuring trade discussed earlier. All of the other securities continue to perform making all required principal and interest payments.

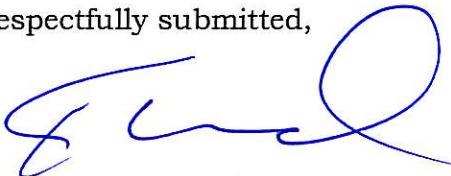
Asset-Backed Securities: Mr. Jones discussed the securities held in the Commonwealth's portfolio that have been downgraded below the regulatory level for purchase. All of these securities continue to perform making all principal and interest payments. Mr. Howard expressed the opinion that within the next 12 to 18 months, federal regulators will review the current rating agency environment and make some changes. Treasurer Hollenbach asked if the forbearance issue the Commission has allowed over the last year has worked to the advantage of the Commonwealth. Mr. Price said that yes it had. Mr. Jones added that by holding these securities, the Commonwealth is receiving the principal back at par. If these had been sold last year at 80% of par, the Commonwealth would be short 20% on these securities. Mr. Price requested a vote of forbearance on the list of securities. Mr. Spragens made the motion to allow forbearance to continue to hold the list of downgraded securities. The motion was seconded by Mr. Ross. Motion **CARRIED**.

Portfolio Performance – Mr. Jason Hamilton was introduced as the new Accounting Supervisor for OFM. He in turn, introduced his staff of two, Jonathan Eakin and Becky Stevenson. Mr. Hamilton explained that the accounting staff allocates the income earned by the security portfolios to over 6,000 different accounts in eMARS (the Commonwealth's accounting system). Additionally, that income plus cash transactions are reconciled daily between eMARS, CAMRA (investment accounting software), and the custodial bank. Additionally, all cash earnings are distributed monthly to the eMARS accounts based on the level of market earnings. Mr. Hamilton presented a report showing that year-to-date through December 31, OFM has distributed over \$50 million in cash earnings to state agencies through this process. Mr. Howard added that these are significant earnings in spite of reduced rates and balances.

Other Business – Next meeting date will be scheduled in May.

A motion was made by Mr. Ross and seconded by Mr. Spragens to adjourn the meeting. Motion **CARRIED**.

Respectfully submitted,



F. Thomas Howard
Secretary