

STATE INVESTMENT COMMISSION

JUNE 7, 2007

MINUTES

The State Investment Commission was called to order on Thursday, June 7, 2007, at 11:00 a.m. in Room 76 of the Capitol Annex by John Farris, Secretary, Finance and Administration Cabinet. Other members present were Libby Milligan, proxy for Governor Ernie Fletcher; Gregory Haskamp, proxy for Jonathan Miller, State Treasurer; and George Spragens, President, Farmers National Bank in Lebanon, Kentucky.

Secretary Farris verified that a quorum was present and that the press had been notified of the meeting.

Secretary Farris called for a motion to approve the minutes of the March 15, 2007 meeting. A motion was made by Mr. Spragens and seconded by Ms. Milligan to approve the minutes of the March 15, 2007 meeting. Motion **CARRIED**.

Dwight Price, Portfolio Administrator, Office of Financial Management, distributed a handout from the monthly report which compared the performance of the Commonwealth's portfolio to its benchmarks. Mr. Price stated that each intermediate and bond proceeds pools have an index which is used to compare the performance of the Commonwealth's portfolio against standard indices. Mr. Price pointed out that the portfolio continues to outperform the benchmarks.

Steve Jones, Portfolio Administrator, Office of Financial Management, presented the quarterly TRAN update. Mr. Jones stated that to date the Commonwealth has earned \$2.5 million on the 2007 TRAN. Mr. Jones pointed out that \$2.5 million was the projection for the net earnings and that the TRAN is performing better than expected at this time. He stated that the trade matures on June 28, and it is anticipated that the net earnings on the TRAN at June 30 will be approximately \$3 million. Mr. Jones stated that staff expects to issue approximated \$350,000,000 of fixed rate notes at a cost of 3.72 percent. He noted that this amount is based on the projected year end balance in the General Fund. Mr. Jones stated that staff will enter into an interest rate swap that will match the maturities of the TRAN size where the Commonwealth pays 1 month LIBOR and receives 5.40 percent on the transaction. Mr. Jones added that if the size of the TRAN is \$350,000,000, he estimates that income from the TRAN would be between \$5.5 million and \$6 million dollars.

F. Thomas Howard, Executive Director, Office of Financial Management, added that the challenge is to project the year-end balance in the General Fund and the size of the TRAN depends on that ending balance. He stated that June is historically the largest receipt month and it is difficult to predict what the balance will be at the end of June 30. Mr. Howard stated that staff uses a model that takes into consideration historical expenditure patterns and fluctuations day-to-day.

Mr. Jones noted that the IRS regulations set restrictions on the size of the TRAN based on the negative balance in the General Fund, which is why the starting point is important. Mr. Howard added that the deficit must be at least 90 percent of the amount borrowed in order to maintain tax exempt status or the excess profit must be returned.

Mr. Jones informed the Commission that the interest rate steeper swap had been in place for approximately one year. Mr. Jones noted that a few months ago the Commonwealth was experiencing a loss on the swap, but recently the swap has moved dramatically and has resulted in a small gain in the trade. Mr. Jones pointed out that this trade was executed in anticipation of the yield curve steepening and it continues to perform as staff anticipated.

George Spragens, President, Farmers National Bank of Lebanon asked if the yield curve is expected to steady in the next few months. Mr. Price stated that the yield curve steepened again today but felt the steeping would stop in the future.

Mr. Price discussed Attachment B, Broker Dealer List. He stated that once each year the Commission is required to approve the list of primary and non-primary dealers who are eligible to conduct business with the Commonwealth. There were two additions to the list; Countrywide Securities Corporation was added to the primary dealers and Stearn Agee was added as a non-primary dealer. Mr. Price also noted that A. G. Edwards & Sons, Inc. is expected to be acquired by Wachovia Securities. Mr. Jones noted that Countrywide offers very attractive rates on repurchase agreements and he expect

A motion was made by Greg Haskamp and seconded by George Spragens to approve the broker dealer list for FY08. Motion **CARRIED** and the broker dealer list was approved.

Kim Bechtel, Short-Term Money Manager, Office of Financial Management, discussed Attachment C, the Linked Deposit Program. Ms. Bechtel stated that to date the loan balance is below \$10 million but number of loans outstanding has increased. Ms. Bechtel reiterated that consideration needs to be given to a cap on the program.

Mr. Jones stated that staff would like to put a cap on the program and the Commission should decide if the cap should be on the total dollar amount of the program or the total number of deposits or a combination thereof. Mr. Jones stated that it is staff's preference to cap the dollar amount because it is easier to track.

Mr. Price stated that this program began in the Treasurer's Office and is not administered by the Cabinet for Economic Development. The program is supported by the Abandoned Properties program which also supports other programs.

Secretary Farris if the change would be made through a policy or a statutory change. Mr. Howard stated that initially when the program started that was a policy. He further stated that to truly enforce a cap would require a regulation change and that a directive from the Commission to move forward in that area would be appropriate. If loans continued to be submitted after the program reached \$10 million, a statutory change would be needed. He added that Abandoned

Property account predominantly holds securities and not cash. He further added that the \$10 million is funded by the General Fund.

Mr. Spragens asked what the balance in the Abandoned Properties Account was. Mr. Priced stated there is \$66 million in securities, but was unsure of the actual cash in the account. He added that the securities are somewhat limited as to when they can be sold and if you sell an abandoned security shorter than the three years it has been held and someone claims it at a later date, they are reimbursed the market value of the security.

Mr. Jones pointed stated loans in the program are secured by collateral and if they default then the collateral is seized. If there is not enough collateral to cover the loan, then the cash in the Abandoned Properties Account is used.

Mr. Howard added that the program has never exceeded \$10 million and a cap at that amount is not expected to exclude anyone.

Mr. Howard informed the members that included as an information item in agenda was the Kentucky Asset/Liability Commission's derivatives policy. He stated that the Asset/Liability Commission is charged with the asset/liability management of the Commonwealth and as part of their statutory responsibility they must keep the State Investment Commission apprised of any policy that may have an impact on the Commission.

With no further business before the Commission, a motion was made to adjourn the meeting. Motion carried and the meeting was adjourned.

Respectfully submitted,

A handwritten signature in blue ink, appearing to be 'F. Thomas Howard', with a large, stylized loop at the end.

F. Thomas Howard, Secretary
State Investment Commission