

STATE INVESTMENT COMMISSION

SEPTEMBER 26, 2007

MINUTES

The State Investment Commission was called to order on Wednesday, September 26, 2007, at 2:00 p.m. in Room 76 of the Capitol Annex by Jonathan Miller, State Treasurer. Other members present were Libby Milligan, proxy for Governor Ernie Fletcher; Mike Burnside, Secretary, Finance and Administration Cabinet; and George Spragens, President, Farmers National Bank in Lebanon, Kentucky.

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

Treasurer Miller called for a motion to approve the minutes of the June 7, 2007 meeting. A motion was made by Mr. Spragens and seconded by Ms. Milligan to approve the minutes of the June 7, 2007 meeting. Motion **CARRIED**.

Steve Jones, Portfolio Administrator, Office of Financial Management, presented the portfolio update. Mr. Jones stated that delinquencies and foreclosures in the sub prime mortgage industry have been accelerating since December of last year and the values of certain securities have declined as a result. He further stated that as a result of a decrease in the value of the securities, investors sell to pay off outstanding debt which causes a spiraling effect. Mr. Jones noted that primarily the asset backed and extendable commercial paper markets have been affected the most. Mr. Jones stated that at June 30, 2007, the Commonwealth held approximately \$750 million in total Commercial Paper but that has dropped significantly.

Kim Bechtel, Short-Term Money Manager, Office of Financial Management, stated that currently the Commonwealth holds approximately \$25 million in outstanding Commercial Paper. Ms. Bechtel noted that as the securities mature it has been reinvested in other opportunities.

F. Thomas Howard, Executive Director, Office of Financial Management, noted that the ratings on the paper were in line with the guidelines established by the Commission.

George Spragens asked if we held any Countrywide securities. Mr. Jones stated that the Commonwealth holds approximately \$959 million of various mortgages and structured products including Countywide. Mr. Jones noted that of that \$959 million, \$330 million of those securities are backed by Fannie Mae and Freddie Mac and an additional \$450 million of the securities are completely unrelated to the housing market (i.e. Student Loans, credit card receivables, and car loan receivables). Mr. Jones stated that the balance of the \$959 million (approximately \$183 million) is structured mortgage products. Mr. Jones pointed out that every security is AAA rated and the rating agencies have reaffirmed those ratings. He added that the Commonwealth owns only two securities in this market whose value has fallen as a result of the aggressive approach taken by mortgage originators in 2006.

Mr. Jones informed the Commission that he was presented with an opportunity to purchase a security that will pay off between April and June of 2008. He added that the collateral behind the security is performing poorly with 6 percent currently in foreclosure status. Mr. Jones stated that the security that could have been purchased was a current pay bond with a AAA rating. He asked the members if they would be comfortable with him taking advantages of these situations when possible. Mr. Spragens stated that he would not pursue these investments for his bank. Treasurer Miller asked if staff would keep the Commission apprised of additional opportunities to purchase securities of this nature. Mr. Jones stated he would keep the Commission apprised of similar opportunities and added that the market had improved since July 2007. He added that liquidity is working and the market seems to have a better tone.

Mr. Jones continued with an update on the 2007 TRAN. He stated that the TRAN matured on June 28, 2007 and exceeded the projection earning approximately \$2.8 million. Mr. Jones informed the members that \$350 million of debt was issued that settled on July 3, 2007 with a maturity of June 26, 2008. He added that staff entered into an interest rate swap with J.P. Morgan which is expected to net \$5.5 million in net earnings for the year. Treasurer Miller asked why the earnings were more on the 2007 TRAN. Mr. Jones stated the earnings were greater because the par amount of the bonds was more in 2008. Treasurer Miller asked why the par amount was greater. Mr. Howard stated that the amount of the TRAN is based upon the projected negative balance of the General Fund for that year. Mr. Howard added that the IRS will only allow you to borrow the expected amount of your deficit in any given year. Mr. Howard pointed out that estimates are conservative so as to not overestimate which would require returning all the profit realized on the TRAN. Mr. Howard stated that there was large carry forward through 2007 and it was expected that the negative balance would not be as great as it had been in previous years. Mr. Jones stated that the TRAN is currently ahead of projected earnings.

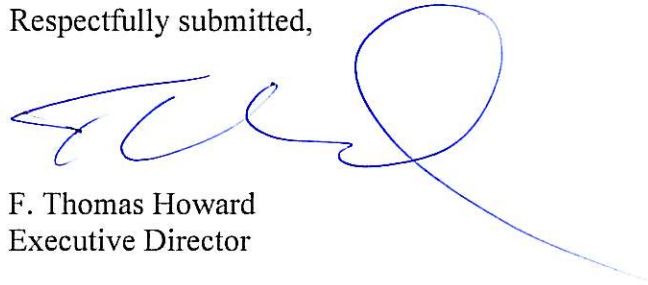
Mr. Jones stated that in June 2006 the Commonwealth entered into a 2-year and a 5-year interest rate swap with Wachovia that would benefit if the yield curve steepened. Mr. Jones stated that the yield curve inverted for an extended period of time instead. He noted that the interest cost for the year was \$344.55. Mr. Jones stated that in June of 2007, the yield curve began to steepen and on June 14, 2007 the trade was unwound for a total net gain to the Commonwealth of \$31,949.77.

Ms. Bechtel informed the Commission that due to the fact that there is no cash available to fund the Linked Deposit Program, it was not necessary to place limitations on the size of the program as discussed in previous meetings. Mr. Howard added that the program has assets but no cash to fund loans. Mr. Jones stated that once cash was available to fund the loans, consideration will be given to limiting the size of the program.

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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, consisting of several loops and a long trailing line that extends to the right.

F. Thomas Howard
Executive Director