

KENTUCKY ASSET/LIABILITY COMMISSION
MINUTES
JULY 10, 2014

The Kentucky Asset/Liability Commission (“ALCo” or the “Commission”) was called to order on Thursday, July 10, 2014 in Room 182 of the Capitol Annex at the conclusion of the Kentucky State Property and Buildings Commission (“SPBC”), at approximately 11:10 a.m. ET by Lori Flanery, Secretary, Finance and Administration Cabinet and Chairperson to the Commission. Other members present were Larry Clarke, proxy for Attorney General, Jack Conway; Edgar C. Ross, Executive Director, Office of the Controller, Finance and Administration Cabinet; Jane Driskell, State Budget Director; and Eugene Harrell, proxy for Todd Hollenbach, State Treasurer.

The Office of Financial Management (“OFM”) Staff Members Present: Mr. Ryan Barrow, Executive Director of OFM and Secretary to the Commission; Sandy Williams, Deputy Executive Director; Robin Brewer, Tom Midkiff, Steve Starkweather, John Brady, Brian Caldwell, and Tammy McCall.

Other Guests Present: Katherine Halloran from the Legislative Research Commission (“LRC”), and Mike Bartlett from the Governor’s Office.

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

A motion was made by Mr. Larry Clarke and seconded by Mr. Ed Ross to approve the previous meeting minutes. Motion **CARRIED** and the minutes of the February 14, 2014 meeting were **APPROVED**.

Secretary Flanery introduced Mr. Ryan Barrow for his presentation and introduction of the **SWAP Agreement Amendment** between **Deutsche Bank AG, New York Branch** and the **Kentucky Asset/Liability Commission**.

Mr. Barrow explained that this was an amendment to an existing SWAP agreement. In the past, a SWAP reassignment was only addressed as an informational item and no formal action was taken by the Committee. Mr. Barrow stated that a formal action would be requested today.

Mr. Barrow used the SWAP Agreement Amendment presentation as a guideline to present the history and why OFM staff believed the amendment was needed. He stated that ALCo had entered into approximately \$250 million in Floating Rate Notes (“FRNs”) that were sold to various investors. The FRNs pay a rate of interest indexed to 3-Month LIBOR plus a fixed spread. He explained the meaning of a SWAP and the value of the mechanism to reduce the variable rate risk exposure for the Commonwealth through SWAP agreements with counterparties. Contained in the agreements are various termination provisions for both parties which are triggered if the ratings of either party or the ratings of the bond insurers fell below a certain level. In February 2011, OFM signed a new SWAP Agreement with Deutsche Bank, AG (“Deutsche Bank”) in which the remaining swap balances were reassigned and included the same terms and conditions, with two exceptions: (a) the new swaps were not insured, and (b) the credit rating triggers were raised for both counterparties to A3/A- and were now symmetrical. Mr. Barrow noted that the markets have settled down and are becoming more stable; therefore, OFM intends to let the swaps go to maturity and amortize out. He stated the issue is that if a termination event would occur now, the Notes mark-to-market would be negative \$28.7 million and the Commonwealth would have to come up with that amount or find another financing option. Mr. Barrow felt that another counterparty could likely not be found that would offer the same terms as the existing agreement.

In order to maintain the present agreement, OFM staff asked the Commission's approval to change the provision in the agreement that pertained to the credit rating triggers for the counterparties. The current ratings in the present agreement are such that very few banks and only one bank in the U.S. could meet the requirements which hinders the negotiation position of the Commonwealth. OFM staff is comfortable with the Deutsche Bank credit exposure in the present SWAP Agreement. Mr. Barrow proposed to amend the current agreement triggers to state that Deutsche Bank maintain an investment grade rating, which is the industry standard, and that the Commonwealth maintain the same rating. The rating triggers would now be Baa3 by Moody's Investor's Service ("Moody's") or BBB- by Standard & Poor's Ratings Services ("S&P").

Mr. Larry Clarke asked for the current rating for Deutsche Bank. Mr. Barrow answered that currently the Moody's rating was A2 and the S&P rating was A.

A motion was made by Ms. Jane Driskell and seconded by Mr. Ed Ross to approve the recommendation to amend the SWAP Agreement. Secretary Flanery asked if there were any other questions or discussion.

Mr. Clarke asked that if Deutsche Bank's credit rating dropped below the industry standard would the Commission need to meet again regarding this issue. Secretary Flanery stated if a credit rating drop caused a trigger in the agreement, some kind of action would be needed. Mr. Barrow explained that the Commonwealth would have to write a check for the amount needed to settle the swap or another financing solution would be needed.

With no further questions or discussion, Motion **CARRIED** and the SWAP Agreement Amendment was **APPROVED**.

With no other business, the meeting stands adjourned.

Respectfully submitted,



Ryan Barrow
Secretary