

# State Investment Commission

March 11, 2013

1:00 p.m. ~ Room 182 ~ Capitol Annex  
Frankfort, Kentucky

The State Investment Commission (“the Commission”) meeting was called to order on, March 11, 2013, at 1:00 p.m. in Room 182 of the Capitol Annex by Todd Hollenbach, Kentucky State Treasurer. Other members present were Lori Flanery, Secretary of the Finance and Administration Cabinet; Jamie Link, proxy for Governor Beshear; Jon Lawson, President, Bank of Ohio County, Beaver Dam, Kentucky and George Spragens, President, Farmers National Bank in Lebanon, Kentucky.

Office of Financial Management (“OFM”) Staff Present: Ryan Barrow, Executive Director and Secretary to the Commission, Steve Jones, Deputy Executive Director, Dwight Price, Kim Bechtel, Kurt Kemper, Ian Blaiklock, John Bailey, and Marcia Adams.

Other Guests: Mr. Ed Ross, Controller, Finance and Administration Cabinet, Kristi Culpepper and Joshua Nacey from Legislative Research Commission (LRC).

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 12, 2012. A motion was made by Mr. Jon Lawson and seconded by Mr. George Spragens to approve the minutes. Motion **CARRIED**.

**Resolution 2013-01 - Appointment of Secretary to the Commission** – Secretary Flanery introduced a Resolution to appoint Ryan Barrow, the Executive Director of the Office of Financial Management, as the Secretary to the State Investment Commission.

Secretary Flanery moved to approve the Resolution and was seconded by George Spragens. Motion **CARRIED** and Resolution 2013-01 was **Adopted** this 11<sup>th</sup> day of March 2013.

**SEC 2a-7 Reports** – Mr. Steve Jones discussed the performance of the Limited Term Pool (“LTP”). The first chart shows performance of the LTP versus the Local Government Investment Pool (LGIP), the closest peer to the Commonwealth’s LTP. The chart, displaying weekly reporting, shows the LTP consistently outperforms the LGIP largely because the LTP fees are substantially lower. The next page shows all the securities held in the LTP by investment category. The third page shows the sector distribution and the credit rating distribution. All of the securities credit ratings are high as required by such a pool. The largest sector is the Government Agency Repurchase Agreement, Government Agency debt, and the Investment Company Money Market Mutual Funds. The next page and charts show maturity and liquidity of the LTP from May 2012 through November 2012. The weighted average maturity is required to be less than 60 days and, the averaged weighted liquidity is required to be less than 90 days. The pool meets these guidelines. The last chart is the Net Asset Value (“NAV”) and the Shadow NAV. The NAV shows the value of a dollar invested in the pool at book value. The shadow NAV shows the marked to market value. Any divergence in either exceeding 0.0025 requires SIC notification. A divergence greater than 0.005 means the pool has “broken the buck”. The maximum divergence has been 0.000182. The next page is a memo to the Commission showing a “stress test” of the pool. The information discusses major

withdrawals by investors from the pool during fiscal years 2011, 2012 and 2013 to date. Three large withdrawals happened in that timeframe and are identified by investor, date, amount, and percentage of the pool. Two of the withdrawals are from investors who provide prior notification. OFM staff controls the third account. The three largest individual accounts in the pool are the Employee Self-Insurance Fund, UK Building Fund, and the Federal Retiree Insurance Account. The Employee Self-Insurance Fund should not experience a large withdrawal without prior budgetary approval. The UK Building Fund provides prior notification of withdrawals. The Federal Retiree Insurance Fund recently withdrew all but \$2.5 million dollars of their account. The pool remained within liquidity limits after this withdrawal. Staff continues to recommend daily liquidity of at least 15 percent and weekly liquidity of at least 30 percent for this pool. The Commission did not take an action as this recommendation continued the approved levels.

**Linked Deposit Program** – Ms. Kim Bechtel reported on four banks not meeting the requirements to enter the program. The Bank of Columbia's non-performing loans have increased weakening their non-performing loans to capital ratio. Bank of Jamestown's loans to deposits ratio held steady below the program limit while Clinton Bank's ratio decreased. The Bank of Carlisle's loans to deposits ratio decreased while the non-performing loans to capital ratio improved slightly. All are well collateralized as the Commonwealth holds the securities for these debts. Staff recommends no action at this time. The Commission took to action.

**Securities Update** - Mr. Price presented the report of securities in the Commonwealth's securities lending portfolio that have been downgraded. The two listed securities are the same as the previous meeting. They continue to perform with a pay-down of \$781,798 in principal since the last meeting, leaving \$977,372 in outstanding principal. Staff expects these to be paid off by June of 2013 or shortly thereafter. Mr. Spragens asked what the original amount was when this list started in June of 2008. Mr. Price answered that there were several securities at that time, but these two were approximately \$9 million in par with a price of \$.80 on the dollar.

Mr. Jones continued with the Direct Securities on the downgraded list and stated that Centex is a new addition due to a recent downgrade. Ally Financial, is split rated AAA/AA+ and now needs to be reported as regulations have changed to look at the lowest rating. These securities continue to perform. Treasurer Hollenbach asked why the Centex was downgraded now given that the housing market has improved. Mr. Jones answered that the rating agencies are just now reviewing and downgrading. Mr. Lawson noted that Ally Financial did not meet their recent stress test. Mr. Jones explained that Ally is the servicer of the loans. The credit is supported by the loans, which are held in a bankruptcy remote trust. Financial problems at the servicer would not affect the credit of the particular investment since there is a backup servicer in place.

Mr. Spragens moved to extend forbearance for the Commonwealth to continue to hold the list of downgraded securities. The motion was seconded by Mr. Lawson. Motion **CARRIED**.

**Approved Credit List**– Mr. Jones noted that PFM, in the 2012 review, recommended that OFM strengthen its credit analysis to reduce reliance of the rating agencies. Staff has undertaken analysis of the credit strength of Corporate Securities within the portfolio. Rule 2A-7 requires that staff prepare a list of issuers, to be approved quarterly by the Commission, which are approved for investment. Staff may remove an issuer from the list between meetings, but only the Commission may add an issuer. While statutes and regulations establish minimum acceptable credit ratings, this process further tightens the restrictions.

There currently are three securities in the portfolio that are not included on the list. An American Express bond matures in April. The other two securities issued by USAA Insurance and Berkshire Hathaway. Staff has not completed the company review for these two issuers but is comfortable holding them until the review, prior to the next SIC meeting.

Treasurer Hollenbach asked if this list will continue to grow and will be brought to the Commission for approval each quarter. Mr. Jones answered that the approval process will happen at each quarterly meeting, per Rule 2a7 guidelines. Treasurer Hollenbach also asked which industries are being reviewed. Mr. Jones replied that currently staff has reviewed Pharmaceuticals, Industrials, and Financials. He added that the financial companies are imperative to this list due to the amount of paper they issue compared to the other industries.

Staff recommends approval of this list, including grandfathering of the three not on the list. Mr. Lawson asked about the listing for Allergan, Inc. and if it was a pharmaceutical and why the limitation is "no longer than 4/1/16". Mr. Jones replied that Allergan will lose certain patent protection then. A motion was made by Mr. Jon Lawson and seconded by Mr. George Spragens to approve the Approved Credit List as presented. Motion **CARRIED**.

Treasurer Hollenbach asked staff to present an explanation at the next meeting of the process to review these companies.

**Other Business** – Mr. Jones updated the Commission of the changes in Regulations. They have been approved and adopted. The Statutory change has passed the General Assembly and is headed to the Governor's desk for signature.

With no further business, the meeting stands adjourned.

Respectfully submitted,



Ryan Barrow  
Secretary