The State Investment Commission Meeting was called to order on Friday, June 12, 2009 at 2:00 p.m. in Room 76 of the Capitol Annex by Todd Hollenbach, State Treasurer. Other members present were Jonathan Miller, Secretary of the Finance and Administration Cabinet; Edmund Sauer, proxy for Governor Steve Beshear; and George Spragens, President, Farmers National Bank in Lebanon, Kentucky.

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

Other Guests: Mary John Celletti, Deputy Treasurer, Lori Flanery, Deputy Secretary, Finance and Administration Cabinet, Kristi Culpepper and Jonathan Lowe of LRC and Brandy Cantner of MLNK Government Solutions.

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 February 6, 2009. A motion was made by Mr. George Spragens and seconded by Secretary Jonathan Miller to approve minutes as written. Motion CARRIED.

TRAN – Mr. Steve Jones discussed the TRAN for Fiscal Year 2009 through the end of May. Matching the floating rate on the investments versus the floating rate on the swap, the Commonwealth has earned approximately $1.7 million dollars. On the fixed side of the debt versus the fixed side of the swap, the Commonwealth has earned approximately $5.2 million dollars, for a total of just under $7 million dollars. Projections from the beginning of FY 2009 were for earnings of $5.9 million dollars. By the June 25th maturity, earnings should exceed $7 million. Secretary Miller asked why there would not be another TRAN for the next fiscal year. Mr. Tom Howard answered that due to credit market issues and the Commonwealth’s fiscal condition, a new TRAN would not generate the spread to make this worthwhile. Treasurer Hollenbach asked if the current market conditions make it just too risky. Mr. Howard stated that with the Commonwealth’s current financial position the credit rating agencies would not likely grant the highest ratings, resulting in a dramatic increase in the cost of capital. Additionally, a lack of available assets for purchase increases the credit risk of this strategy. Treasurer Hollenbach complimented the OFC staff on a job well done.

Securities Update - Mr. Dwight Price discussed the securities lending portfolio. Three asset-backed securities have been downgraded to Aa3, Aa2 and A2, which is below the requirement for purchase of AAA. The amortized cost is about $20 million with approximately $1 million per month of principal pay downs.

Asset-Backed Securities: Mr. Jones discussed the securities held in the Commonwealth’s portfolio that have been downgraded below the regulatory level for purchase. The first security listed was a Commercial Mortgage Backed Security issued
by Credit Suisse, which has defaulted. This bond is backed by two mortgage loans to
motels. The loans have a current loan-to-value ratio of approximately 50%. Wachovia, as servicer to the security, is working on a resolution to these loans. Upon
resolution, the Commonwealth should recover a large portion of the principal involved.

The second security is an Asset Backed Security issued by Countrywide, which is
backed by home equity loans and also carries insurance issued by XL Capital
Insurance. The underlying equity lines have suffered defaults that the bond missed a
small amount of a principal payment. However, the insurance policy from XL Capital
is still in force. XL is not required to make timely principal payments but is required to
ultimately cover this principal shortfall. The security continues to make all interest
payments. These are the two most serious problems within the portfolio. Most of the
other securities have been downgraded due to downgrades on the insurance issuers or
due to over reactions by the credit rating agencies. Staff continues to believe it is in
the Commonwealth’s best interest to hold these securities currently.

Treasurer Hollenbach asked additional questions about the defaulted Credit Suisse
Commercial Mortgage Backed Security. He asked if the owners are trying to liquidate
the hotels. Mr. Jones answered that the servicer was in search of buyers to refinance
or investors to take over the existing loans. Mr. Spragens asked who the servicer is on
the CMBS and the Countrywide home equity piece. Mr. Jones answered Wachovia for
the CMBS and Bank of America for the Countrywide.

Treasurer Hollenbach asked whether granting of forbearance has been a wise decision
by the Commission. Mr. Jones responded that of the securities held one year ago that
are still held, over $400 million at that point, the Commonwealth has received over
$200 million in principal at par as well as interest. Had these securities been sold, the
Commonwealth would have received a significant discount and would have reinvested
the funds at a much lower interest rate. Mr. Jones believes the Commonwealth
should continue to hold these securities. Mr. Jones also pointed out the OFM has
paid out nearly $83 million in cash to state agencies during fiscal year 2009 even with
certain problem securities.

Mr. Spragens made the motion to extend forbearance for the Commonwealth to
continue to hold the list of downgraded securities. The motion was seconded by
Secretary Miller. Motion CARRIED.

Broker Dealer List – Mr. Price discussed the Broker-Dealer list. Every year, the
Commission approves the Broker-Dealers list. This identifies all of the broker-dealers,
which the state is eligible to do business with. There was only one addition, MBS
Securities, to this year’s list although several firms were removed. With no questions,
Mr. Spragens made the motion to approve the list of broker-dealers. The motion was
seconded by Secretary Miller. Motion CARRIED.

NOW Accounts – Mr. Jones stated the Commonwealth holds a great deal of money in
an overnight investment. Historically, tri-party repos have been used. With these, the
Commonwealth receives collateral in exchange for an overnight investment. Currently, these investments pay about 15 basis points. Last fall, the FDIC set up the
program, which insured NOW accounts up to $250,000 dollars, and allow governmental entities to invest in a NOW account of an unlimited size, with a full faith and credit insurance. The account may pay up to 49 basis points. The Commonwealth has opened a NOW account with US Bank, which has completely replaced tri-party repos. This account pays 49 basis points and carries a full faith and credit guarantee of the United States through the FDIC. By making this change, the Commonwealth was able to increase earnings while reducing credit risk. Mr. Price added that this program is expected to cease on December 31, 2009.

Credit Suisse – Mr. Price updated the Commission on the Credit Suisse Securities Lending trade from this spring. While this is a long-term position, it already has a market value gain. Mr. Jones added that Credit Suisse is one of the strongest banks in the world.

Treasury Hollenbach asked about Indiana pension system’s recent purchase of GM bonds at about 48 cents on the dollar. He asked if Kentucky had made any similar investments. Mr. Price answered that because of minimum credit criteria, the Commonwealth is unable to purchase distressed bonds. Treasurer Hollenbach also asked if any of the Commonwealth’s assets or securities had been damaged by the actions of the federal government. Mr. Price answered that AIG and autos have been below credit standards for quite some time. The only government damage to the Commonwealth was the failure of Lehman Brothers and Washington Mutual. Treasurer Hollenbach asked that as the staff continues to monitor holdings and if occasion arises that legal counsel is needed, to not hesitate to confer with him or the Commission.

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

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

Respectfully submitted,

[Signature]

F. Thomas Howard
Secretary