

## State Investment Commission

March 19, 2015

2:00 p.m. ~ Room 182 ~ Capitol Annex  
Frankfort, Kentucky

The State Investment Commission (“the Commission”) meeting was called to order on March 19, 2015 at 2:00 p.m. in Room 182 of the Capitol Annex by Todd Hollenbach, Kentucky State Treasurer. Other members present were W. Fred Brashear, II, President & CEO, Hyden Citizens Bank, Hyden, Kentucky; William Fallon, President & CEO, The Bankers’ Bank of Kentucky, Frankfort, Kentucky; Lori Flanery, Secretary of the Finance and Administration Cabinet (“FAC”); and Mary Lassiter, proxy for Governor Beshear.

Office of Financial Management (“OFM”) Staff Present: Steve Jones, Deputy Executive Director; Brian Caldwell, Ian Blaiklock, J.D. Lester, Hannah Hogston, Kim Bechtel, Jonathan Eakin and Tammy McCall.

Other Guests: Ed Ross, Controller, Office of the Controller, FAC; Donna Duncan, Executive Director, Office of Policy and Audit, FAC; Debbie Paulus, Office of Policy and Audit, FAC; Katherine Halloran, Legislative Research Commission; Joshua Nacey, Legislative Research Commission; and Sarah Haydon, Office of the Secretary, FAC.

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 the December 12, 2014, meeting. A motion was made by Secretary Lori Flanery and seconded by Mr. Bill Fallon to approve the minutes as written. Motion **CARRIED**.

Treasurer Hollenbach recognized Mr. Brian Caldwell.

**Updated Trading Authorization** – For background purposes, Mr. Caldwell informed the Commission that he was hired to replace Dwight Price in October 2013. Under the direction of Mr. Ryan Barrow, Executive Director of OFM, Mr. Caldwell informed the Commission that Mr. Barrow wanted him to complete his probation period of employment before appointing his trading authorization to Senior Portfolio Manager. The only change to the trading authorizations was to move Brian Caldwell from Junior to Senior Portfolio Manager. OFM staff recommended the change and Mr. Caldwell asked for the Commission’s approval. Treasurer Hollenbach moved to approve Brian Caldwell as a Senior Portfolio Manager. Mr. Fallon seconded, and the Motion **CARRIED**.

**Update on Cash Management Alternatives** – Mr. Jones updated the Commission on actions taken by Staff regarding cash management issues. He reported that the Insured Cash Sweep (“ICS”) account with Traditional Bank was fully implemented. The account balance was \$95 million; and it was earning 25 bps on \$20 million and 75 bps on the remainder, which was well above the Repo rate. Mr. Jones reported that in January 2015 a bilateral repurchase agreement was executed with Investco REIT. Two separate repos are currently in place with each being rolled monthly for roughly a one month term. On the morning of the meeting there was a balance of \$73 million, earning at a rate of 21 bps. Mr. Jones stated that some preliminary negotiations were progressing with another company interested in doing bilateral repos on an overnight basis, and hoped to have

more information at the next meeting. He informed the Commission that he attended the Government Investment Officers' Association Meeting on March 11-13, 2015. He found out that Kentucky was one of about five states being represented at the Conference that were using bilateral repos. Treasurer Hollenbach asked who were the other states and Mr. Jones told him that Oregon was one of them. Treasurer Hollenbach stated it was good to know that Kentucky was not the only state doing bilateral repos.

**Updated on Compliance Reporting** – Mr. Steve Jones updated the Commission regarding the improvements toward compliance monitoring. He reported there were 2 compliance alerts triggered from the Bloomberg system since the last Commission meeting. One alert was due to a mistake in setting up a rule while staff was working on improving the rules in the Bloomberg system. It was corrected the next day. The second alert was due to typing too many zeros on a trade ticket that was put into the system and it was immediately cancelled. There were no compliance violations since the last meeting.

Mr. Jones recognized Executive Director Donna Duncan and Ms. Debbie Paulus from the Office of Policy and Audit in the Finance and Administration Cabinet. With the help of OFM staff, Ms. Paulus created the Investment Manual Draft dated 2/28/15 that was being presented to the Commission for approval. The manual is composed of definitions, summaries and links regarding all statute and regulation requirements and policy statements for the State Investment Commission. Mr. Jones stated that, upon approval by the Commission, the Investment Manual will be passed out to every member of the investment and accounting staff who will be required to give an assurance that the Manual was read and understood. Over time as changes are made to the regulations, statutes, or policies, the Investment Manual will be updated and the Commission will be made aware of those changes. The next step toward improving compliance monitoring is to input and properly set up in the Bloomberg Compliance Module all the rules it could possibly monitor to make sure everything is working right. Mr. Jones stated this was still in progress. He added that another step to be refined is to make sure Jonathan Eakin, from OFM's Accounting staff, is made aware of any rule changes. Mr. Eakin would report to upper management of any violations or actions that would cause alarm. Mr. Jones thanked everyone who was involved in putting the Investment Manual together. Ms. Duncan added that what Ms. Paulus accomplished was to take a compilation of documents and fragments of public information that already existed either on the website or in many different of places and organized them into the Investment Manual to produce a more discernible document to take as a whole. It was not original material in which something could have been taken out of context. Treasurer Hollenbach asked for a motion to approve the Investment Manual Draft of 2/28/15. Mr. Bill Fallon made a motion and it was seconded by Secretary Mary Lassiter. Motion **CARRIED**.

**Proposed Regulatory Changes** – Mr. Jones presented the proposed changes to 200 KAR 14:011 and 200 KAR 14:081. He stated the changes were recommended due to SEC changes to Rule 2a-7 which governs how money market mutual funds are managed. Rule 2a-7 is referenced in the Commission's regulations concerning the Limited Term Pool. Mr. Jones explained that one of the changes states that any fund except a retail fund and a 99.5% government fund must go to a floating NAV. Another change is if the Pool drops below certain liquidity requirements the Commission would have the right, but not the obligation, to enact a liquidity fee and a redemption gate. The liquidity fee is a charge of 2% if money is pulled out and the redemption gate is a hold on the money for 30 days. Mr. Jones explained that these new changes were a problem for the Limited Term Pool because: 1) the system does not allow a 2% fee on a transaction; 2) the system does not allow a 30

day hold on a redemption; and 3) the 2% fee runs into other legal issues and conflicts with other rules.

Mr. Jones continued with a brief summary of the regulation changes being proposed. He stated that all of the restrictions on money market mutual funds were being kept in place but the reference to Rule 2a-7 was being eliminated so that the new SEC regulation would not be a problem. The restriction in the Limited Term Pool was changed and stated that every security must be one year or less to maturity at time of purchase, so that every security in that pool maintained book value accounting. Restrictions were added on the amount of municipal securities that can be purchased. Some new electronic exchanges have been developed recently and the option to be able to use them was added. Language was added to explicitly allow bilateral repos with non-traditional counterparties. He concluded there were some minor changes made to clean-up mistakes in language and references. There was a brief discussion regarding the proposed changes. There being no further questions, Treasurer Hollenbach called for a motion to begin the process to update the regulations as proposed. Mr. Fred Brashear made a motion and it was seconded by Mr. Bill Fallon. Motion **CARRIED**.

**Bridges Pool** – Mr. Jones reported that the balance of the Bridge Pool was slightly under \$300,000,000. The Current Holdings identified each individual security. The Income Generated showed a small unrealized gain, but when all the securities matured the gain would be zero. The Book Income earnings was \$817,643.64 with an unrealized gain of \$124,653.52 for a total income amount of \$942,297.16. The Projected Net Cash Flow graph showed the cash that's available to be spent by the Transportation Cabinet. Mr. Jones noted that the balance is expected to be zero towards the end of the project schedule in 2016. Part of the funds for this project will be supplemented from federal funds which are not reflected in this report.

**Intermediate Pool Performance** – Brian Caldwell directed the Commission members to the Intermediate Term Pool report as of February 28, 2015. The Pool market value stood just over \$2.6 billion. The Yield to Worst was 0.55% which was slightly under the benchmark. Quality remained high at Aaa. Duration stood at 1 year which is close to two-thirds of a year short of the benchmark, which is held as a defensive position against higher rates. The Portfolio Sector Allocations page showed a comparison between the Intermediate Pool and the Benchmark as of February 28, 2015. The difference to the Portfolio's allocation from the last meeting was higher cash and mortgage-backed securities positions at 2% each. Mr. Caldwell continued with the Portfolio Performance page, which showed the Pool performance versus the Benchmark as of February 28, 2015. The one month, three month, fiscal year to date and one year numbers slightly out-performed the Benchmark. The three year, five year, ten year and since inception numbers were close to the Benchmark but slightly under-performed.

**Limited Term Pool Performance** – Ms. Kim Bechtel discussed the monthly performance of the Limited Term Pool compared to the Local Government Investment Pool benchmark as of February 28, 2015. The first page was the monthly performance graph showing the Commonwealth out-performing the benchmark. The second page listed all the securities held in the Pool as of February 28, 2015. The next page showed a breakdown by credit rating and sector distributions. Ms. Bechtel noted that the portfolio currently showed a large amount of cash but should decrease during the months from July to October when an increase in spending is normally expected. The next page provided detail on the weighted average maturity and life plus liquidity positions. She stated that liquidity was higher than in the past due to the seasonal inflow of cash as well as the availability of different types of securities. The Net Asset Value graph was steady as it should be. The most recent

largest daily withdrawal was to the University of Kentucky Hospital on 1/20/15. The largest weekly withdrawals were the same as the daily withdrawals. The largest individual accounts in the portfolio were the Employee Self-Insurance Fund at 31.09%, UK Building Fund at 12.50%, and the UK General Receipts Bond Issue at 10.32%. The daily liquidity requirement as set forth by the Commission is 15% and the weekly liquidity requirement is 30%. Staff recommended maintaining the current liquidity requirements of the Pool requiring no action from the Commission. The Commission took no action.

**Linked Deposit Program (Country Bank Program)** – Mr. J.D. Lester stated that out of the seven banks that qualify for the program, three were identified in this report that would not qualify to the join if they weren't already a member. The Bank of Jamestown had a loan to deposit ratio of 53% and Farmers Deposit Bank had a ratio of 47%, which is below the threshold of 70%. The Bank of Columbia's non-performing loans to capital ratio was 31% which is above the threshold of 25%. Mr. Lester noted that although there wasn't a change in the ratio from last quarter, the Bank of Columbia's ratio from one year ago has dropped by about 20%. Mr. Jones added that when Bank of Columbia was contacted they were expecting to have resolution sometime during the first half of 2015. Staff recommended no action from the Commission. Treasurer Hollenbach asked if either one of the bankers on the Commission had any concerns or questions. Mr. Fallon stated he had no concerns because, due to banking regulations, the Bank of Columbia's ratio will be corrected and there was no risk. The Commission took no action.

**Credit Considerations** – Ms. Hannah Hogston reported that as of March 19, 2015, there were 33 non-financial companies and 28 financial companies for a total of 61 companies on the approved credit list. Ms. Hogston stated that, since the last SIC meeting, Texas Instruments Inc. was added to the approved list for Debt and Royal Bank of Canada was added as a repo counterparty. There were no names removed. Staff recommended approval of the proposed credit list. Treasurer Hollenbach called for a motion to approve the Corporate Credits list. Mr. Bill Fallon made a motion and it was seconded by Mr. Fred Brashear. Motion **CARRIED**.

**Other Business** – Secretary Lori Flanery introduced Sarah Haydon, a summer intern for the Finance and Administration Cabinet. She came to the Secretary's Office through the Association of Independent Kentucky Colleges and Universities. She attends St. Catherine's College and is from Springfield, Kentucky. Secretary Flanery stated that she was sending Ms. Haydon around to learn about the Cabinet.

With no further business, Treasurer Hollenbach called for a motion to adjourn. Mr. Fred Brashear made a motion and was seconded by Mr. Bill Fallon. The meeting stands adjourned.

Respectfully submitted,



Ryan Barrow  
Secretary