The State Investment Commission (“the Commission”) meeting was called to order on June 25, 2015 at 1:30 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; Donna Duncan, proxy for Secretary Lori Flanery of the Finance and Administration Cabinet (“FAC”); and Mike Bartlett, proxy for Governor Beshear.

Office of Financial Management (“OFM”) Staff Present: Ryan Barrow, Executive Director of OFM and Secretary to the Commission; Steve Jones, Deputy Executive Director; Sandy Williams, Deputy Executive Director; Brian Caldwell, J.D. Lester, Hannah Hogston, Kim Bechtel, Jonathan Eakin, Denise Pitts, Liz Columbia and Tammy McCall.

Other Guests: Ed Ross, Controller, Office of the Controller, FAC; Katherine Halloran, Legislative Research Commission; and Joe Lancaster, Legislative Research Commission.

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 March 19, 2015, meeting. A motion was made by Mr. Bill Fallon and seconded by Ms. Donna Duncan to approve the minutes as written. Motion CARRIED.

Treasurer Hollenbach recognized Mr. Steve Jones.

Mr. Steve Jones announced that Ian Blaiklock of OFM would be leaving state government. Mr. Blaiklock was a staff member of OFM for approximately three years, was a valuable asset to the office and would be greatly missed.

Update on Compliance Reporting – Mr. Steve Jones updated the Commission on the improvements in compliance monitoring. The Investment Manual, composed of definitions, summaries and links regarding all statutes and regulations plus policy statements of the State Investment Commission, was approved at the last meeting. All investment and accounting staff certified they had read the manual. It will be required for all new investment and accounting personnel. Since the last meeting, Mr. Jones stated that he and Kim Bechtel, OFM, had reviewed all rules in the Bloomberg Portfolio Order Management System Compliance Module to assure accuracy and functionality, and to assure all needed rules were in place. After fiscal year end, a hypothetical portfolio will be set up with numerous face trades input in order to intentionally break the rules and test the monitoring procedures. Some rules have been identified that the Bloomberg system cannot measure which OFM staff is in the process of developing some accounting procedures for monitoring.
Mr. Jones reminded the Commission of the APA's finding in last year's audit regarding Ms. Bechtel's authority to change a rule in the Compliance Manager. They recommended that someone from accounting should monitor those actions. A process was developed and put in place in which Mr. Jonathan Eakin, from OFM's accounting group, could now monitor transactions and is notified if Mr. Jones or Ms. Bechtel were to change a rule in the Compliance Manager or execute an unauthorized trade in POMS. The Commission and OFM staff discussed the details of the process that was put in place.

Mr. Jonathan Eakin presented the final procedure for monitoring compliance rule changes which has three parts. First, on a weekly basis, a Compliance Rule Audit Trail report is generated in Bloomberg and reviewed by the Accounting staff. Second, the report is then compared to the Compliance Rule Change log updated by Investment staff. Mr. Eakin stated he verifies that those two documents match to ensure that any changes in the compliance rules are fully documented and disclosed on a timely basis. Third, the two reports plus a manual Bloomberg log of all rule changes are provided to the Auditor of Public Accounts on an annual basis. Since the previous SIC meeting, there were two compliance alerts triggered and one that should have been triggered. On June 5, 2015, as the Investment staff was updating rules, a mistake was made on the sign of a rule triggering an alert. There was no violation and the rule has been fixed. On May 8, 2015, Fitch downgraded the rating for McDonald's from A to BBB+. This fell below the Investment Policy of A- and McDonald's was removed from the Approved list. This was a violation. All McDonald's holding have since been liquidated. On March 27, 2015, S&P downgraded the short term ratings of Sumitomo Corp. from A-1 to A-2. This fell below the Investment Policy of A-1. A piece of commercial paper was held at that time that should have triggered an alert but didn't. The security matured on March 31, 2015. This was a violation. A rule has been created in Bloomberg to identify this violation in the future. Mr. Jones stated that Mr. Eakin will be attending the SIC meetings in the future to report on whatever rules were changed and what alerts were triggered during the quarter.

Mr. Brian Caldwell presented a timeline in regards to McDonald's rating downgrade. In summary, two of the rating agencies (S&P and Moody's) downgraded McDonald's one notch but maintained in the A category. Fitch rating agency downgraded McDonald's two notches to BBB+ causing a forced sell. Two holdings had been purchased before the downgrade, one on March 18, 2015 for $5 million par and the other on April 2, 2015, for $10 million par. The first holding was sold mid-May, the remaining holding was sold mid-June. Holdings are now compliant from a NRSRO corporate rating standpoint.

**Update on Cash Management Alternatives** — Mr. Jones updated the Commission on actions taken by Staff regarding cash management alternatives. He reported that the Insured Cash Sweep ("ICS") account with Traditional Bank had an account balance $95 million as of the date of this meeting. Another alternative was to move away from the traditional counterparties with a triparty repo. A relationship was started in January with Investco REIT under a bilateral repurchase agreement. A list of new counter parties will be brought before the Commission today for approval. Two of those counter parties are going to be for a bilateral repo on an overnight basis, one is for a pension plan in Ontario and the other is called Wedbush Securities, which is a specialty broker focused on the repo market. At the last meeting, Secretary Flenery had asked how many other states were doing these kinds of transactions. Mr. Jones stated he didn't have a complete list but knew that Georgia, Washington, Maryland, New Mexico, Idaho, and Missouri were doing them.
Proposed Regulatory Changes – Mr. Jones stated that at the last meeting the Commission approved changes to 200 KAR 14:011 and 200 KAR 14:081. Those changes principally did the following: 1) explicitly allowed bilateral repurchases with non-brokers; 2) removed any reference to Rule 2A-7 from the regulations; and 3) put a $25 million per name limit on municipals within each portfolio. The changes were filed and are in the comment period as of the day of this meeting. No comments had been received to date. The regulation changes are scheduled to go before the Administrative Regulation Review Committee on July 14, 2015. If they are approved at that meeting, a second committee will need to review them. If they are approved or if the Committee doesn’t meet, then the regulatory changes would become effective September 4, 2015. Once that happens, then some SIC policy statements will have to be reviewed and changed to reflect the changes to the regulations.

Bridges Pool – Mr. Jones reported that the balance of the Bridge Pool was approximately $253,000,000, as of June 11, 2015. The Current Holdings identified each individual security. The Income Generated showed an unrealized gain of $119,364.64, but when all the securities matured the gain will be zero. The Book Income earnings was $938,405.99. 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 is approximately $50 million a year. Mr. Jones noted that the Bridges project looked like it may come in a little under budget and ahead of schedule.

Intermediate Pool Performance – Brian Caldwell directed the Commission members to the Intermediate Term Pool report as of May 31, 2015. The Pool market value stood just under $2.4 billion. The Yield to Worst was 0.57% which was slightly under the benchmark. Quality remained high at Aaa. Duration stood at 1 year which is one-half of a year short of the benchmark. The Portfolio Sector Allocations page showed a comparison between the Intermediate Pool and the Benchmark as of May 31, 2015. The difference to the Portfolio’s allocation from the last meeting was a lower cash position and a higher treasury position at 9% each. Mr. Caldwell continued with the Portfolio Performance page, which showed the Pool performance versus the Benchmark as of May 31, 2105. The one month, three month, and fiscal year to date numbers slightly underperformed the Benchmark. There was a slight out-performance at the one year point, but underperformance at the three year, five year, ten year and since inception numbers.

Limited Term Pool Performance – Ms. Kim Bechtel presented the monthly performance of the Limited Term Pool compared to the Local Government Investment Pool benchmark as of May 31, 2015. The first page was the monthly performance graph showing the Limited Term Pool outperforming the Local Government Investment Pool. The second page listed all the securities held in the Pool as of May 31, 2015. The next page showed a breakdown by credit rating and sector distributions. The next page provided detail on the weighted average maturity and life plus liquidity positions. Ms. Bechtel noted that the weighted average maturity was 38.68 days as of May 31, 2015. The Net Asset Value graph was steady as it should be. The most recent largest daily withdrawal was by the University of Kentucky Hospital on 1/20/15. The largest weekly withdrawals were the same as the daily withdrawals. The largest individual account in the portfolio was the Employee Self-Insurance Fund. 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. JD Lester stated there was no change in the Country Bank Program since the last meeting. The program size was still seven banks with a total loan value of approximately $13.5 million. The three banks identified in the report were the same banks identified in the last meeting and would not qualify to the joint if they weren’t already a member. The Bank of Jamestown and the Farmers Deposit Bank had a low loan to deposit ratio but were not a concern because of their strong performance. The Bank of Columbia had a non-performing loans to capital ratio above the required 25%, but that ratio had fallen substantially throughout the year. 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 and Mr. Brashear stated they had no concerns. The Commission took no action.

Credit Considerations – Ms. Hannah Hogston reported there were five additions to the approved Corporate Credit list. They were Healthcare of Ontario Pension Plan (HOOPP), Wedbush Securities Inc., Home Depot Inc., Costco Wholesale Corp., and The Toronto-Dominion Bank. There were also 10 companies removed from the list. The following four were removed due to a rating downgrade: Sumitomo Corp., McDonald’s Corp., Barclays Capital Inc., and Deutsche Bank AG. The following six were removed due to not enough issuance of debt: 3M Co., Google Inc., United Parcel Service, The Travelers Cos Inc., Colgate-Palmolive Co., and Honeywell International, Inc. Treasurer Hollenbach called for a motion based upon staff’s recommendation to approve the Corporate Credits list as presented. Mr. Fred Brashear made a motion which was seconded by Mr. Bill Fallon. Motion CARRIED.

Approval of Broker-Dealer List – Ms. Hogston presented the list of Primary Dealers and Non-Primary Dealers for Fiscal year 2016. There were two additions to the list: Mitsubishi UFJ and Wedbush Securities, Inc. Staff recommended approval. Treasurer Hollenbach called for a motion. Mr. Mike Bartlett made a motion to approve which was seconded by Mr. Fred Brashear. Motion CARRIED.

Approval of NRSRO’s – Ms. Hogston presented the Nationally Recognized Statistical Rating Organizations (NRSRO) for Fiscal Year 2016. She stated that according to 200 KAR 14:011 Section 6 Investment Securities (11), the Commission must approve on an annual basis the NRSRO’s that will be used in determining investment compliance for fiscal year 2016. From the list of credit rating agencies as of December 2014, staff recommended S&IC approve S&P, Moody’s and Fitch. Treasurer Hollenbach called for a motion. Ms. Donna Duncan made a motion to approve which was seconded by Mr. Bill Fallon. Motion CARRIED.

Other Business – Mr. Jones stated he had two items to bring up. First, he reminded the Commission of the upcoming election this November and that there would be some turnover in the membership of the Commission at some point in the future. He also stated that the Commission is required to meet every quarter. He proposed having the 4th quarter meeting before the turnover in administration, possibly late November, if it meets with everyone’s schedules. Second, Mr. Jones informed the Commission that State Street Bank, the Commonwealth’s Custodian, announced they had received a Well’s Notice from the SEC. The allegations were that State Street had hired lobbyists to help them win contracts for custodial services for pension plans from larger states. Mr. Jones assured the Commission that he was on the RFP committee when the Commonwealth hired State Street and there were no lobbyists involved. He stated that this did not impact the Commonwealth and there was no need to take any action.
With no further business, Treasurer Hollenbach called for a motion to adjourn. Mr. Fred Brashear made a motion which was seconded by Mr. Bill Fallon. The meeting stands adjourned.

Respectfully submitted,

Ryan Barrow
Secretary