

STATE INVESTMENT COMMISSION
MINUTES
June 30, 2003

The State Investment Commission ("the Commission") meeting was called to order by Jonathan Miller, State Treasurer at 2:05 p.m. on June 30, 2003, in Room 264 of the Capitol Annex. Other members present were James O. King, Peoples State Bank and Gordon Duke, Secretary, Finance and Administration Cabinet.

Treasurer Miller confirmed a quorum was present and that the press had been notified of the meeting. The first item on the agenda was approval of the February 5, 2003 minutes. A motion was made by Secretary Duke and seconded by Mr. King to approve the minutes of the February 5, 2003 meeting. Motion **CARRIED**.

Treasurer Miller introduced RESOLUTION SIC 03-02 approving broker/dealers for fiscal year 2003-2004.

Mr. Price indicated that this Resolution approves the addition of one primary dealer and three non-primary dealers who may conduct business with the Commonwealth. The primary dealer added was Mizuho Securities USA and the non-primary dealers added were Huntington Bank, NBC Capital Markets Group, and U. S. Bancorp/Piper Jaffray. Mr. Price indicated all additions to the list met the criteria as stated in KAR 14:011, Section 9.

A motion was made by Mr. King and seconded by Secretary Duke to adopt Resolution SIC 03-02. Motion carried and **Resolution SIC 03-02 was adopted**.

Treasurer Miller introduced RESOLUTION SIC 03-03 authorizing the execution and delivery of a financial agreement to hedge interest sensitive assets for the purpose of managing interest rate risk.

Stephen Jones, Financial Portfolio Administrator of the Office of Financial Management, discussed the performance of the interest rate swaps used in the TRAN portfolio. In November 2002, the Commonwealth entered into a Basis Swap and two standard interest rate swaps which hedged the interest rate risk between the investments in the TRAN portfolio and the outstanding debt. The debt, investments and swaps all matured or were sold on June 26, 2003. The net result of this transaction was \$350,000 in income for the Commonwealth. Mr. Jones then reviewed the proposed use of Total Return Swaps to synthetically create investment positions at higher yields than are available in the cash markets. The security examined was a generic FNMA, 4.50% coupon, 30-year pass-through. It is projected that the Total Return Swap will generate \$43,750 more earnings over 3 months than buying the security itself. The Commission expressed interest in seeing the results of this activity at the next meeting. Mr. Jones also explained that, while approval of this Resolution will allow staff freedom to enter into such transactions when they are available, it also places market value restrictions on the overall positions of \$50 million in total and \$15 million with any single broker-dealer.

A motion was made by Mr. King and seconded by Secretary Duke to adopt Resolution SIC 03-03. Motion carried and **Resolution 03-03 was adopted**.

Mr. Price, Portfolio Manager of the Office of Financial Management, presented the Monthly Investment Income Report for May 2003. Mr. Price indicated that the report included a summary of the types of securities held by the Commonwealth and their total market values. Mr. Price indicated that the market value of the Commonwealth's portfolio at the end of May was \$2.674 billion. Mr. Price informed the Commission that the portfolio consists of U.S. Treasury Notes, U.S. Agency Bonds, municipals, asset-backed securities, repurchase agreements and money market securities. Mr. Price further indicated that the securities in the portfolio are of high quality and present little or no risk to the portfolio.

Mr. King asked about the yield on the corporates versus other securities. Mr. Price indicated that the high yield corporates perform well but the Commonwealth does not purchase these securities because they do not meet the Commonwealth's prudent credit requirements. He further indicated that the Commonwealth's portfolio has an average rating of AAA.

Mr. Price informed the Commission members that the Transportation Cabinet is the only agency in the long-term pool. The Transportation Cabinet is spending down their balance, which will liquidate the long-term portfolio. Mr. Price indicated that the portfolio is outperforming the index and staff is considering a 5-year rolling average for annualized yield.

George Burgess, Executive Director of the Office of Financial Management, asked Mr. Price to discuss interest expense. Mr. Price indicated that the General Fund borrowed money from other state agencies during most of Fiscal Year 2003 at an overnight rate. A transfer of \$8.5 million was initiated on June 27, 2003, to pay the interest expense on the loans.

Secretary Duke indicated that this becomes important because the \$8.5 million will be reflected on the Monthly Receipts Report as a negative balance and could be perceived as a loss of investments. Both Mr. Burgess and Secretary Duke felt it was important to clarify this with the Commission members.

With no further business before the Commission, a motion was made by Mr. King and seconded by Secretary Duke to adjourn the meeting at 3:00 p.m.

Respectfully submitted,

A handwritten signature in black ink, appearing to be 'J. H. ...', written over a horizontal line.

Secretary
State Investment Commission

RESOLUTION NO. 03-03

A RESOLUTION PROVIDING FOR THE AUTHORIZATION, EXECUTION AND DELIVERY OF A FINANCIAL AGREEMENT FOR THE PURPOSE OF HEDGING A PORTFOLIO OF INTEREST-SENSITIVE ASSETS TO MANAGE THE COMMONWEALTH'S PORTFOLIO EXPOSURE TO INTEREST RATE RISK.

WHEREAS, pursuant to Section 42.500 et seq. of the Kentucky Revised Statutes (the "Act"), the State Investment Commission (the "Commission") was created and exists as a constituted authority of the Commonwealth of Kentucky (the "Commonwealth"), with the statutory authority to invest excess state funds and to make purchases, sales, exchanges, investments, and reinvestments, of any securities or of the proceeds of such investments, through the use of various financial instruments and agreements; and

WHEREAS, pursuant to the Act, the Commission is directed to, and has, promulgated certain administrative regulations to govern its investment of state funds (the "Regulations"); and

WHEREAS, the Act and the Regulations authorize the Commission to enter into certain financial agreements in order to manage the Commonwealth's portfolio exposure to interest rate risk in order that the Commission may better meet the goal of maximum earnings on the investment pools within the appropriate constraints of liquidity and safety; and

WHEREAS, the Commission has determined that it is necessary and desirable to enter into an agreement for such purpose and that such determination is in compliance with the Commission Regulations set forth in 200 KAR 14 et seq.;

NOW, THEREFORE, BE IT RESOLVED by the State Investment Commission that:

Section 1. Determination by Commission. The Commission hereby finds and determines that (i) the facts set forth in the recitals hereto are true and correct, (ii) the Commission shall enter into agreements from time to time consisting of interest rate swaps and similar transactions as defined in Section (1) of 200 KAR 14:011 with broker-dealers meeting the criteria set forth in Section (9) of 200 KAR 14:011 and (iii) the form, terms and provisions of the agreements being the International Swaps and Derivatives Association, Inc. Master Agreement including all Schedules and Annexes, attached thereto, in the form presented to the Commission (with such changes, not inconsistent with the intent of this Resolution as the officer(s) executing the same, as evidenced by their execution thereto, shall deem necessary or desirable), and the actions contemplated thereby (including the entry by the Commission into transactions, as defined in the Master

Agreement, with such broker dealers evidenced by confirmations thereof) be and hereby are, in all respects approved, authorized, adopted, ratified and confirmed.

Section 2. Approvals and Authorizations. The Commission, through the Executive Director or Deputy Executive Director of the Office of Financial Management, is hereby authorized to enter into International Swaps and Derivatives Association, Inc. Master Agreements, including all attached Schedules and Annexes, with broker-dealers meeting the criteria set forth in Section (9) of 200 KAR 14:011. The Commission is further authorized, from time to time, to enter into one or more interest rate swap transactions and agreements terminating any such interest rate swap transactions, pursuant to the Master Agreements and the documents (each a "Confirmation") exchanged between the parties confirming such interest rate swap transactions. The terms of each interest rate swap transaction, including interest rate, term, Notional Amount and options as to commencement and termination of payments, and each termination agreement, shall be as described in the applicable Confirmation, as approved from time to time by the staff of the Commission authorized to execute the Confirmation, which shall include the Executive Director of the Office of Financial Management, Fixed Income Trading/Risk Management Administrator, or Financial Portfolio Administrator.

Section 3. Further Authorization. All staff of the commission and its agents and counsel be, and each of them hereby is, authorized to take all such further actions, to execute and deliver such further instruments and documents in the name of and on behalf of the Commission and if necessary or advisable or otherwise, to pay all such expenses as in their judgment shall be necessary or advisable in order fully to carry out the purposes of the foregoing resolutions.

Section 4. Ratification. All actions previously taken or that will be taken by any staff to or agent of the Commission in connection with or related to the matters set forth in or reasonably contemplated by the foregoing resolutions be, and each of them hereby is, adopted, ratified, confirmed and approved in all respects as the acts and deeds of the Commission.

Section 5. Exposure Limits. At least quarterly, the commission shall determine the market value of each outstanding interest rate swap by discounting the expected cash flows at current market rates. A total market value of interest rate swaps with each counter-party shall be determined on a net basis. The absolute value of the total market value for each counter-party shall not exceed \$15,000,000. The absolute value of the total market value for all counter-parties combined shall not exceed \$50,000,000. If either of these limits is exceeded, the commission shall take appropriate action to bring the market values back in to compliance as rapidly as practical.

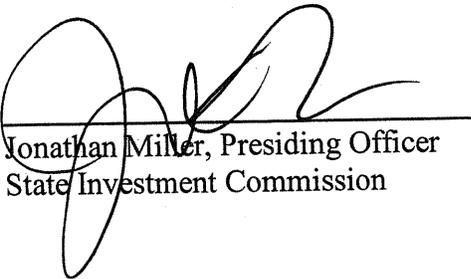
Section 6. Severability. Should it be judicially determined by a court having jurisdiction to pass upon the validity of this Resolution, any Master

Section 7. Open Meetings Determination. The Commission hereby finds and determines that all formal actions relative to the adoption of this Resolution were taken in an open meeting of this Commission, and that all deliberations of this Commission and of its committees, if any, which resulted in formal action, were taken in meetings open to the public, in full compliance with applicable legal requirements.

Section 8. Resolution 95-03. The Commission hereby rescinds and repeals Resolution 95-03 in its entirety.

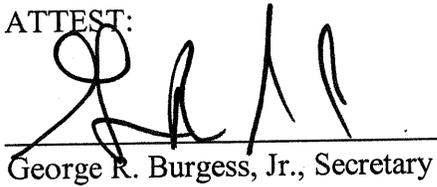
Section 9. Effective Date. This Resolution shall take effect immediately upon its adoption.

ADOPTED ON: June 30, 2003.



Jonathan Miller, Presiding Officer
State Investment Commission

ATTEST:

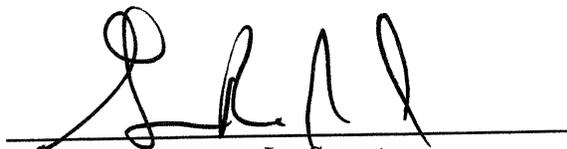


George R. Burgess, Jr., Secretary

CERTIFICATE

It is hereby certified that the foregoing is a true and correct copy of a resolution duly adopted by the State Investment Commission on the 30th day of June 2003, and such resolution has not been altered, amended or repealed.

IN WITNESS WHEREOF, the undersigned has executed this Certificate this 30th day of June 2003.



George R. Burgess, Jr., Secretary
State Investment Commission

SIC-03-02

**A RESOLUTION OF THE STATE INVESTMENT COMMISSION OF
THE COMMONWEALTH OF KENTUCKY APPROVING
BROKER/DEALERS FOR FISCAL YEAR 2003-2004.**

WHEREAS, the State Investment Commission is empowered pursuant to KRS 42.505 to invest all funds,

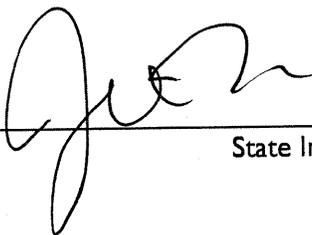
WHEREAS, in the course of implementing that provision it is necessary to acquire eligible securities,

WHEREAS, access to such securities is provided through intermediaries, and

WHEREAS, all broker/dealers on the attached list meet the criteria under 200 KAR 14:011 section 9.

**NOW, THEREFORE, THE STATE INVESTMENT COMMISSION OF
THE COMMONWEALTH OF KENTUCKY DOES HEREBY RESOLVE THAT:**

1. The attached list of Broker/Dealers is approved.
2. The list is effective July 1, 2003 and shall be in effect for Fiscal Year 2003-2004.


_____, Presiding Officer
State Investment Commission

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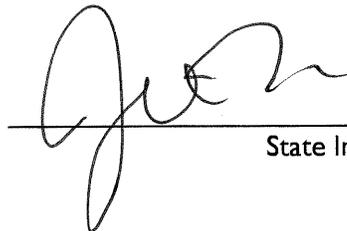
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