

FINANCE AND ADMINISTRATION CABINET
State Investment Commission
(Amendment)

200 KAR 14:081. Repurchase agreement.

RELATES TO: KRS ~~[41.610,]~~42.500(9)-(14), 42.520, 42.525

STATUTORY AUTHORITY: KRS 42.500(10), 42.520(2), 42.525

NECESSITY, FUNCTION, AND CONFORMITY: KRS 42.500(10) requires the State Investment Commission to promulgate administrative regulations for the investment and reinvestment of state funds. KRS 42.520(2) requires the commission to promulgate administrative regulations concerning the assignment of priorities to public depositories. KRS 42.525(1) requires the commission to promulgate administrative regulations for the investment and reinvestment of state funds and the acquisition, retention, management, and disposition of investments. This administrative regulation establishes the general standards which shall apply to the employment of repurchase agreements as investment vehicles with eligible financial institutions.

Section 1. Definitions.

- (1) "Commission" means the State Investment Commission.
- (2) "Eligible financial institution" means an entity approved for repurchase agreements by the commission.
- (3) "Office" means the Office of Financial Management.
- (4) "Repurchase agreement" means an actual, conditional purchase or sale of securities of the United States Treasury, an agency, instrumentality, or corporation of the United States, or another security authorized for investment pursuant to KRS 42.500(9)(a) or (b), with an agreement to resell or repurchase the securities to their original owner on a specific date in the future.

Section 2. Minimum Interest Rates. Except as provided by KRS 41.610, the commission shall not invest public funds in a repurchase agreement with a yield less than could be received on a directly purchased United States Treasury security of comparable maturity.

Section 3. Reporting Requirements for Eligible Investment Institutions. The commission shall inform eligible financial institutions of the reporting requirements for the investment of state funds in eligible financial institutions established by this section. An eligible financial institution shall:

- (1) Submit a copy of its quarterly financial reports including accompanying schedules, to the commission within thirty (30) days from the end of each quarter; and
- (2) Complete and sign the Securities Industry and Financial Markets Association Master Repurchase Agreement, incorporated by reference in 200 KAR 14:011.

Section 4. Eligible Securities. Investment securities authorized for investment pursuant to KRS 42.500(9)(a) and (b) shall be considered eligible securities for repurchase agreements.

Section 5. Sufficiency of Securities Purchased.

- (1) The securities purchased shall have a market value, including accrued interest, of not less than 102 percent of the face value of the repurchase agreement.
- (2) The review for the sufficiency of collateral on all repurchase agreements shall occur every business day excluding holidays by the office ~~[The state's custodian banking contract shall require the custodial bank to review the sufficiency of collateral on all repurchase agreements, except those subject to a triparty agreement. The review shall occur at least every seven (7) calendar days with periodic reviews made by the office].~~

(3) The commission shall demand additional securities to be delivered immediately, ~~during~~ market conditions that cause the value of the securities purchased to drop below 102 percent of the face value of the repurchase agreement.

Section 6. Status of Parties.

(1) The commission and the eligible financial institutions authorized to enter into repurchase agreements:

- (a) Shall be considered principals in repurchase agreements; and
- (b) Shall not be considered agents for third parties.

(2) Contractual obligations shall apply to and be binding on the commission and the specific eligible financial institution with which the repurchase agreement is initially negotiated and settled.

(3) The commission shall approve the eligible financial institutions quarterly following fundamental analysis of the most recent financial releases.

(4) The office ~~of Financial Management~~ shall monitor credit worthiness of eligible financial institutions daily based on financial market indicators.

Section 7. Default.

(1)

~~(a)~~ If an eligible financial institution with which the commission has entered into a repurchase agreement defaults, or is determined by the commission to be in danger of default, the commission shall set off claims and liquidate property held in respect to the repurchase agreement against obligations owing to the eligible financial institution under other repurchase agreements.

~~(2)~~ ~~(b)~~ Payments, deliveries, and other transfers made under a repurchase agreement shall be deemed to have been made in consideration of payments, deliveries, and other transfers made under any other repurchase agreement by the eligible financial institution.

~~(3)~~ ~~(c)~~ The obligation to make payments, deliveries and other transfers under a repurchase agreement may be applied against the obligation to make payments, deliveries and other transfers under any other repurchase agreements of the eligible financial institution and netted.

~~(4)~~ ~~(2)~~

~~(a)~~ From the proceeds of liquidated property, the commission shall pay itself the full principal and accrued interest due as of the date of liquidation.

~~(5)~~ ~~(b)~~ Remaining cash balances shall be forwarded to the financial institution with which the repurchase agreement was originally executed.

Section 8. Kentucky Bank Repurchase Program.

(1) Repurchase agreements with commercial banks and savings and loan associations chartered by the Commonwealth of Kentucky or by the U.S. government with offices located in Kentucky before being placed shall meet the following criteria:

- (a) A loan to deposit ratio equal to or greater than seventy (70) percent;
- (b) A nonperforming loan to capital ratio of equal to or less than twenty-five (25) percent;
- (c) A capital to assets ratio equal to or greater than eight (8) percent or regulatory requirements; and
- (d) A return on assets ratio greater than one-half~~five-tenths~~ (0.5) percent.

(2) Repurchase agreements with maturities equal to or greater than 365 days with commercial banks and savings and loan associations chartered by the Commonwealth of Kentucky or by the U.S. government with offices located in Kentucky shall be limited to \$5,000,000 per institution.

(3) The office shall review the financial ratios listed quarterly to determine eligibility of institutions. Existing repurchase agreements with institutions which fail to meet the

minimum criteria for two (2) consecutive quarters shall be subject to call at par value by the commission. Repurchase agreements shall be placed according to:

- (a) Availability of funds;
- (b) Demand for funds by the institutions; and
- (c) Highest loan to deposit ratio of eligible institutions.

(4)

~~[(a)]~~ A repurchase agreement with a commercial bank or savings and loan shall not be an amount in excess of its capital structure or ten (10) percent of the institution's deposits, whichever is less.

~~(5) [(b)]~~ The commission shall not enter into a Kentucky Bank Repurchase Program repurchase agreement with a commercial bank or savings and loan association that will cause that institution to exceed in aggregate a total of ~~\$50,000,000~~~~[\$25,000,000]~~ in repurchase agreements.

~~(6) [(5)]~~ Yield charged and collateral requirements for commercial banks and savings and loans.

(a) A commercial bank or savings and loan submitting U.S. Treasuries and agencies excluding mortgage backed securities and collateralized mortgage obligations as collateral shall be charged the ~~same duration yield generic~~ repurchase rate with an equivalent term as quoted by Bloomberg ~~L.P. Financial Markets with~~ and shall have a market value of 102 percent of the repurchase agreement face value~~collateral~~.

(b) A commercial bank or savings and loan submitting mortgage-backed securities and collateralized mortgage obligations shall be charged the ~~same duration yield generic~~ repurchase rate with an equivalent term as posted on Bloomberg ~~L.P. Financial Markets~~, plus fifty (50) basis points and shall have a market value of~~with~~ 105 percent of the repurchase agreement face value~~collateral~~.

~~(7) [(6)]~~ Payment for and holding collateral~~safekeeping~~ of purchases.

(a) Each transaction shall be conducted on a payment-versus-delivery basis.

(b) The office ~~[A party]~~ shall not allow state funds to be released until delivery of adequate, negotiable collateral has been verified.

(c) Securities purchased from commercial banks or savings and loan associations in a repurchase agreement shall be received, verified, and held~~safe kept~~ by the state's custodial bank or its agent.

KIM BECHTEL, Deputy Executive Director

APPROVED BY AGENCY: August 14, 2024

FILED WITH LRC: August 15, 2024 at 8:30 a.m.

PUBLIC HEARING AND COMMENT PERIOD: A public hearing on this administrative regulation shall be held on Wednesday, October 23, 2024, at 10:00 a.m. Eastern time, at the Kentucky Finance and Administration Cabinet, Room C117, 200 Mero Street, Frankfort, Kentucky 40622. Individuals interested in being heard at this hearing shall notify this agency in writing five workdays prior to the hearing of their intent to attend. If no notification of intent to attend the hearing is received by that date, the hearing may be cancelled. A transcript of the public hearing will not be made unless a written request for a transcript is made. If you do not wish to be heard at the public hearing, you may submit written comments on the proposed administrative regulation. Written comments shall be accepted until 11:59 p.m. on Thursday, October 31, 2024. Send written notification of intent to be heard at the public hearing or written comments on the proposed administrative regulation to the contact person.

CONTACT PERSON: Laura Sharp, Administrative Specialist III, Office of General Counsel, 200 Mero Street, 5th Floor, Frankfort, Kentucky 40622; phone (502)564-6660, fax (502)564-9875, email laura.sharp@ky.gov.

REGULATORY IMPACT ANALYSIS AND TIERING STATEMENT

Contact Person:Laura Sharp

(1) Provide a brief summary of:

(a) What this administrative regulation does:

This regulation governs the state's investments in repurchase agreements.

(b) The necessity of this administrative regulation:

The state invests substantial funds in tri-party repurchase agreements. This regulation requires prudent use of those agreements and establishes monitoring requirements to assure safety of state funds are maintained.

(c) How this administrative regulation conforms to the content of the authorizing statutes:

This is required by KRS 42.500(10) and establishes the limitations required by that clause.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes:

This administrative regulation provides guidance on the investment of state funds and requires prudent investment activities which will limit the exposure of state funds to investment losses.

(2) If this is an amendment to an existing administrative regulation, provide a brief summary of:

(a) How the amendment will change this existing administrative regulation:

This amendment contains primarily technical and grammatical updates. This amendment brings the regulation up to the current standards adopted by the State Investment Commission

(b) The necessity of the amendment to this administrative regulation:

Technical and grammatical changes are needed to maintain clarity, and other changes are necessary to keep the regulation in line with current economic trends.

(c) How the amendment conforms to the content of the authorizing statutes:

The amendment is compliant with KRS 42.500(10).

(d) How the amendment will assist in the effective administration of the statutes:

The amendment updates investment language to reduce the risk of loss of state funds.

(3) List the type and number of individuals, businesses, organizations, or state and local governments affected by this administrative regulation:

This regulation only affects actions by the Office of Financial Management.

(4) Provide an analysis of how the entities identified in question (3) will be impacted by either the implementation of this administrative regulation, if new, or by the change, if it is an amendment, including:

(a) List the actions that each of the regulated entities identified in question (3) will have to take to comply with this administrative regulation or amendment:

No impact is expected from the implementation of this administrative regulation.

(b) In complying with this administrative regulation or amendment, how much will it cost each of the entities identified in question (3):

No costs.

(c) As a result of compliance, what benefits will accrue to the entities identified in question (3):

The amendment clarifies technical aspects of the regulation for the Investment Commission.

(5) Provide an estimate of how much it will cost the administrative body to implement this administrative regulation:

(a) Initially:

No additional cost.

(b) On a continuing basis:

No additional cost.

(6) What is the source of the funding to be used for the implementation and enforcement of this administrative regulation:

No additional funding is necessary for implementation of this regulation.

(7) Provide an assessment of whether an increase in fees or funding will be necessary to implement this administrative regulation, if new, or by the change if it is an amendment:

No additional funding is necessary for implementation of this regulation.

(8) State whether or not this administrative regulation establishes any fees or directly or indirectly increases any fees:

No fees are established or increased.

(9) TIERING: Is tiering applied?

There is no tiering because it is not applicable.

FISCAL IMPACT STATEMENT

(1) Identify each state statute, federal statute, or federal regulation that requires or authorizes the action taken by the administrative regulation.

KRS 42.500 requires the State Investment Commission to promulgate this regulation.

(2) Identify the promulgating agency and any other affected state units, parts, or divisions:

None should be directly affected. The regulation concerns the internal operations of the State Investment Commission and its investments.

(a) Estimate the following for the first year:

Expenditures:\$0

Revenues:\$0

Cost Savings:\$0

(b) How will expenditures, revenues, or cost savings differ in subsequent years?

No subsequent year impacts on expenditures, revenues, or cost savings are expected.

(3) Identify affected local entities (for example: cities, counties, fire departments, school districts):

None should be directly affected. The regulation concerns the internal operations of the State Investment Commission and its investments.

(a) Estimate the following for the first year:

Expenditures:\$0

Revenues:\$0

Cost Savings:\$0

(b) How will expenditures, revenues, or cost savings differ in subsequent years?

No subsequent year impacts on expenditures, revenues, or cost savings are expected.

(4) Identify additional regulated entities not listed in questions (2) or (3):

None should be directly affected. The regulation concerns the internal operations of the State Investment Commission and its investments.

(a) Estimate the following for the first year:

Expenditures:\$0

Revenues:\$0

Cost Savings:\$0

(b) How will expenditures, revenues, or cost savings differ in subsequent years?

No subsequent year impacts on expenditures, revenues, or cost savings are expected.

(5) Provide a narrative to explain the:

(a) Fiscal impact of this administrative regulation:

None.

(b) Methodology and resources used to determine the fiscal impact:

The regulation is being amended to bring it into alignment with current Office of Financial Management practice.

(6) Explain:

(a) Whether this administrative regulation will have an overall negative or adverse major economic impact to the entities identified in questions (2) - (4). (\$500,000 or more, in aggregate)

No major economic impact is expected.

(b) The methodology and resources used to reach this conclusion:

The regulation is being amended to bring it into alignment with current Office of Financial Management practice.