

## FINANCE AND ADMINISTRATION CABINET

### State Investment Commission (Amended at ARRS Committee)

#### 200 KAR 14:011. Qualified investments.

RELATES TO: KRS 42.500(9)-(14), 42.520, 42.525, 17 C.F.R. 270.2a-7, 15 U.S.C. 80a, 26 U.S.C. 1-9834

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 standards that govern the commonwealth's investment and cash management programs.

#### Section 1. Definitions.

- (1) "Commission" means the State Investment Commission.
- (2) "Hedge" means a position in a financial instrument taken to minimize or eliminate the risk associated with an existing instrument or portfolio of instruments.
- (3) "Interest rate swaps" means an agreement governed by an International Swap and Derivatives Association master contract between two (2) parties to exchange, or have the conditional right to exchange, specified cash flows.
- (4) "NRSRO" means "Nationally Recognized Statistical Ratings Organization", which is a credit rating agency that is registered with the Securities and Exchange Commission, and which provides its opinion on the creditworthiness of an entity and the financial obligations issued by that entity.
- (5) "Office" means the Office of Financial Management.
- (6) "Options" means a contract that provides the right, but not the obligation, to buy or sell a specific amount of a security within a predetermined time period and includes specific bonds or notes, an exchange traded futures contract, or the cash value of an index.
- (7) "Pools" means the investment pools that are managed by the Office of Financial Management, under the guidance of the commission.

#### Section 2. The commission shall:

- (1) Not invest state funds in an institution or instrument that it deems unsafe and a threat to the security of state funds;
- (2) Maintain adequate liquidity to meet the cash needs of the state; and
- (3) Within the limits established by this administrative regulation, invest in securities that maximize yield or return to the Commonwealth.

#### Section 3.

- (1) The commission may:
  - (a) Engage in securities lending; ~~and~~
  - (b) Allow internal~~inter-pool~~ transfers between pools to meet short term cash needs.
- (2) Within the limited term pool, if borrowing exceeds thirty-three (33) percent of the value of the pool's total assets resulting from a change in values of net pool assets at any time, the pool shall then reduce borrowing to no more than thirty-three (33) percent within three (3) business days and shall continue to use prudence in bringing the percentage of borrowing back into conformity.

Section 4. Interest earned on the cash balances shall be calculated daily on an accrual basis.

Section 5. Investment Criteria.

- (1) The criteria to determine the amount of funds per investment instrument shall be the:
  - (a) Safety of principal and interest [~~Liquidity needs of the state in aggregate as budgeted~~];
  - (b) Liquidity needs of the state in aggregate as budgeted [~~Rates available per instrument~~]; and
  - (c) Rates available per instrument [~~Safety of principal and interest~~].
- (2) An investment instrument shall qualify if it is specified by:
  - (a) KRS 42.500;
  - (b) This administrative regulation;
  - (c) 200 KAR 14:081; or
  - (d) 200 KAR 14:091.

Section 6. Investment Securities. The commission shall invest only in the following security types as established in this section.~~+~~

- (1) Securities issued by the U.S. Treasury, agency, and government-sponsored enterprises~~[government sponsored entity agency securities]~~ with a maturity of less than seven (7) years, or an embedded put of less than three (3) years.
- (2) Mortgage pass-through securities issued by U.S. government agencies or by government-sponsored enterprises~~[government sponsored entities]~~, including the Government National Mortgage Association, Fannie Mae, Freddie Mac, and Small Business Administration with an average life of less than four (4) years at the time of purchase, using Bloomberg consensus prepayment projections, if available, or other reasonable prepayment assumptions if there is no consensus. The commission may hold pass-throughs purchased under this subsection that~~[which]~~ have an average life of less than six (6) years, using Bloomberg consensus prepayment projections, if available, or other reasonable prepayment assumptions if there is no consensus.
- (3) Real estate mortgage investment conduit obligations, as defined by the Internal Revenue Code, 26 U.S.C. 1-9834, also known as collateralized mortgage obligations, or CMOs, rated in the highest category by a commission approved~~[an]~~ NRSRO with an average life of less than four (4) years at the time of purchase, using Bloomberg consensus prepayment projections, if available, or other reasonable prepayment assumptions if there is no consensus. The commission may hold CMOs purchased under this subsection that~~[which]~~ have an average life of less than six (6) years, using Bloomberg consensus prepayment projections, if available, or other reasonable prepayment assumptions if there is no consensus.
- (4) Asset-backed securities (ABS) rated in the highest category by a commission approved~~[an]~~ NRSRO with an average life of four (4) years or less.
- (5) U.S. dollar denominated corporate and Yankee securities issued by foreign and domestic issuers, rated in one (1) of the three (3) highest categories by a commission approved~~[an]~~ NRSRO, with a maturity not longer than five (5) years, or an embedded put of less than three (3) years.
- (6) U.S. dollar denominated sovereign debt rated in one (1) of the three (3) highest categories by a commission approved~~[an]~~ NRSRO, with a maturity not to exceed five (5) years.
- (7) Money market securities including commercial paper, certificates of deposit, and bankers' acceptances issued by banks with the highest short-term rating by a commission approved NRSRO. Maturities shall be limited to ~~one~~ 180 days for bankers' acceptances and 270 days for all other money market securities.  
~~[(7)]~~  
~~[(a)] [Money market securities, including:]~~

~~{1.} [Commercial paper;]~~

~~{2.} [Certificates of deposit; and]~~

~~{3.} [Bankers' acceptances issued by banks having the highest short-term rating by an NRSRO.]~~

~~{(b)} [Maturities shall be limited to 180 days for bankers' acceptances and 270 days for all other money market securities.]~~

(8) Repurchase agreements collateralized at a minimum of 102 percent (marked to market daily) with treasuries, agencies, and agency mortgage backed obligations with a maximum maturity of one (1) year and a maximum of three (3) years for the Kentucky Bank Repurchase Program participants.

(9) Municipal obligations rated in one (1) of the three (3) highest categories by a commission approved~~[an]~~ NRSRO, with a maturity not to exceed five (5) years. The maturity and credit restriction shall be waived for obligations issued by the Commonwealth of Kentucky or any entity within the Commonwealth of Kentucky.

(10) Mutual funds in which the underlying holdings of the fund are in securities that meet the investment criteria listed in Section 5 of this administrative regulation~~[in which the pools could invest directly].~~

(11) In meeting credit standards listed previously in this section, the lowest rating issued by a commission approved~~[an]~~ NRSRO shall be used to determine compliance. The commission, at a minimum on an annual basis, shall determine which NRSRO's shall be used.

#### Section 7. Limits Per Pool on Investment Securities.

(1) U.S. agency mortgage backed securities and collateralized mortgage obligations shall not exceed twenty-five (25) percent of ~~[total] pool assets~~~~[in aggregate].~~

(2) Asset-backed securities shall not exceed twenty (20) percent of ~~[total] pool assets~~.

(3) U.S. dollar denominated corporate and Yankee and sovereign securities issued by foreign and domestic issuers shall not exceed thirty-five (35) percent of pool assets~~[an individual pool]~~ or \$25,000,000 per issuer~~[within an individual pool]~~, inclusive of commercial paper, bankers' acceptances~~[commercial paper, bankers' acceptances,]~~ and certificates of deposit unless these securities are guaranteed by the full faith and credit of the United States government.~~[.]~~

~~{(a)} [These securities are guaranteed by the full faith and credit of the United States government; or]~~

~~{(b)} [These securities were purchased between February 19, 2] **/009/** [and March 31, 2009.]~~

(4) Municipal securities shall not exceed \$25,000,000 per issuer.

(5) U.S. dollar denominated sovereign debt shall not exceed five (5) percent of pool assets~~[any individual portfolio]~~ and \$25,000,000 per issuer.

(6) The investment amount for a single mutual fund shall not exceed ten (10) percent of pool assets with an exception of twenty-five (25) percent for the short-term pool~~[total pool assets].~~

(7) The credit and diversification requirements documented in this administrative regulation shall apply at the time of purchase based on book value for the limited term pool and market value for other pools.

(8) The limits set forth in this section may be waived by unanimous vote of the commission~~[if a situation arises which could damage the state's credit].~~

Section 8. Risk Management. The pools may utilize interest rate swaps, over-the-counter and exchange traded U.S. Treasury contracts, and options to manage the portfolio's exposure to interest rate risk. These instruments shall only be used if the results are ~~[demonstratively]~~ superior to cash market transactions.

## Section 9. Pools and Operating Procedures.

### (1) Limited term pool.

(a) The ~~limited-term~~ pool shall not purchase a security with a final maturity exceeding 365 days.

(b)

1. The weighted average maturity, adjusted for interest rate resets and demand features, shall not exceed sixty (60) days; and

2. The weighted average life, adjusted for demand features only, but not interest rate resets, shall not exceed 120 days.

(c) At a minimum:

1. Ten (10) percent of the pool shall be invested in cash, direct obligations of the U.S. government or securities that mature or are subject to a demand feature payable within one (1) business day; and

2. Thirty (30) percent of the pool shall be invested in cash, direct obligations of the U.S. government, government agency discount note maturing in sixty (60) days or less or securities that mature or are subject to a demand feature payable within five (5) business days.

(d) All securities purchased for the pool shall be rated by a commission approved~~an~~ NRSRO.

~~[(e)] [No more than five (5) percent of the pool shall be invested in illiquid securities.]~~

~~[(f)] [No more than three (3) percent of the pool shall be invested in second tier securities and no more than five one hundredths (.05) percent of the pool shall be invested in a second tier security issuer.]~~

~~[(g)]~~ The net asset value of pool shares shall be computed using the amortized cost method of valuing the pool's investments.

~~[(h)]~~ The shadow net asset value using the market value of pool holdings shall be computed at least~~no less than~~ monthly and made public within sixty (60) days of the calculation date.

~~[(i)]~~ Stress testing of the pool based on redemption and changes in market value shall be performed at least~~no less than~~ quarterly and reported to the commission.

~~[(j)]~~ Monthly portfolio listings shall be published to a public Web site and shall remain available for at least~~no less than~~ six (6) months.

### (2) Operating procedures.

(a) Except as provided by paragraph (b) of this subsection, state funds held in agency or university accounts, the interest of which accrues to the agency or university, shall be placed in the intermediate pool.

(b) These funds may be placed in the limited-term pool, if the commission determines that the liquidity needs of an agency require shorter term investment.

(c) The duration of the intermediate pool shall not exceed three (3) years.

## Section 10. Approved Broker-Dealers.

(1) A broker-dealer who was approved by the commission prior to the effective date of this administrative regulation shall be considered an approved broker-dealer.

(2) Except as provided by subsection (1) of this section, a broker-dealer shall be approved by the commission if the broker-dealer has met the requirements established by subsection (3), (4), or (5) of this section, as applicable.

(3) An approved broker-dealer shall be a broker dealer who meets one (1) of the following qualifications:

(a) Is a primary dealer of the Federal Reserve;

(b) Maintains an office in Kentucky, and has either \$50,000,000~~[\$25,000,000]~~ in excess net capital or has trades that are guaranteed by a primary dealer of the Federal Reserve;

- (c) Has a minimum of ~~\$130,000,000~~~~[\$100,000,000]~~ in excess net capital; or
- (d) Is an alternative trading system as defined by the Securities and Exchange Commission.
- (4) An approved broker-dealer for hedge vehicles shall:
  - (a) Have at least ~~\$130,000,000~~~~[\$100,000,000]~~ in excess net capital;
  - (b) Have market value transactions limited to his excess net capital; and
  - (c) Have executed the:
    - 1. International Swap and Derivatives Association Agreement prior to the implementation of a swap; and
    - 2. Commonwealth of Kentucky Master Agreement, Over-the-counter Option Transactions - U.S. Treasury Securities, prior to the implementation of an over the counter option transaction.
- (5)
  - ~~[(a)]~~ Within 180 days of the end of each broker-dealer's fiscal year, a broker-dealer shall submit a copy of the broker-dealer's audited financial statements for that fiscal year.
  - ~~[(b)]~~ A broker-dealer who wishes to be approved by the commission as an approved broker-dealer shall submit a copy of the broker-dealer's current audited financial statements.
  - ~~[(c)]~~ Notwithstanding the broker-dealer requirements described in this section, the state may purchase securities directly from the issuer.

#### Section 11. Incorporation by Reference.

- (1) The following material is incorporated by reference:
    - (a) "Securities Industry and Financial Markets Association Master Repurchase Agreement", 12/08;
    - (b) "Custodial Undertaking in Connection with Master Repurchase Agreement, Bank of New York", 12/08;
    - (c) "Custodial Undertaking in Connection with Master Repurchase Agreement, Chase Manhattan", 12/08;
    - (d) "International Swap and Derivatives Association Agreement", 12/02; and
    - (e) "Commonwealth of Kentucky Master Agreement, Over-the-counter Option Transactions - U.S. Treasury Securities", 12/97.
  - (2) This material may be inspected, copied, or obtained, subject to applicable copyright law, at State Investment Commission, 200 Mero Street, 5th Floor~~[Suite 76, Capitol Annex]~~, Frankfort, Kentucky ~~40622~~~~[40601]~~ Monday through Friday, 8 a.m. to 4:30 p.m. and online at the Office of Financial Management's Web site at <https://finance.ky.gov/office-of-the-controller/office-of-financial-management/Pages/default.aspx>.
- (19 Ky.R. 537; Am. 1065; eff. 10-22-1992; 24 Ky.R. 1353; 1645; eff. 2-10-1998; 26 Ky.R. 418; 993; eff. 10-28-1999; 29 Ky.R. 2727; 30 Ky.R. 20; eff. 7-17-2003; 31 Ky.R. 1878; 32 Ky.R. 47; eff. 8-5-2005; 35 Ky.R. 2332; 2664; eff. 7-6-2009; 39 Ky.R. 814; 1108; eff. 1-4-2013; 41 Ky.R. 2604; eff. 9-4-2015; Cert. eff. 3-29-2022; 51 Ky.R. 515, 1074; eff. 3-4-2025.)

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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](mailto:laura.sharp@ky.gov).