

**Minutes
Investment Committee
Board of Trustees
January 23, 2008**

IN ATTENDANCE:

Investment Committee Members:	Mr. Billy B. Wilcoxson, Chair Mr. Stephen P. Branscum Mr. James F. Hardymon Ms. Myra Leigh Tobin Ms. JoEtta Y. Wickliffe (attended meeting until 11:45am)
Board of Trustees Members:	Ms. Mira S. Ball
Investment Staff & Consultants:	Mr. Marc A. Mathews Ms. Susan I. Krauss Ms. Donna A. Counts* Mr. Steve Voss (Ennis, Knupp & Associates)* Mr. Matt Russ (Ennis, Knupp & Associates)* Mr. Steve Cummings (Ennis, Knupp & Associates)*
Others:	Mr. Henry Clay Owen Mr. Sergio Melgar* Mr. John Deans**

* Attended open session only.

** Attended closed session only.

The meeting was called to order at 8:35 a.m.

Mr. Wilcoxson asked for a motion to approve the September 11, 2007 and October 15, 2007 minutes. Mr. Hardymon made a motion to approve the minutes, Mr. Branscum seconded the motion and all approved.

Mr. Mathews introduced Ms. Donna Counts, Director of Treasury Operations, noting that Ms. Counts began in July 2007. Ms. Counts has the responsibility of overseeing the cash management function for the University, which includes the overnight and short term investment programs. Mr. Mathews provided background on IC1, which is a recommendation that the Committee approve a new Overnight and Short Term Investment Policy. Ms. Counts drafted the new policy to clearly define the investment objectives and other matters related to the overnight and short term investment program in a format similar to the endowment investment policy. Additionally, the new policy allows the Office of the Treasurer to make direct investments in a broader range of securities or to invest in the fixed income pools managed by the Commonwealth of Kentucky Office of Financial Management, consistent with KRS 42.500 (9) and Kentucky Administrative Regulations (200 KAR 14:011). Ms. Counts stated that the policy should enable the Office of the Treasurer to maximize returns on the University's operating assets, however the primary objective is maintaining a high degree of safety and liquidity. Ms. Counts stated that an annual report on the performance of the overnight and short term investments would be provided to the Committee. Mr. Wilcoxson requested that a quarterly report be provided. After some discussion by the Committee, Mr. Hardymon made a motion to approve IC1, Ms. Tobin seconded the motion and all approved.

Ms. Krauss presented IC2, which is a recommendation that the Committee approve investment guideline changes requested by PIMCO, one of the University's core-plus fixed income managers. Specifically, PIMCO has requested an increase in the emerging markets sector limit from 10% to 15% due to the firm's economic outlook for strong growth in developing countries. Additionally, PIMCO has requested an increase in the foreign currency exposure limit from 5% to 10% due to the firm's expectation that the U.S. dollar will depreciate, particularly relative to developing market currencies. The increase to the emerging markets sector limit would necessitate an increase in the maximum combined limit of below BBB, non-U.S. dollar denominated and emerging market investments from 30% to 35%. Ms. Krauss reviewed the guidelines for both fixed income managers, noting the guidelines are different in some sectors due to the managers' particular investment strategies and sector expertise. Ms. Krauss stated that PIMCO's proposed guideline changes were reviewed with Ennis Knupp and the consultants are supportive of the changes. The investment guideline changes should allow PIMCO to enhance long-run performance while maintaining risk similar to the Lehman Brothers Aggregate Bond Index. Ms. Wickliffe made a motion to approve IC2, Mr. Branscum seconded the motion and all approved.

Mr. Krauss provided an update on three administrative items as follows:

- The Endowment Investment Policy was updated to reflect asset allocation and manager changes approved by the Investment Committee since January 2006, when the policy was last reviewed and approved by the Committee. The updated policy was posted on the University's website for access by donors and other interested parties.
- The University executed a contract amendment effective January 1, 2008 with Wellington in order to implement a performance-based fee structure for the global equity portfolio. Under the new fee structure, Wellington will reduce the current asset-based fee of 71 basis points by 25 basis points and implement a performance fee calculated at 12.5% participation in outperformance over the MSCI All Country World index, capped at 50 basis points. This fee structure will result in fees in the range of 46 to 96 basis points, with the University paying lower fees (by 25 basis points) if Wellington underperforms the Index and higher fees (up to 25 basis points) if Wellington exceeds the Index by 200 to 400 basis points.
- The University executed a Conversion Agreement consenting to the conversion of the legal structure of the UBS real estate investment from an insurance company separate account (formed by Aetna in 1991) to a private REIT structure with UBS Realty Investors serving as the investment advisor of the new limited partnership fund. The conversion, scheduled for January 31, 2008, will not change how the real estate fund is managed, as the fund will continue to be managed by the same investment team using the same investment process and strategy. The new LP structure will be the same legal structure as the University's real estate investment with RREEF.

Ms. Krauss reported on the endowment asset allocation, reporting the endowment pool had a market value of \$958.9 million as of December 31, 2007, comprised of 68.3% equities, 1.1% private equities, 22.2% fixed income and 8.4% real estate. Ms. Krauss reported that the Legg Mason portfolio was transitioned to the Russell 3000 Enhanced Index Fund at the end of September, utilizing State Street Global Markets as a transition manager. Additionally, \$6.0 million of new gifts/RCTF funds was invested on December 19th and allocated to the managers based on their undertarget positions. Ms. Krauss concluded that the December 31st asset allocation is within established asset class ranges and that no rebalancing action is needed at this time.

Mr. Russ reviewed the December flash report, noting the endowment pool had returned -0.53% for the six months ended December 31, 2007, compared to the policy benchmark return of 0.75%. The underperformance is mainly due to poor performance of Legg Mason's whole-stock strategy for the period July through September and Capital Guardian's whole-stock strategy for the period October through December. Capital underperformed the Wilshire 5000 by 562 basis points for the quarter ended December 31, 2007, contributing to an underperformance of 497 basis points for the six months ended

December 31, 2007. Mr. Russ commented that Capital's exposure to certain financial stocks such as Ambac, Washington Mutual, MBIA and Sallie Mae contributed to the poor performance. Mr. Voss commented that Ennis Knupp is concerned about the performance of Capital Guardian, however still has confidence in the managers' ability to generate outperformance in the future. Mr. Owen inquired if Ennis Knupp is still committed to the whole-stock strategy in light of both Legg Mason and Capital Guardian's performance in this strategy. Mr. Voss stated that Ennis Knupp still likes the idea of whole-stock and loosening the constraints on managers, however the U.S. equity market is very efficient and has been a difficult space for active managers to outperform in the last couple of years. Mr. Voss commented that it may make more sense to index the U.S. equity allocation and focus the Committee's efforts on the non-U.S. and alternative investment areas, for which the markets are less efficient. Mr. Wilcoxson expressed concern about Capital Guardian's performance and asked the staff and consultants to monitor and report back to the Committee.

At 9:30 a.m. Mr. Wilcoxson indicated that the committee needed to go into closed session in order to hear presentations from finalists in the endowment investment consultant search. Mr. Wilcoxson made a motion that the investment committee go into closed session pursuant to KRS 61.810 (1) (g). (This statutory citation is the exception in the open meetings law that permits a closed session to discuss a specific proposal with a business entity, if, an open discussion would jeopardize the selection of the business entity.) Ms. Wickliffe seconded the motion and all approved.

Following the closed session, Mr. Wilcoxson announced that the closed meeting had concluded, that no matters other than the announced matter were discussed during the closed session and that no action was taken during the closed session. Mr. Wilcoxson indicated that the committee was now back in open session.

Ms. Tobin made a motion to request that the University's Purchasing Division enter into contract negotiations with R. V. Kuhns & Associates, contingent on additional reference checks, Mr. Branscum seconded the motion and all approved.

With no further business, Mr. Hardymon made a motion that the meeting be adjourned, Mr. Branscum seconded the motion and all approved. The meeting adjourned at 2:45 p.m.

Susan I. Krauss
Office of the Treasurer

IC 1

Office of the Treasurer
January 23, 2008

Members, Investment Committee

APPROVAL OF OVERNIGHT AND SHORT-TERM INVESTMENT POLICY

Recommendation: that the Investment Committee approve the attached Overnight and Short-Term Investment Policy.

Background: On December 12, 1995, the Investment Committee approved the Statement of Objectives and Policies for short-term current funds investments for the University of Kentucky. Under the current policy, investments are limited to the Commonwealth of Kentucky's University pool, U.S. treasury and agency securities, repurchase agreements of U.S government obligations, and certificates of deposit collateralized by U.S. government obligations or general obligations of the University of Kentucky. Additionally, investments are limited to periods up to 24 months.

This action is recommended to allow the Office of the Treasurer to make direct investments in a broader range of securities or to invest in the fixed income investment pools managed by the Commonwealth of Kentucky Office of Financial Management, consistent with KRS 42.500(9) and Kentucky Administrative Regulations (200 KAR 14:011). Approval of this policy will enable the Office of the Treasurer to maximize returns on current funds, consistent with the primary objective to maintain a high degree of safety and liquidity.

Action Taken: Approved Disapproved Other _____

UNIVERSITY OF KENTUCKY
Office of the Treasurer

Overnight and Short-Term Investment Policy

University of Kentucky
University of Kentucky Research Foundation
University of Kentucky Athletic Association
The Fund for Advancement of Education and Research in the UK Medical Center
University of Kentucky Business Partnership Foundation, Inc.
University of Kentucky Mining Engineering Foundation, Inc.
University of Kentucky Equine Research Foundation, Inc.
University of Kentucky Humanities Foundation, Inc.
University of Kentucky Center on Aging Foundation, Inc.

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Overnight and Short-Term Investment Policy University of Kentucky

Overview

The Office of the Treasurer manages the overnight and short-term investment programs of the University of Kentucky and its affiliated corporations consistent with this Overnight and Short-Term Fund Investment Policy.

This policy applies to the investment of short-term operating funds. Longer term funds including endowments and trusts are covered by a separate policy. Bond proceeds are invested pursuant to investment guidelines in bond documents. The purpose of the overnight and short-term investment program is to invest all collected cash balances on a daily basis (including "float" representing outstanding checks) in either overnight or short-term investments.

Except for cash in certain restricted and special funds, the University will consolidate cash balances from all funds to maximize investment earnings. Investment earnings will be allocated to the various funds in accordance with University policy.

Board of Trustees Investment Committee

The Board of Trustees has established an Investment Committee ("Committee") with members appointed annually by the Chair of the Board of Trustees. The Investment Committee is responsible for the review and oversight of investments of the University of Kentucky and its affiliated corporations. The Investment Committee also approves the Overnight and Short-Term Investment Policy of the University of Kentucky.

Delegation of Authority

The Office of the Treasurer is responsible for the custody, investment and disbursement of all funds of the University in accordance with established policies and procedures. The Treasurer shall establish additional specific written procedures and policies for the operation of the investment program which are consistent with the approved investment policy. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Treasurer. The Treasurer will ensure the establishment of a system of controls to regulate investment activities. The controls shall be designed to prevent and control losses of funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets or imprudent actions by officers or employees.

Treasury Services Operations

The treasury staff ("Staff") includes the Treasurer, the Treasury Operations Director and employees in the Treasury Services department of the Office of the Treasurer. Staff will manage the daily cash and short-term investments and prepare analysis and recommendations for the Treasury Investment Advisory Group. Staff will prepare daily, monthly, quarterly and annual assessments of investment balances and performance for the total overnight and short-term investments.

Treasury Investment Advisory Group

The Treasury Investment Advisory Group will consist of the Treasurer, the Controller, the Assistant Treasurer for Investments and the Treasury Operations Director. The Treasury Investment Advisory Group will meet periodically as needed to review short-term investments and to advise on investment allocations. Staff will prepare investment reports and make recommendations to the Treasury Investment Advisory Group.

Overnight and Short-Term Investment Policy University of Kentucky

Investment Objectives

The primary investment objective is to achieve and maintain a high degree of safety and liquidity. The secondary objective is to maximize investment income taking into consideration investment risk constraints and liquidity needs. Investments will be made in a manner that seeks to balance these goals for the overall portfolio.

Safety of Capital: Credit risk will be minimized by limiting investments to the safest types of securities, pre-qualifying the financial institutions, broker/dealers, and advisors and diversifying the investment portfolio so that potential losses will be minimized. Total portfolio management will seek to ensure capital losses are avoided, whether they be from securities defaults or erosion of market value.

Investment risk can result from changes in credit quality underlying a security, issuer defaults, market price changes or temporary liquidity problems. In order to reduce investment risk while attaining market average rates of return, the investment portfolio will be diversified with respect to the type of securities in the portfolio, the concentration of investments held by any financial institution, and the length of maturities of investments.

Interest rate risk, the risk that the market value of securities will fall due to changes in general market rates, will be minimized by structuring the portfolio so that securities mature to meet cash flow requirements, thereby avoiding the need to sell securities before maturity. Operating funds will be invested primarily in shorter-term securities, money market mutual funds or similar investment pools.

Securities will not be sold prior to maturity unless a security with declining credit may be sold early to minimize loss of principal, a security swap would improve the quality, yield or target duration, or liquidity needs of the portfolio require that the security be sold.

Liquidity: The investment portfolio will maintain sufficient liquidity to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs. Cash flow forecasts, based on reasonable knowledge of future fiscal events and historical fiscal trends, will be developed by Staff. Investment maturities will be based on these forecasts so that cash may be available to meet anticipated expenditures.

Since all cash needs cannot be anticipated, the portfolio will consist largely of securities with active secondary or resale markets. A portion of the portfolio will be placed in money market mutual funds or investment pools which offer same-day liquidity for short-term funds.

Yield: The investment portfolio shall be designed with the objective of attaining a market rate of return taking into account the investment risk constraints and liquidity needs. The investment portfolio shall be designed with the objective of regularly exceeding the average return on the three-month U.S. Treasury bills. This index is considered riskless investment transactions and therefore comprise a minimum standard for the portfolio's rate of return. The investment program shall seek to augment returns above this threshold, consistent with risk limitations identified herein and prudent investment principles.

The standard of prudence to be used by staff shall be the "prudent person" standard and shall be applied in the context of managing the overall portfolio. Investment officers acting in accordance with written procedures and the investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and the liquidation and sale of securities are carried out in accordance with the terms of this policy.

Overnight and Short-Term Investment Policy University of Kentucky

Permissible Investments

The overnight and short-term investments will be invested in any security permitted by KRS 42.500(9) and Kentucky Administrative Regulations (200 KAR 14:011) which identifies the permitted investments and maturities for state funds (Appendix).

Investments Purchased Directly by the Office of the Treasurer – The Office of the Treasurer may invest in the following securities directly.

1. U.S. Treasury securities.
2. Securities issued by U.S. government agencies or by government sponsored entities, including, Government National Mortgage Association, Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Small Business Administration, and Student Loan Marketing.
3. Money market securities, including:
 - (a) Commercial paper rated the highest (A-1/P-1) by a nationally recognized rating agency, with maturities limited to nine (9) months ;
 - (b) Collateralized Certificates of Deposit; and
 - (c) Bankers' acceptances for banks rated A or higher with maturities limited to one year.
4. Repurchase and reverse repurchase agreements collateralized at 102 percent (marked to market daily) with treasuries, and agencies that meet the requirements established by this policy.
5. Municipal obligations rated A1 or higher by a nationally-recognized rating agency.
6. Money market mutual funds whose portfolios consist of government securities or broadly diversified money market instruments listed as eligible investments above and regulated by the Securities and Exchange Commission.

Limits of Investment Purchased Directly by the Office of the Treasurer

1. The amount of money invested at any time in commercial paper, bankers acceptances and municipal obligations shall not exceed twenty (20) percent.
2. No investment shall be purchased on a margin basis or through the use of any similar leveraging technique.

Investment Pools Managed by the Commonwealth of Kentucky Office of Financial Management: The State Investment Commission is charged with oversight of the Commonwealth's investment programs. The day-to-day management of the Commonwealth's investments is delegated to the Office of Financial Management. OFM manages a variety of investment pools including those described below.

1. Short-Term Proceeds Pool – This pool invests in direct obligations of the United States Treasury, its agencies and instrumentalities, repurchase agreements relating to such obligations issued by approved financial institutions and broker/dealers and in money market instruments including, but not limited to Certificates of Deposit, Commercial Paper, Bankers Acceptances.
2. Intermediate-Term Proceeds Pool – This pool includes all investments outlined above and collateralized mortgage obligations (CMO's), asset backed securities rated in the highest category, U.S. dollar denominated corporate and Yankee securities issued by foreign and domestic issuers and U.S. dollar denominated sovereign debt rates A1 or Higher. The pool maintains a modified duration of 1.5 years or less.
3. Long-Term Proceeds Pool – This pool can invest in all the same securities as the Intermediate-Term Pool, but the modified duration is 2.5 to 3.5 years.

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Safekeeping and Collateralization

All investment securities purchased shall be held in third-party safekeeping by an institution designated as primary agent. All cash deposits in excess of FDIC insurable amounts and investments maintained by any financial institution will be collateralized. Collateralized securities shall be purchased using the delivery versus payment procedure. Collateral shall be marked to market daily.

Investment Custodian

The bank selected as the primary depository for the University will serve as the Custodian ("Custodian") for the University's bank deposits, overnight and short-term investments and perform standard custodial functions, including security safekeeping, collection of income, settlement of trades, maintenance of collateral levels and collection of proceeds of maturing securities, distribution of income. The Custodian will provide monthly account statements and other reports as requested by the Office of the Treasurer. Staff may also establish a collateral account with the Federal Reserve Bank in the name of the University of Kentucky for collateral requirements for short-term securities.

Financial Institutions and Broker/Dealers

In selecting financial institutions, the credit-worthiness of the institution shall be considered. Banks and savings and loan associations seeking to be eligible for the University's certificate of deposit purchase program, security transactions, repurchase agreements and safekeeping agreements shall annually submit audited financial statements and regulatory reports on financial condition. Security broker-dealers will be selected by creditworthiness. These may include "primarily" dealers or regional dealers that qualify under the Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).

All financial institutions and broker/dealers who desire to become qualified for investment transactions must supply audited financial statements, proof of National Association of Security Dealers (NASD) certification, proof of state registration and a certification of having read and understood and agreeing to comply with the University's investment policy.

The Office of the Treasurer shall formulate a program to provide specific criteria to determine the qualification of a financial institutions or broker/dealers.

Reporting Requirements

The Office of the Treasurer will generate daily, monthly, quarterly and annual reports for management purposes and will submit quarterly status reports to the Treasurer and will submit annual reports to the Investment Committee.

Ethics and Disclosure of Conflicts of Interest

Members of the Investment Committee, Treasury Investment Advisory Group or Staff involved in the investment process will refrain from personal business activity that could conflict with the proper execution and management of the investment program or that could impair their ability to make impartial decisions. Disclosure shall be made of any material financial interests in financial institutions that conduct business with the University or personal financial interests or investments that could be related to the performance of the University's portfolio that could reasonably be considered a conflict of interest.

Appendix

1. KRS 42.500
2. 200 KAR 14:011

Appendix 1

42.500 State Investment Commission -- Powers.

- (1) There shall be a State Investment Commission composed of the Governor who shall be chairman; the State Treasurer who shall be vice chairman and serve as chairman in the absence of the Governor; the secretary of the Finance and Administration Cabinet; and two (2) persons appointed by the Governor.
- (2) The individuals appointed by the Governor shall be selected as follows: one (1) to be selected from a list of five (5) submitted to the Governor by the Kentucky Bankers Association, and one (1) to be selected from a list of five (5) submitted to the Governor by the Independent Community Bankers Association.
- (3) The State Investment Commission shall meet at least quarterly to review investment performance and conduct other business. This provision shall not prohibit the commission from meeting more frequently as the need arises.
- (4) The Governor, State Treasurer, and secretary of the Finance and Administration Cabinet shall each have the authority to designate, by an instrument in writing over his or her signature and filed with the secretary of the commission as a public record of the commission, an alternate with full authority to:
 - (a) Attend in the member's absence, for any reason, any properly convened meeting of the commission; and
 - (b) Participate in the consideration of, and vote upon, business and transactions of the commission.Each alternate shall be a person on the staff of the appointing member or in the employ of the appointing member's state agency or department.
- (5) Any designation of an alternate may, at the appointing member's direction:
 - (a) Be limited upon the face of the appointing instrument to be effective for only a specific meeting or specified business;
 - (b) Be shown on the face of the appointing instrument to be a continuing designation, for a period of no more than four (4) years, whenever the appointing member is unable to attend; or
 - (c) Be revoked at any time by the appointing member in an instrument in writing, over his or her signature, filed with the secretary of the commission as a public record of the commission.
- (6) Any person transacting business with, or materially affected by, the business of the commission may accept and rely upon a joint certificate of the secretary of the commission and any member of the commission concerning the designation of any alternate, the time and scope of the designation, and, if it is of a continuing nature, whether and when the designation has been revoked. The joint certificate shall be made and delivered to the person requesting it within a reasonable time after it has been requested in writing, with acceptable identification of the business or transaction to which it refers and the requesting person's interest in the business or transaction.
- (7) Any three (3) persons who are members of the commission or alternates authorized under subsections (4) and (5) of this section shall constitute a quorum and may, by

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majority vote, transact any business of the commission. Any three (3) members of the commission may call a meeting.

- (8) The provisions of KRS 61.070 shall not apply to members of the commission.
- (9) The commission shall have authority and may, if in its opinion the cash in the State Treasury is in excess of the amount required to meet current expenditures, invest any and all of the excess cash in:
 - (a) Obligations and contracts for future delivery of obligations backed by the full faith and credit of the United States or a United States government agency, including but not limited to:
 - 1. United States Treasury;
 - 2. Export-Import Bank of the United States;
 - 3. Farmers Home Administration;
 - 4. Government National Mortgage Corporation; and
 - 5. Merchant Marine bonds;
 - (b) Obligations of any corporation of the United States government, including but not limited to:
 - 1. Federal Home Loan Mortgage Corporation;
 - 2. Federal Farm Credit Banks;
 - a. Bank for Cooperatives;
 - b. Federal Intermediate Credit Banks; and
 - c. Federal Land Banks;
 - 3. Federal Home Loan Banks;
 - 4. Federal National Mortgage Association; and
 - 5. Tennessee Valley Authority obligations;
 - (c) Collateralized or uncollateralized certificates of deposit, issued by banks rated in one (1) of the three (3) highest categories by a nationally recognized rating agency or other interest-bearing accounts in depository institutions chartered by this state or by the United States, except for shares in mutual savings banks;
 - (d) Bankers acceptances for banks rated in one (1) of the three (3) highest categories by a nationally recognized rating agency;
 - (e) Commercial paper rated in the highest category by a nationally recognized rating agency;
 - (f) Securities issued by a state or local government, or any instrumentality or agency thereof, in the United States, and rated in one (1) of the three (3) highest categories by a nationally recognized rating agency;
 - (g) United States denominated corporate, Yankee, and Eurodollar securities, excluding corporate stocks, issued by foreign and domestic issuers, including sovereign and supranational governments, rated in one (1) of the three (3) highest categories by a nationally recognized rating agency;

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- (h) Asset-backed securities rated in the highest category by a nationally recognized rating agency; and
 - (i) Shares of mutual funds, not to exceed ten percent (10%) of the total funds available for investment as described in subsection (9) of this section, each of which shall have the following characteristics:
 - 1. The mutual fund shall be an open-end diversified investment company registered under Federal Investment Company Act of 1940, as amended;
 - 2. The management company of the investment company shall have been in operation for at least five (5) years;
 - 3. At least ninety percent (90%) of the securities in the mutual fund shall be eligible investments pursuant to this section; and
 - (j) State and local delinquent property tax claims which upon purchase shall become certificates of delinquency secured by interests in real property not to exceed twenty-five million dollars (\$25,000,000) in the aggregate. For any certificates of delinquency that have been exonerated pursuant to KRS 132.220(5), the Department of Revenue shall offset the loss suffered by the Finance and Administration Cabinet against subsequent local distributions to the affected taxing districts as shown on the certificate of delinquency.
- (10) The State Investment Commission shall promulgate administrative regulations for the investment and reinvestment of state funds in shares of mutual funds, and the regulations shall specify:
- (a) The long and short term goals of any investment;
 - (b) The specification of moneys to be invested;
 - (c) The amount of funds which may be invested per instrument;
 - (d) The qualifications of instruments; and
 - (e) The acceptable maturity of investments.
- (11) Any investment in obligations and securities pursuant to subsection (9) of this section shall satisfy this section if these obligations are subject to repurchase agreements, provided that delivery of these obligations is taken either directly or through an authorized custodian.
- (12) Income earned from investments made pursuant to this section shall accrue to the credit of the investment income account of the general fund, except that interest from investments of excess cash in the road fund shall be credited to the surplus account of the road fund and interest from investments of excess cash in the game and fish fund shall be credited to the game and fish fund, interest earned from investments of imprest cash funds and funds in the trust and revolving fund for each state public university shall be credited to the appropriate institutional account, and interest earned from the investment of funds accumulated solely by means of contributions and gifts shall not be diverted to any purpose other than that stipulated by the donor, when the donor shall have designated the use to which the interest shall be placed. Except as otherwise provided by law, or by the obligations and covenants contained in resolutions and trust indentures adopted or entered into for state bond issues, interest earned from the investment of moneys appropriated to the

capital construction accounts, trust and agency accounts, and trust and agency revolving accounts shall accrue to the capital construction investment income account. If the total general fund revenue receipts are less than the total revenue estimates for the general fund under KRS 48.120 and 48.130, the secretary of the Finance and Administration Cabinet, upon the recommendation of the state budget director, may direct the transfer of excess unappropriated capital construction investment income to the general fund investment income account. The amount of the transfer shall not exceed the amount of the shortfall in general fund revenues. If the capital construction investment income is less than that amount appropriated by the General Assembly, the secretary of the Finance and Administration Cabinet may, upon recommendation of the state budget director, direct the transfer of excess unappropriated general fund investment income to the capital construction investment income account. The transfer of general fund investment income revenues to the capital construction investment income account shall be made only when the actual general fund revenues are in excess of the revenue estimates under KRS 48.120 and shall be limited to the amount of the excess general fund revenues. The amount of the transfer shall not exceed the amount of the shortfall in the capital construction fund revenues.

- (13) The authority granted by this section to the State Investment Commission shall not extend to any funds that are specifically provided by law to be invested by some other officer or agency of the state government.
- (14) The authority granted by this section to the State Investment Commission shall only be exercised pursuant to the administrative regulations mandated by KRS 42.525.
- (15) Each member of the State Investment Commission, with the exception of the Governor, shall post bond for his acts or omissions as a member thereof identical in amount and kind to that posted by the State Treasurer.

Effective: June 20, 2005

History: Amended 2005 Ky. Acts ch. 85, sec. 54, effective June 20, 2005. -- Amended 1998 Ky. Acts ch. 209, sec. 19, effective March 30, 1998. -- Amended 1997 (1st Extra. Sess.) Ky. Acts ch. 4, sec. 36, effective May 30, 1997. -- Amended 1996 Ky. Acts ch. 101, sec. 1, effective July 15, 1996. -- Amended 1990 Ky. Acts ch. 277, sec. 1, effective July 13, 1990; ch. 291, sec. 1, effective July 13, 1990; and ch. 294, sec. 1, effective July 13, 1990. -- Amended 1988 Ky. Acts ch. 368, sec. 2, effective July 15, 1988. -- Amended 1986 Ky. Acts ch. 408, sec. 1, effective July 15, 1986. -- Amended 1984 Ky. Acts ch. 324, sec. 60, effective July 13, 1984. -- Amended 1982 Ky. Acts ch. 300, sec. 5, effective July 15, 1982, repealed, reenacted and amended as KRS 42.500, ch. 382, sec. 6, effective July 15, 1982; and amended ch. 450, sec. 58, effective July 1, 1983. -- Amended 1980 Ky. Acts ch. 295, sec. 11, effective July 15, 1980; and ch. 347, sec. 1, effective January 1, 1982. -- Amended 1954 Ky. Acts ch. 245, sec. 1, effective June 17, 1954. -- Created 1952 Ky. Acts ch. 86, sec. 1.

Formerly codified as KRS 41.380.

2006-2008 Budget Reference. See State/Executive Branch Budget, 2006 Ky. Acts ch. 252, Pt. V, G.7., at 1406; and State/Executive Branch Budget Memorandum, 2006 Ky. Acts ch. 257, at 1573 (Final Budget Memorandum, at 12).

Appendix 2

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200 KAR 14:011. Qualified investments.

200 KAR 14:011. Qualified investments.

RELATES TO: KRS 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 standards that govern the commonwealth's investment and cash management programs.

Section 1. Definitions. (1) "Commission" means the State Investment Commission.

(2) "Floating rate" means that the interest rate:

(a) That is paid on the specific security changes periodically on a preestablished schedule;

(b) May be tied directly to an index plus some spread or margin; and

(c) Includes hybrid adjustable rate mortgages if the first repricing date is less than six (6) years from the issuance date.

(3) "Hedge" means a position in a financial instrument taken to minimize or eliminate the risk associated with an existing instrument or portfolio of instruments.

(4) "Interest rate swaps" means an agreement governed by an International Swap Dealers Association master contract between two (2) parties to exchange, or have the conditional right to exchange, specified cash flows.

(5) "Nationally-recognized rating agency" means Moody's Investors Service, Standard and Poor's, or Fitch Ratings.

(6) "Office" means the Office of Financial Management.

(7) "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.

(8) "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;

(3) Within the limits established by this administrative regulation, invest in securities that maximize yield or return to the commonwealth; or

(4) Not borrow money to enlarge the pool.

Section 3. Interest earned on the cash balances shall be calculated daily on an accrual basis.

Section 4. Investment Criteria. (1) The criteria to determine the amount of funds per investment instrument shall be the:

(a) Liquidity needs of the state in aggregate as budgeted;

(b) Rates available per instrument; and

(c) 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 5. Investment Securities. The commission shall invest only in the following security types:

(1) U.S. Treasury, agency, and 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 entities, including, government national mortgage association, Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Small Business Administration, and Student Loan Marketing Association 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 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, also known as collateralized mortgage obligations, or CMOs, rated A or higher by a nationally-recognized rating agency 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 which have an average life of less than six (6) years, using Bloomberg consensus prepayment projections, if available, or other reasonable prepayment

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assumptions if there is no consensus.

(4) Asset-backed securities (ABS) rated in the highest category by a nationally-recognized rating agency 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 A or higher by a nationally-recognized rating agency, 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 A1 or higher by a nationally-recognized rating agency, with a maturity not to exceed five (5) years.

(7) Money market securities, including:

(a) Commercial paper;

(b) Certificates of deposit; and

(c) Eurodollars and time deposits rated in the highest short-term rating with assets in excess of one (1) billion dollars and bankers' acceptances rated A or higher. Maturities shall be limited to six (6) months for bankers' acceptances and nine (9) months for all other money market securities.

(8) Repurchase and reverse repurchase agreements collateralized at 102 percent (marked to market daily) with treasuries, agencies, and collateralized mortgage obligations that meet the requirements established by subsection (4) of this section, with a maximum maturity of one (1) year if executed with approved broker-dealers as provided by Section 8 of this administrative regulation and a maximum of three (3) years for the Kentucky Bank Repurchase Program participants.

(9) Municipal obligations rated A1 or higher by a nationally-recognized rating agency, with a maturity not to exceed five (5) years. The maturity 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 at least ninety (90) percent of the underlying holdings of the fund are in securities in which the pools could invest directly.

(11) Any floating rate securities which would otherwise qualify under this section except for maturity or average life restrictions.

Section 6. Limits 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 securities issued by foreign and domestic issuers shall not exceed twenty-five (25) percent of an individual pool and \$25,000,000 per issuer, inclusive of commercial paper, bankers' acceptances, and certificates of deposit.

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

Section 7. 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 8. Pools and Operating Procedures. (1)(a) Except for the Budget Reserve Trust Fund, state funds held in accounts the interest of which accrues to the General Fund shall be placed in the short-term pool or the intermediate pool.

(b) The short-term pool shall not purchase a security with a duration exceeding one (1) year.

(c) The duration of the short-term pool shall not exceed ninety (90) days.

(2)(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 short-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.

(3)(a) Bond proceeds from state issued bonds shall be placed in the bond proceeds pool.

(b) The bond proceeds pool shall consist of U.S. Treasury, agency and government-sponsored entity notes, bills and bonds, and repurchase agreements.

(4)(a) The portion of the Budget Reserve Trust Fund, the disposition of which the approval of the General Assembly is required, and agency funds which the commission and agency determine need not be expended for a period of two (2) years, shall be placed in the long-term pool.

(b) The duration of the long-term pool shall not exceed four and one-half (4.5) years.

Section 9. 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:

(a) Is a primary dealer of the Federal Reserve rated A1-P1 by a nationally-recognized rating agency;

(b) Maintains an office in Kentucky, and;

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1. Has \$25,000,000 in excess net capital; or
2. Whose trades are guaranteed by a primary dealer of the Federal Reserve who is rated A1-P1 or higher by Standard and Poor's or Moody's Investors Service; or
- (c) Has a minimum of \$100,000,000 in excess net capital.
- (4) An approved broker-dealer for repurchase agreements shall:
 - (a) Be rated A1 or higher by a nationally-recognized rating agency;
 - (b) Have transaction amounts limited to his excess net capital; and
 - (c) Have executed the:
 1. Public Securities Association Master Repurchase Agreement prior to entering into a repurchase transaction; and
 2. Appropriate Custodial undertaking in Connection with Master Repurchase Agreement.
- (5) An approved broker-dealer for hedge vehicles shall:
 - (a) Have at least \$100,000,000 in excess net capital;
 - (b) Be rated A1 or higher by a nationally-recognized rating agency;
 - (c) Have market value transactions limited to his excess net capital; and
 - (d) Have executed the:
 1. International Swap Dealers' 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.
- (6)(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

Section 10. Incorporation by Reference. (1) The following material is incorporated by reference:

- (a) "Commonwealth of Kentucky, Bond Proceeds Pool, Prospectus, (12/97)";
 - (b) "Commonwealth of Kentucky, Short-term Pool, Prospectus, (12/97)";
 - (c) "Commonwealth of Kentucky, Intermediate-term Pool, Prospectus, (12/97)";
 - (d) "Commonwealth of Kentucky, Long-term Pool, Prospectus, (12/97)";
 - (e) "Public Securities Association Master Repurchase Agreement (12/97)";
 - (f) "Custodial Undertaking in Connection with Master Repurchase Agreement, Bank of New York (12/97)";
 - (g) "Custodial Undertaking in Connection with Master Repurchase Agreement, Chase Manhattan (12/97)";
 - (h) "International Swap Dealers' Association Agreement (12/97)", and
 - (i) "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, Suite 261, Capitol Annex, Frankfort, Kentucky 40601, Monday through Friday, 8 a.m. to 4:30 p.m. (19 Ky.R. 537; Am. 1065; eff. 10-22-92; 24 Ky.R. 1353; 1645; eff. 2-10-98; 26 Ky.R. 418; 993; eff. 10-28-99; 29 Ky.R. 2727; 30 Ky.R. 20; eff. 7-17-2003; 31 Ky.R. 1878; 32 Ky.R. 47; eff. 8-5-05.)

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Office of the Treasurer
January 23, 2008

Members, Investment Committee

APPROVAL OF CHANGES TO INVESTMENT GUIDELINES FOR PIMCO

Recommendation: that the Investment Committee approve PIMCO's requested investment guidelines changes detailed on the attached summary.

Background: PIMCO, one of the University's core-plus fixed income managers, has requested an increase in the emerging markets sector limit from 10% to 15% due to the firm's economic outlook for strong growth in developing countries. Additionally, PIMCO has requested an increase in the foreign currency exposure limit from 5% to 10% due to the firm's expectation that the U.S. dollar will depreciate, particularly relative to developing market currencies.

This action is recommended to allow PIMCO more flexibility in implementing their investment strategies. The investment guideline changes should allow PIMCO to enhance the long-run performance while maintaining benchmark risk levels.

Action Taken: Approved Disapproved Other _____

PROPOSED CHANGES TO INVESTMENT GUIDELINES FOR PIMCO

Below is a summary of current and proposed guidelines for PIMCO, with changes highlighted. The current guidelines for Reams are shown for comparative purposes.

	<u>PIMCO</u>		<u>Reams</u>
	<u>Current Limit</u>	<u>Proposed Limit</u>	<u>Current Limit</u>
Issue or issuer	5%	5%	3%
Below BBB*	10%*	10%*	15%*
Non-U.S. Dollar Denominated*	30%*	30%*	15%*
Emerging Markets*	10%*	15%*	5%*
Private Placements	10%	10%	10%
Convertible Securities	5%	5%	5%
Foreign Currency Exposure	5%	10%	5%
 * Maximum combined limit	 30%	 35%	 30%
 Duration	 +/-25%	 +/-25%	 Greater of +/-25% or +/- 1.5 yrs.
 Minimum Average Portfolio Quality	 A-	 A-	 A-
Minimum Issue Quality	B-	B-	B-
Minimum Commercial Paper Quality	A2/P2	A2/P2	A2/P2