UNIVERSITY OF KENTUCKY
Office of the Treasurer

Operating Fund Investment Policy

Revised February 2014
Overview

This policy applies to the investment of operating funds of the University of Kentucky and its affiliated corporations. Endowments and trusts are covered by separate policies and bond proceeds are invested pursuant to investment guidelines in bond documents.

The purpose of the operating fund investment program is to invest all collected cash balances on a daily basis (including “float” representing outstanding checks) in either overnight, short-term investments (maturing within one year), or intermediate investments (maturing within seven years).

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 all applicable laws and 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 Assistant Treasurer and employees in the Treasury Services department. Staff shall manage the daily operating fund investments and prepare analysis and recommendations for the Treasury Investment Advisory Group. Staff shall prepare assessments of investment balances and performance. The Office of the Treasurer may retain the services of a qualified investment manager to invest funds pursuant to this policy.

Treasury Investment Advisory Group

The Treasury Investment Advisory Group (TIAG) consists of the Treasurer, Controller, Chief Investment Officer and Assistant Treasurer. The TIAG will meet periodically as needed to review operating fund investments and to advise Staff on investment allocations. Staff will prepare investment reports and make recommendations to the Treasury Investment Advisory Group.

Investment Objectives, Guidelines and Constraints

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 shall be made in a manner that seeks to balance these goals for the overall portfolio.

Safety of Capital: Credit risk shall 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 are minimized. Total portfolio management will seek to ensure capital losses are avoided, whether 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 shall 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 fall due to changes in general market rates, shall 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 shall be invested primarily in securities maturing less than three years, money market mutual funds or similar investment pools.

**Liquidity:** The investment portfolio shall 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, shall be developed and maintained by Staff. Investment maturities shall be based on these forecasts so that cash may be available to meet anticipated expenditures.

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

**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 a riskless investment transaction and therefore comprises 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.

**Laws and Regulations:** The operating funds shall be invested in accordance with KRS 273.600 to 273.645, KRS 42.500(9) and Kentucky Administrative Regulations (200 KAR 14:011 and KAR 14:091) included in the Appendices.

**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 shall be collateralized. Collateralized securities shall be purchased using the delivery versus payment procedure. Collateral shall be marked to market daily.
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Investment Custodian

The bank selected as the primary depository for the University will serve as the Custodian (“Custodian”) for the University's bank deposits, operating fund investments and perform standard custodial functions, including security safekeeping, collection of income, settlement of trades, maintenance of collateral levels, collection of proceeds of maturing securities, and distribution of income. The Custodian shall 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.

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 primary dealers of the Federal Reserve rated A1-P1 by a nationally recognized rating agency or other dealers that qualify under 200 KAR 14:011, Section 9.

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 qualifications of financial institutions or broker/dealers.

Reporting Requirements

The Office of the Treasurer shall generate reports for management purposes and provide the Investment Committee periodic information updates on the operating fund investment program.

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 significant interest that could directly or materially affect the University’s investment activity and investment performance.
Appendices

1. KRS 273.600 to 273.645
2. KRS 42.500
3. 200 KAR 14:011
4. 200 KAR 14:091
APPENDIX 1
Kentucky Uniform Prudent Management of Institutional Funds Act
(KRS 273.600 to KRS 273.645)
273.600 Definitions for KRS 273.600 to 273.645.
In KRS 273.600 to 273.645:
(1) "Charitable purpose" means the relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose the achievement of which is beneficial to the community;
(2) "Endowment fund" means an institutional fund or part thereof that, under the terms of a gift instrument, is not wholly expendable by the institution on a current basis. The term does not include assets that an institution designates as an endowment fund for its own use;
(3) "Gift instrument" means a record or records, including an institutional solicitation, under which property is granted to, transferred to, or held by an institution as an institutional fund;
(4) "Institution" means:
   (a) A person, other than an individual, organized and operated exclusively for charitable purposes;
   (b) A government or governmental subdivision, agency, or instrumentality, to the extent that it holds funds exclusively for a charitable purpose; or
   (c) A trust that had both charitable and noncharitable interests, after all noncharitable interests have terminated;
(5) "Institutional fund" means a fund held by an institution exclusively for charitable purposes. The term does not include:
   (a) Program-related assets;
   (b) A fund held for an institution by a trustee that is not an institution; or
   (c) A fund in which a beneficiary that is not an institution has an interest, other than an interest that could arise upon violation or failure of the purposes of the fund;
(6) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, public corporation, government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity;
(7) "Program-related asset" means an asset held by an institution primarily to accomplish a charitable purpose of the institution and not primarily for investment; and
(8) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.
Effective: July 15, 2010

273.605 Standard of conduct in managing and investigating institutional fund.
(1) Subject to the intent of a donor expressed in a gift instrument, an institution, in managing and investing an institutional fund, shall consider the charitable purposes of the institution and the purposes of the institutional fund.
(2) In addition to complying with duty of loyalty imposed by law other than in KRS 273.600 to 273.645, each person responsible for managing and investing an institutional fund shall manage and invest the fund in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.
(3) In managing and investing an institutional fund, an institution:
   (a) May incur only costs that are appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to the institution; and
   (b) Shall make a reasonable effort to verify facts relevant to the management and investment of the fund.
(4) An institution may pool two (2) or more institutional funds for purposes of management and investment.
(5) Except as otherwise provided by a gift instrument, the following rules apply:
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(a) In managing and investing an institutional fund, the following factors, if relevant, shall be considered:
   1. General economic conditions;
   2. The possible effect of inflation or deflation;
   3. The expected tax consequences, if any, of investment decisions or strategies;
   4. The role that each investment or course of action plays within the overall investment portfolio of the fund;
   5. The expected total return from income and the appreciation of investments;
   6. Other resources of the institution;
   7. The needs of the institution and the fund to make distributions and to preserve capital;
   and
   8. An asset's special relationship or special value, if any, to the charitable purposes of the institution;

(b) Management and investment decisions about an individual asset shall be made not in isolation but rather in the context of the institutional fund's portfolio of investments as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the fund and to the institution;

(c) Except as otherwise provided by law other than KRS 273.600 to 273.645, an institution may invest in any kind of property or type of investment consistent with this section;

(d) An institution shall diversify the investments of an institutional fund unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversification;

(e) Within a reasonable time after receiving property, an institution shall make and carry out decisions concerning the retention or disposition of the property or to rebalance a portfolio in order to bring the institutional fund into compliance with the purposes, terms, and distribution requirements of the institution as necessary to meet other circumstances of the institution and the requirements of KRS 273.600 to 273.645; and

(f) A person that has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those skills or that expertise in managing and investing institutional funds.

Effective: July 15, 2010

273.610 Appropriation for expenditure or accumulation of endowment -- Rules of construction.
(1) Subject to the intent of a donor expressed in the gift instrument, an institution may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established. Unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution. In making a determination to appropriate or accumulate, the institution shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and shall consider, if relevant, the following factors:
   (a) The duration and preservation of the endowment fund;
   (b) The purposes of the institution and the endowment fund;
   (c) General economic conditions;
   (d) The possible effect of inflation or deflation;
   (e) The expected total return from income and the appreciation of investments;
   (f) Other resources of the institution; and
   (g) The investment policy of the institution.
(2) To limit the authority to appropriate for expenditure or accumulate under subsection (1) of this section, a gift instrument must specifically state the limitation.

(3) Terms in a gift instrument designating a gift as an endowment, or a direction or authorization in the gift instrument to use only "income," "interest," "dividends," or "rents, issues, or profits," or "to preserve the principal intact," or words of similar import:
   (a) Create an endowment fund of permanent duration unless other language in the gift instrument limits the duration or purpose of the fund; and
   (b) Do not otherwise limit the authority to appropriate for expenditure or accumulate under subsection (1) of this section.

Effective: July 15, 2010

273.615 Delegation of management and investment functions.
(1) Subject to any specific limitation set forth in a gift instrument or in law other than KRS 273.600 to 273.645, an institution may delegate to an external agent the management and investment of an institutional fund to the extent that an institution could prudently delegate under the circumstances. An institution shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, in:
   (a) Selecting an agent;
   (b) Establishing the scope and terms of the delegation, consistent with the purposes of the institution and the institutional fund; and
   (c) Periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation.

(2) In performing a delegated function, an agent owes a duty to the institution to exercise reasonable care to comply with the scope and terms of the delegation.

(3) An institution that complies with subsection (1) of this section is not liable for the decisions or actions of an agent to which the function was delegated.

(4) By accepting delegation of a management or investment function from an institution that is subject to the laws of the Commonwealth, an agent submits to the jurisdiction of the courts of the Commonwealth in all proceedings arising from or related to the delegation or the performance of the delegated function.

(5) An institution may delegate management and investment functions to its committees, officers, or employees as authorized by law of the Commonwealth other than KRS 273.600 to 273.645.

Effective: July 15, 2010

273.620 Release or modification of restrictions on management, investment, or purpose.
(1) If the donor consents in a record, an institution may release or modify, in whole or in part, a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund. A release or modification may not allow a fund to be used for a purpose other than a charitable purpose of the institution.

(2) The court, upon application of an institution, may modify a restriction contained in a gift instrument regarding the management or investment of an institutional fund if the restriction has become impracticable or wasteful, if it impairs the management or investment of the fund, or if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund. The institution shall notify the Attorney General of the application, and the Attorney General shall be given an opportunity to be heard. To the extent practicable, any modification shall be made in accordance with the donor's probable intention.

(3) If a particular charitable purpose or a restriction contained in a gift instrument on the use of an institutional fund becomes unlawful, impracticable, impossible to achieve, or wasteful, the court, upon
application of an institution, may modify the purpose of the fund or the restriction on the use of the fund in a manner consistent with the charitable purpose expressed in the gift instrument. The institution shall notify the Attorney General of the application, and the Attorney General shall be given an opportunity to be heard.

(4) If an institution determines that a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund is unlawful, impracticable, impossible to achieve, or wasteful, the institution, sixty (60) days after notification to the Attorney General, may release or modify the restriction, in whole or part, if:
   (a) The institutional fund subject to the restriction has a total value of less than fifty thousand dollars ($50,000);
   (b) More than twenty (20) years have elapsed since the fund was established; and
   (c) The institution uses the property in a manner consistent with the charitable purposes expressed in the gift instrument.

Effective: July 15, 2010

273.625 Reviewing compliance with KRS 273.600 to 273.645.
Compliance with KRS 273.600 to 273.645 is determined in light of the facts and circumstances existing at the time a decision is made or action is taken, and not by hindsight.

Effective: July 15, 2010
History: Created 2010 Ky. Acts ch. 34, sec. 6, effective July 15, 2010.

273.630 Application of KRS 273.600 to 273.645 to existing institutional funds.
KRS 273.600 to 273.645 apply to an institutional fund existing on or established after July 15, 2010. As applied to institutional funds existing on July 15, 2010, KRS 273.600 to 273.645 govern only decisions made or actions taken on or after that date.

Effective: July 15, 2010


Effective: July 15, 2010
History: Created 2010 Ky. Acts ch. 34, sec. 8, effective July 15, 2010.

273.640 Uniformity of application and construction of the Kentucky Uniform Prudent Management of Institutional Funds Act.
In applying and construing this uniform act, consideration shall be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

Effective: July 15, 2010
History: Created 2010 Ky. Acts ch. 34, sec. 9, effective July 15, 2010.

273.645 Short title for KRS 273.600 to 273.645.
KRS 273.600 to 273.645 may be cited as the Kentucky Uniform Prudent Management of Institutional Funds Act.

Effective: July 15, 2010
APPENDIX 2
KRS 42.500
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 majority vote, transact any business of the commission. Any three (3) members of the commission may call a meeting.
The provisions of KRS 61.070 shall not apply to members of the commission.

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 or government-sponsored enterprise, 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 statistical rating organization 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 the highest short-term category by a nationally recognized statistical rating organization;

(e) Commercial paper rated in the highest short-term category by a nationally recognized statistical rating organization;

(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 long-term categories by a nationally recognized statistical rating organization;

(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 long-term categories by a nationally recognized statistical rating organization;

(h) Asset-backed securities rated in the highest category by a nationally recognized statistical rating organization; and

(i) Shares of mutual funds, 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. The mutual fund shall be rated in the highest category by a nationally recognized statistical rating organization;

4. All 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) (a) 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.

(b) 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.

(c) If there is a revenue shortfall, as defined in KRS 48.010, of five percent (5%) or less, 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.

(d) 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 enacted 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 25, 2013


Formerly codified as KRS 41.380.
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) "Floating rate" means that the interest rate:
(a) Is paid on the specific security changes periodically on a pre-established 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 and Derivatives Association master contract between two (2) parties to exchange, or have the conditional right to exchange, specified cash flows.

(5) "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.

(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; 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.
(b) Allow inter-pool transfers 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) 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 6. 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, 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 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 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 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 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 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 an NRSRO, with a maturity not to exceed five (5) years.
(7) (a) Money market securities, including:
1. Commercial paper;
2. Certificates of deposit; and
3. Banker's acceptances issued by banks having the highest short-term rating by an NRSRO.

(b) Maturities shall be limited to 180 days for banker's 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 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 in one (1) of the three (3) highest categories by 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 in which the pools could invest directly.

(11) In meeting credit standards listed previously in this section, the lowest rating issued by 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 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 an individual pool or $25,000,000 per issuer within an individual pool, inclusive of commercial paper, bankers' acceptances, and certificates of deposit unless:

(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, 2009 and March 31, 2009.

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

(5) The investment amount for a single mutual fund shall not exceed ten (10) percent of total pool assets.

(6) 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.

(7) 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 demonstrably superior to cash market transactions.

Section 9. Pools and Operating Procedures. (1)(a) The limited-term pool shall be managed to meet the requirements of Rule 2a-7 of the Investment Company Act of 1940, 17 C.F.R. 270.2a-7. Terms used in this section shall have the definitions prescribed in the Investment Company Act of 1940, 15 U.S.C. 80a-1 through 80a-64.

(b) The limited-term pool shall not purchase a security with a final maturity exceeding 397 days, except for governmental securities, which may have a final maturity of up to 762 days.

(c) The weighted average maturity, adjusted for interest rate resets and demand features, shall not exceed sixty (60) days; and the weighted average life, adjusted for demand features only but not interest rate resets, shall not exceed 120 days.

(d) 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.

(e) All securities purchased for the pool shall be rated by an NRSRO.

(f) No more than five (5) percent of the pool shall be invested in illiquid securities.

(g) 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.

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

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

(j) Stress testing of the pool based on redemption and changes in market value shall be performed no less than quarterly and reported to the commission.

(k) Monthly portfolio listings shall be published to a public Web site and shall remain available for no less than six (6) months.

(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 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 paragraph (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 $25,000,000 in excess net capital or has trades that are guaranteed by a primary dealer of the Federal Reserve; or
(c) Has a minimum of $100,000,000 in excess net capital.
(4) An approved broker-dealer for repurchase agreements shall:
(a) Have transaction amounts limited to his excess net capital;
(b) Have executed the:
   1. Public Securities Association Master Repurchase Agreement prior to entering into a repurchase transaction; and
   2. Appropriate third-party custodial agreement or Custodial Undertaking in connection with Master Repurchase Agreement for tri-party repurchase agreements; and
(c) Be primary dealer of the Federal Reserve.
(5) An approved broker-dealer for hedge vehicles shall:
(a) Have at least $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.
(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.
(7) 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, Suite 76, 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; 35 Ky.R. 2332; 2664; eff. 7-6-2009; 39 Ky.R. 814; 1108; eff. 1-4-13.)
200 KAR 14:091. Guidelines for money market instruments.

RELATES TO: KRS 41.610, 42.014(1), 42.500, 42.505-42.545
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 requires the State Investment Commission to prescribe standards for the operation of the state's investment program. This administrative regulation establishes the standards which shall apply to the use of certain money market instruments which include bankers' acceptances, commercial paper, and negotiable collateralized and uncollateralized certificates of deposit.

Section 1. Definitions. (1) "Bankers' acceptance" means a short-term negotiable discount note drawn on and accepted by a bank or trust company which is obligated to pay the face value amount at maturity.
(2) "Commercial paper" means an unsecured promissory obligation having a maturity of less than 270 days.
(3) "Commission" means the State Investment Commission.
(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.

Section 2. Bankers' Acceptances. (1) The office may purchase bankers' acceptances if rated in the highest short-term rating category by an NRSRO.
(2) The purchase of these instruments shall be:
   (a) Made on a delivery versus payment basis; and
   (b) Held in the Commonwealth's account in whatever depository shall be designated as eligible by the commission.
(3)(a) Investment in bankers' acceptances shall be made for a period of no longer than 180 days per investment.
   (b) The total amount of the investment in this security shall not exceed the amount of twenty-five (25) million dollars in one (1) institution at a time.

Section 3. Commercial Paper. (1) The office may purchase commercial paper rated in the highest short-term rating category by an NRSRO.
(2) The purchase of these instruments shall be:
   (a) Made on a delivery versus payment basis; and
   (b) Held in the Commonwealth's account in whatever depository shall be designated as eligible by the commission.
(3) The investments in commercial paper shall be made for a period of no longer than 270 days per investment and the total amount of the investment in this security shall not exceed the amount of twenty-five (25) million dollars by any issuer at a time.

Section 4. Negotiable Certificates of Deposit, Collateralized and Uncollateralized. (1) The office may purchase collateralized certificates of deposit if issued by banks rated in one (1) of the three (3) highest categories by an NRSRO.
(2) The office may purchase uncollateralized negotiable certificates of deposit if issued by banks rated in one (1) of the two (2) highest categories by an NRSRO or subject to 200 KAR 14:200.
(3) The purchase of these instruments shall be:
   (a) Made on a delivery versus payment basis; and
   (b) Held in the Commonwealth's account in whatever depository shall be designated as eligible by the commission.
(4)(a) Investment in negotiable certificates of deposits shall be made for a period of no longer than 270 days per investment unless specifically authorized by KRS 41.610.
(b) The total amount of investments in certificates of deposit shall not exceed the amount of twenty-five (25) million dollars in any one (1) institution at a time.

Section 5. Limit of Money Market Instruments of the State's Total Portfolio. The aggregate investment in bankers' acceptances, commercial paper, and negotiable certificates of deposit shall not exceed thirty-five (35) percent of the Commonwealth's total investment portfolio. (19 Ky.R. 540; Am. 1068; eff. 10-22-92; 26 Ky.R. 422; 996; eff. 10-28-99; 39 Ky.R. 820; 1111; eff. 1-4-13.)