



STATE OF MISSISSIPPI
TREASURY DEPARTMENT

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TATE REEVES
STATE TREASURER

March 8, 2011

Honorable Stacey Pickering
State Auditor, State of Mississippi
8th Floor, Woolfolk Building
Jackson, Mississippi 39201

Dear Mr. Pickering:

We have reviewed the financial audit findings in reference to our fiscal year 2010 audit. Listed below are our responses and plan for corrective action:

AUDIT FINDING: Supervisory Review of Arbitrage Schedules Should Be Performed and Documented

Response: We concur with this finding.

Corrective Action: The employee responsible for preparing arbitrage schedules spends a considerable amount of time reviewing MERLIN reports and compiling the schedules before they are sent to the arbitrage attorney for calculation (who then spends a substantial amount of time calculating actual arbitrage for the State). In order to fully comply with the request as stated in the audit finding, a supervisor would be required to review the reports and trace all numbers back to supporting documentation to ensure they were properly prepared without error. A supervisor will perform a very fundamental review and this review will be documented.

AUDIT FINDING: Investment Ratios Should be Maintained in Accordance with State Law

Response: We do not concur with the audit finding. We fundamentally disagree with the application of the 50 percent limitation to certain Agency securities.

Corrective Action: Under the conservatorship put in place on September 7, 2008,

FNMA and FHLMC are being run by the Federal Housing Finance Agency. The US Treasury's actions on September 7th included the institution of Preferred Stock Purchase Agreements, which are the foundation of the direct financial support of the US government to the agencies. The Treasury secretary's speech highlighted the additional security and clarity that these agreements provide to debt holders of FNMA and FHLMC. There were other steps that provided additional security to the debt holders through the provision of greater market stability, but the Purchase Agreements are, in our view, the most important and direct source of financial support. Because FNMA and FHLMC are congressionally chartered, only Congress can effect a permanent change in the status of the companies – either making them entirely public or entirely private. That is a matter that has yet to be determined, although it has been taken up in Congress recently. Reform will likely occur in some form over the next couple of years, and we will see what ultimately becomes of FNMA and FHLMC. The point put forth by Treasury is that what we know today is that the debt is for all intents and purposes fully supported by the US government, and therefore the debt of FNMA and FHLMC held in the portfolio should not be included in the 50 percent calculation. There is not an explicit legal guarantee, and there will not be – partly because of the balance sheet effects on the US as a whole and partly because of the congressional charters of these companies, to say nothing of the precedent set by the US assuming a public/private entity's debt. But the net result of the conservatorship is financial support of the companies, which includes support to pay its debt obligations and amounts to a guarantee from the federal government on the debt. Hopefully, some clarity will be given by Congress with regard to FNMA and FHLMC, at which time, we will review the status of the Agencies and act appropriately to ensure the safety and security of taxpayer dollars.

Treasury does not believe it is in the best interests of the taxpayers to liquidate FNMA and FHLMC holdings in favor of Treasuries to lower the allocation to Agencies due to the large losses in income to the portfolio that would result from such a rebalancing. The allocation to FNMA and FHLMC securities does not represent additional risk vis-à-vis Treasuries to the State or the taxpayers but does offer meaningfully higher yields.

If you have any question, please call Liz Welch, Deputy Treasurer at 359-3600.

Sincerely,



Tate Reeves
State Treasurer