

MINUTES OF THE SENATE COMMITTEE ON WAYS AND MEANSThe meeting was called to order by Senator Paul Hess at
Chairperson2:30 a.m./p.m. on February 28, 1983, 19__ in room 123-S of the Capitol.All members were present except:
Senators Bogina and Hein

Committee staff present:

Research Department: Richard Ryan, Sherry Brown, Mary Galligan
Revisor's Office: Norman Furse
Committee Office: Mark Skinner, Doris Fager

Conferees appearing before the committee:

Don Hoffman, Attorney, for State Treasurer Joan Finney
Kansas Bankers Association, Jim Maag
Jay Briedenthal, Security National Bank, Kansas City, Kansas
Ernie Mosher, Kansas League of Municipalities
Ron Todd, Insurance Commissioner's OfficeSB 219 - Continued from 11:00 meeting

Mr. Hoffman referred to charts distributed at the 11:00 meeting, and noted there had been questions about the origin of the data. He noted that the graff shows the average for the day in question for repurchase agreements and it came from Morgan Guaranty Trust.

The other exhibits distributed at the earlier meeting depict December, 1982, and January, 1983. The information was derived in the following manner, according to Mr. Hoffman: Usually, on a given day there are two repurchases that are done by telephone. The amount is given to banks who show an interest in bidding. In ten minutes there is a call-back with the bids. At exactly the same time, four calls were made to the following companies: Solomon Brothers, Harris Trust, Morgan Guaranty Trust, and Dean Witter. Those companies gave the quote which they would have given to a bank. Of the four quotes, the Treasurer's office placed on the charts the lowest bid received from them. The charts represent what that office considered to be the absolute minimum which would have been received for that repurchase. Mr. Hoffman stressed that it was a simultaneous situation. He added that any of those brokers say they will give a better rate to a state than they give to a bank, because they are more certain a state will not default. Mr. Hoffman stated that, owing to the present system, it is believed the State of Kansas is losing anywhere from one-half million dollars to \$1 million each year.

The Kansas Bankers Association distributed written testimony.
(See Attachment A)

Mr. Briedenthal appeared in opposition to SB 219. He noted that the amount lost by the State of Kansas each year on repurchase agreements is a very small percentage of the total agreements handled. He added that there are all kinds of repurchase agreements and the state should add some new personnel who know about this type of transaction. He noted that his bank would deal only with primary Government dealers, because there are many people who are dealing with repurchase agreements who have no capital.

According to Mr. Breidenthal, repurchase agreement interest is not secure and the state insists upon 105% collateral. He suggested that if the state goes directly to a broker for a repurchase agreement and gives him that kind of stipulation, it probably will not be available.

In connection with the charts shown by Mr. Hoffman, Mr. Briedenthal suggested that it is important to look at an entire year in order to get a good idea about what is going on in financial markets.

SB 219 - Continued

There were questions from committee members. During the discussion, it was noted that there are four to six banks in Kansas having an investment division.

Mr. Briedenthal concluded by stating that he feels the State of Kansas is doing an extremely capable job of handling repurchase agreements. He added that, if they are going to go directly to the broker, they probably will need to increase overhead.

SB 218 - Local government investment pool for investment of idle funds

Mr. Hoffman briefly explained SB 218 and distributed a paper entitled "State-Local Cooperation: The Local Government Investment Pool" (See Attachment B) He then discussed performance audit reports on school districts, and noted the recommendation had been made in the area of tightening investment management capabilities. He suggested that the proposal being considered would give to school districts the availability of state service which does not exist at the present time. Mr. Hoffman said he realizes that banking changes have made higher interest rates available to the small investor, but the State Treasurer feels the bill is advisable, because states using such a system have had success.

When asked by Senator Talkington if there is a fiscal note on SB 218, Mr. Hoffman answered that the Pooled Money Investment Board anticipates two or three employees would be necessary. This probably would run between \$60,000 and \$100,000.

Mr. Mosher appeared in support of SB 218. He said at least 14 states have established these pools, and they are functioning well. These states are on a local option basis, and they say it is a significant granting of state assistance at a small cost to state governments. Mr. Mosher said proposals of this type have been recommended by the Advisory Commission on Inter-Governmental Relations. It would give professional management, higher yield, greater convenience, etc.

Senator Hess asked if this proposal might pull out significant dollars from local banks. Mr. Mosher said it would, if the assumption is made that money is kept locally by the local bank; and if that is so, it would have a substantial impact on banking institutions.

Mr. Maag distributed his prepared statement (See Attachment C). His testimony was in opposition to the proposal. Following his statement, he added that the performance audit reports referred to by Mr. Hoffman might reflect a much different light had they been written after December 15, 1982 when new instruments became available to individuals and small units of governments. There were questions from committee members and a brief discussion concerning his testimony.

SB 212 - Establishment of a preference for hiring state residents

Senator Steineger explained the proposal, noting that it is a Kansas full employment bill and gives preference to Kansas employees. There was a discussion concerning contractors coming into Kansas to bid on jobs. Senator Steineger said he felt there should be something in the bill stating that a Kansas bidder got the contract if he was within 5% of the lowest bidder. Senator Talkington suggested there may be a problem with Section 2, which provides that resident workers shall be terminated last. He explained that it may be necessary to reduce only one trade, instead of the total work force, and that there may need to be an escape valve in that section.

SB 212 - Continued

Mr. Mosher appeared to oppose SB 212. There were questions from committee members and a lengthy discussion concerning the bill. Mr. Mosher said he felt that a number of employees would need to be added to the department of administration in order to carry out the provisions of the bill. He further stated that his organization is doubtful that a United States Supreme Court decision on anti-trust would allow this kind of law.

It was noted by Senator Talkington that Oklahoma has a similar law applying to highway contracts, with a five percent differential.

SB 216 - Placing employees of State Treasurer in unclassified service

Mr. Hoffman explained that this is a request by the State Treasurer to place employees in her office in the unclassified service. Including the Treasurer, there are 47 employees, 11 are presently unclassified and 36 are classified. This bill would place in the unclassified service the balance of the employees. The State Treasurer believes that this is in line with previous actions taken by the Legislature regarding other elective offices. The State Treasurer feel that her office would be provided with greater flexibility in hiring, it would not affect expenditures, and would put her in conformity with other offices with the exception of the Insurance Department. Senator Steineger noted that the Secretary of State, Attorney General, Governor, etc., do not have classified employees, and questioned the reason for those in the State Treasurer's office and Insurance Commissioner's office being classified. Mr. Hoffman said he had never understood the difference.

Mr. Todd respectfully requested that the office of Commissioner of Insurance be afforded the same treatment being asked by the State Treasurer, for basically the same reasons. He reminded the committee that a bill was introduced last year and did not pass the Senate; and that in 1980 a similar bill passed the Senate but died on the House calendar.

SB 252 - Classification and administration of Pooled Money Investment Board

Mr. Hoffman stated that this proposal would take the administrative responsibilities of the staff of the Pooled Money Investment Board out of the Secretary of Administration and place them under the State Treasurer. It would also place the executive officer of the Pooled Money Investment Board in unclassified service and make that official serve at the pleasure of the three-member Board. Mr. Hoffman said the board is an autonomous functioning agency, performs an important function for the state, and it is his feeling that it should be treated the same as other Boards in the state; and the executive officer should serve in unclassified service as do his counterparts. He said one of the major problems is that the PMIB staff is now treated as part of the Secretary of Administration's office. The PMIB functions physically out of the office of the State Treasurer, and there is more rational connection between the Treasurer's office and the Board staff than there has ever been in relation to the Secretary of Administration.

SB 255 - Interest paid on inactive bank accounts

Mr. Hoffman said that, at the present time, there are 619 banks in Kansas which have on deposit in inactive accounts \$245 million. SB 255 would change the present payment of interest on those inactive accounts to provide for payment of interest compounded monthly as opposed to simple interest quarterly. Mr. Hoffman said that, had this bill been in effect last quarter, it would have resulted in an additional \$37,000 of interest income to the state.

Following several questions from committee members concerning rates of interest, Mr. Hoffman concluded his presentation.

SB 255 - Interest paid on inactive bank accounts

Mr. Maag said his organization has no objection to SB 255, but would like to have the effective date changed to publication in the statute book so banks can get a little better organized.

Following additional discussion by the committee of the proposals presented at the meeting, it was adjourned by the Chairman.

February 28, 1983



The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

TO: Senate Committee on Ways and Means

RE: SB 219 -- Repurchase agreements

Mr. Chairman and members of the Committee:

We appreciate the opportunity to appear before the Committee to discuss SB 219 which would amend a number of Kansas statutes relating to the powers of the Pooled Money Investment Board and allow the PMIB to enter into repurchase agreements of less than 30 days duration with institutions other than Kansas banks. Committee members will recall that this has been a recurring topic over the past few years and was even the subject of extensive discussion by the Governor's Commission on State Investment Practices back in 1980. While that Commission spent a number of hours discussing the current method of repurchase agreement procedures, the final report to the Governor did not include any recommendations for change in the repurchase procedures used by the Pooled Money Investment Board. We do not believe that anything has occurred since that time which should result in any legislative mandate to change the current procedures. In fact, a good case could be drawn that based on events in the national money markets over the past two years the PMIB should continue to work with institutions where they know the people involved and can be assured of the safety and soundness of the institutions.

As Committee members are well aware, repurchase agreements are unique financial instruments and do demand significant expertise on both the part of the state and the institution involved in the transaction. The banks of Kansas over the years have proven to be as capable as any financial institutions in the country in making a market in repurchase agreements for the state of Kansas. They have shown a willingness and ability to enter into the repo agreement contracts with the state since the establishment of the program and have assured the ability of the state to invest its funds on a daily basis through some extremely difficult market conditions in recent years. The program has allowed for a fair and reasonable rate of return on the state's investments and has been a very efficient and workable system for the state.

It should be further noted that it is highly unlikely that the state of Kansas could find anyone but the most "marginal" of operators who would be willing to work with the PMIB regulations relating to the requirement for market value on the securities involved in the repo agreement. Kansas banks have been willing to participate in the program despite these restrictions and we believe this only proves the willingness of Kansas banks to make concessions to the state in order to accommodate the program and make it work to the benefit of the state.

Thank you for the opportunity to appear on SB 219 and we respectfully request that no action be taken on this legislation during the 1983 session.

Office of Executive Vice President • 707 Merchants National Building
Eighth and Jackson • Topeka, Kansas 66612 • (913) 232-3444

AA A 2-28-83 2:30p.m.

Retail Repos

WASHINGTON FINANCIAL REPORTS

FDIC TO RULE ON PRIORITY OF RETAIL REPURCHASE AGREEMENTS

Retail repurchase agreements are getting special Federal Deposit Insurance Corporation scrutiny as a result of the failure of a small Iowa bank Aug. 6.

The FDIC must make a legal determination of where certain retail "repo" investors stand in the queue of creditors of the failed bank. Although the amount of retail repurchase agreements involved is small, "the decision is going to have ramifications for the entire banking industry," said Dorothy Stassun, a

staff attorney at the bank closing, so the agency is taking extra care with the "sensitive issue."

Retail repos usually involve small individual investors who buy a part interest in a security backed by the U.S. government or an agency. The bank that owns the security sells an interest to an investor, and agrees to buy back the interest in a specified period of time.

Unlike deposits, retail repos are not insured by the Federal Savings and Loan Insurance Corporation. And, although the repos are "collateralized" by a government investment, investors are not necessarily secure against insolvency. In a bank failure the question arises who owns the security on which a repo is based.

According to Stassun, the failure of Mt. Pleasant Bank and Trust Company is the first time the issue has to be decided by the FDIC. A new bank took on some liabilities of the defunct bank, but did not assume \$350,000 worth of retail repo agreements. The investors now have to look to the FDIC, the receiver of the failed institution, to recover their investments. In other closings, the banks that have assumed deposit liabilities have also assumed the retail repos, Stassun said.

The Mt. Pleasant Bank was closed by the Iowa Banking Commissioner Aug. 6. The newly created Hawkeye Bank and Trust Company assumed deposits of \$25.5 million and will receive a cash advance of \$15.7 million. The FDIC received \$18.4 million in assets and a purchase premium of \$1.5 million. (39 WFR 312)

Prompted by growing use of retail repos to attract funds, the FDIC last October published guidelines on retail repos. (39 WFR A-4, 1981) The policy suggested that banks properly secure retail repos so that a customer would not lose money in case of insolvency.

However, Stassun said the agency has to decide whether Mt. Pleasant created a "perfected security interest" to protect its investors.

Meanwhile, Rep. Benjamin Rosenthal (D-N.Y.), chairman of a House consumer subcommittee wants to know what protections Mt. Pleasant Bank repo customers had under FDIC regulations.

In an Aug. 13 letter to FDIC chairman William Isaac, Rosenthal sought information on the status of the repos and whether the agency had evidence that investors may have been misled about the risk of the repos.

In addition, Rosenthal asked if more regulation of repos might be necessary. "If, as is presently anticipated, the repo investors do not recover their full investment from direct liquidation of the collateral on their behalf because of flaws in the repurchase agreement contracts, does the FDIC contemplate improving its regulations on retail repurchase agreements, and if so, how?"

However, the FDIC Aug. 16 decided to eliminate some regulation of the retail agreements. An FDIC spokesman claimed that the issues raised by Mt. Pleasant bank had no effect on the relaxed regulation.

The agency voted to permit banks to automatically renew repo agreements. Currently investors who want to keep a repo have to reinvest their money every time the repo agreement matures.

The FDIC also decided to propose ending limits on repo maturity and denominations. Presently repos must mature in less than 90 days and be in denominations of less than \$100,000.

The agency also suggested in its October policy statement that in order to "avoid potential liability under the securities laws and to exercise safe and sound banking practices" certain disclosures and advertising guidelines should be followed.

The agency called for a bold-typeface disclosure on the front of the retail repo stating, in part, "this obligation is not a deposit and is not insured" by the FDIC. In addition the corporation suggested that the bank tell depositors on the cover that if the interest is not properly secured, then the investor would lose money in case of insolvency.

BANKING NEWSLETTER

10/1/82
Ann
October, 1982

This newsletter is a monthly publication of the banking section of Devine, Millimet, Stahl & Branch, Professional Association, Manchester, New Hampshire, prepared exclusively for the use of firm clients. The materials contained herein have been abridged from federal laws, court decisions and administrative rulings, and should not be construed as legal advice or opinions on specific facts.

RETAIL REPURCHASE AGREEMENTS--BUYERS' INTEREST IN UNDERLYING GOVERNMENT SECURITIES

A recent bank failure in Iowa has brought the safety of retail repurchase agreements (repos) into question again. As noted in the November, 1981 Newsletter, retail repos have long posed serious questions regarding the nature of a purchaser's interest and the disclosure required by the selling banks under the federal securities laws. Many banks, which knew that the repos were not insured deposits, had assumed that investors were protected by the value of the securities underlying the repos. The FDIC, as receiver for Mt. Pleasant Bank & Trust Company, has taken the position that the bank customers, who had invested \$353,000 in repos, are in no better position than other general creditors of the Bank. The agency cautioned that its decision was based on the particular situation in Iowa and was not a general statement on the status of repo buyers. The Iowa bank had segregated the underlying securities by transferring them to another bank in an attempt to protect its investors. However, it did not take steps sufficient to create a perfected security interest in the securities for the purchasers under state law. The FDIC's determination will be reviewed by an Iowa court.

FDIC POLICY STATEMENT--SUBSIDIARIES OF NON-MEMBER BANK ENGAGING IN SECURITIES ACTIVITIES

The FDIC board of directors recently stated that the Glass Steagall Act did not prohibit an insured non-member bank from establishing, acquiring, or affiliating itself with a subsidiary corporation engaged in issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate

State-Local Cooperation: The Local Government Investment Pool

by James E. Jarrett and Tom A. Landgraf*

IN RECENT YEARS state and local government officials have increased their cooperation in financial management. Municipal bond banks, in which municipalities may voluntarily market their debt to quasi-state agencies, have been established in Vermont, Maine, Alaska, and Puerto Rico. North Carolina's Local Government Commission provides an array of financial services to localities, and municipal debt advisory commissions have been created in several States.

A promising innovation in intergovernmental fiscal cooperation is investment of localities' idle reserves by state investment officials. Mechanisms for state investment of municipal funds, initiated by officials in Oregon in late 1974, were subsequently adopted in Wisconsin and Illinois, and in September 1976 became law in California.

These state-local cooperative efforts represent a major advance over other types of cooperation: direct economic benefits may accrue to state government in addition to the indirect benefits of having more fiscally sound

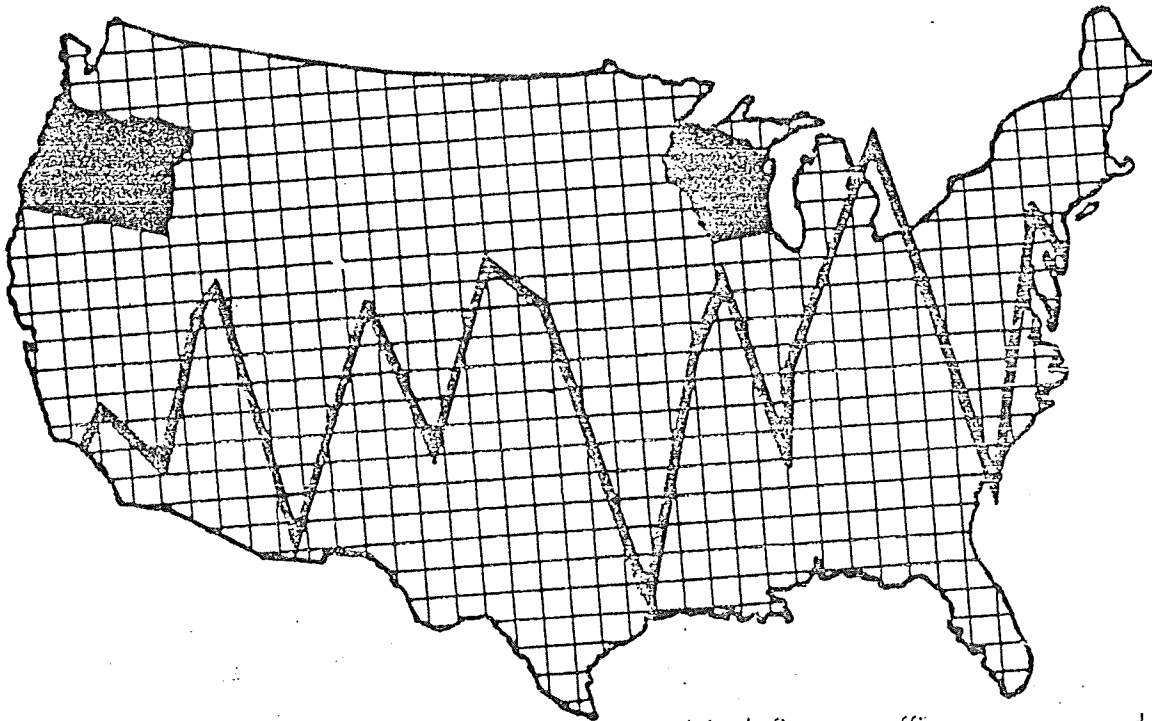
local governments. The Wisconsin program, one of two examined here, has already enabled state officials to avert a temporary state cash flow predicament through use of municipalities' surplus funds. Investment of municipalities' reserves may also engender a higher investment return on the State's short-term investments.

OPERATION OF A POOLED INVESTMENT FUND

In February 1976 a bill was enacted in Wisconsin which created two local government investment funds to be managed by the State's investment board: a trust fund and a pooled investment fund.¹ The local government pooled investment fund is a vehicle for short-term investments by localities. It is a completely voluntary arrangement by which counties, cities, towns and villages may deposit with the State Treasurer any state-shared taxes, local revenues, or idle reserves for investment by the investment board. A municipality's funds, while credited to an individual account for accounting purposes, are pooled with other municipalities' funds and with the State's short-term funds.

A municipality's interest earnings are equivalent to the average rate of return, determined quarterly, for all short-term investments of the board.² Each locality's earnings are based on its average daily balance as determined by

*Dr. Jarrett is a member of the Innovations Transfer Project, supported by the National Science Foundation, at the Council of State Governments. Mr. Landgraf is Director of State Budget Operations, Wisconsin Department of Administration. The authors wish to thank Richard A. Barnett, Senior Investment Officer of the Oregon Treasury Department, for providing materials about the Oregon pool and for reviewing a draft version of this article.



computer programs. Interest earnings not withdrawn are added to each town's original principal for investment during the next quarter.

Operationally, the deposit and withdrawal system is simple. If a local unit of government is depositing money in the pooled fund from its state-shared taxes, that government provides the State Treasurer written instructions as to the amount which the State should retain. If a locality deposits idle cash from its own treasury, the local treasurer asks the local government's commercial bank to transfer funds to the State Treasurer. A municipality's funds are then added to the State's short-term cash balances, and the board is informed daily of the total amount available for short-term investments.

For withdrawals, a similar process is used. If notice of a partial or total withdrawal is made by 10 a.m., the State Treasurer's office will issue a check that same day to the local government. The check will be dated for the next day which allows the government unit to receive interest earnings from the pool for the next day. (If the local government deposits the treasurer's check by 2 p.m. the next day in its local bank, it would receive interest from the bank as well.)

Conceptually, the Oregon local investment pool is similar to Wisconsin's, but differences do exist. In Oregon, only municipal funds are pooled, and a Local Government Investment Board advises the State Treasurer and Investment Council regarding management of the pool. This five-member board includes three

municipal finance officers recommended by municipal organizations. Interest earnings are computed monthly instead of quarterly as in Wisconsin. Finally, correspondent banks are involved in transferring funds, all deposits are made by telephone and later confirmed by mail, and withdrawals of amounts in excess of \$1 million require one day's notice.

ADVANTAGES TO LOCAL GOVERNMENTS

Because of inadequate financial expertise or insufficient monetary balances, many local governments cannot enter short-term money markets. Often, a locality's funds earn little or no interest as they have been deposited in noninterest-bearing demand accounts in local banks.³ State management of local funds resolves both problems.

In Wisconsin the investment board invests in high-yielding, short-term investments such as bankers' acceptances, commercial paper, treasury bills, repurchase agreements, and reverse repurchase agreements.⁴ Very few communities possess expertise for such activity, and others are prohibited legally: Oregon localities may invest only in collateralized certificates of deposit of Oregon banks, in municipal securities of adjoining States, and in U.S. Treasury and agency debt.

An investment pool allows local governments to contribute uneven, small surpluses, thereby encouraging even the smallest villages to invest. Moreover, because all local

governments receive an identical rate of return regardless of whether they invest \$2,000 or \$200,000 (there is dollar averaging across units), smaller government units achieve a higher interest than if their accounts were invested separately. In addition, investment risks are reduced since each municipality has a share in many different short-term instruments.

The flexibility of pooled investment funds in both Oregon and Wisconsin permits an integration of local governments' investment programs with their cash flow systems. Municipal funds can be withdrawn almost on demand and transfer of funds is rapid; no municipality will be caught in a cash flow emergency because of nonliquid investments. The pooled investment fund, in short, operates as a checking account which pays a high rate of return on low-risk investment instruments.

ADVANTAGES TO STATES

A constant flow of new short-term capital from Wisconsin local governments has enabled investment in those fiscal instruments providing the best current rates of return. While it is very difficult to calculate the precise impact of these better investments on the overall rate returned on the State's short-term investments, these yields normally will be superior. Furthermore, economies of scale in short-term investment costs may be realized: larger purchases and proportionately lower dealer fees.

Establishment of a local government pooled fund proved enormously beneficial in another respect. A temporary provision, which will expire 30 days after the enactment of the 1977-79 biennial budget, provided Wisconsin state officials the authority to use, with localities' permission, local government funds to alleviate a short-term cash flow problem. This temporary cash flow difficulty resulted from large payments to local governments which were legally mandated and not from problems in normal operation expenditures. Nineteen local units of government left \$61.5 million of their state-shared taxes in the pooled fund for 10 days and received a 7.44 percent average annual rate of return. In other States which prohibit interfund transfers and borrowing for current obligations (Wisconsin is limited to \$100,000), temporary use of localities' funds in a pooled investment fund might prove beneficial as well—provided (1) local governments voluntarily loan money, and (2) corrective action is initiated to integrate cash

flow considerations with policy decisions through better scheduling of state expenditures, especially state aid to municipalities.

In States such as Oregon, in which municipalities' funds are not commingled with short-term state investments and which have not utilized the pooled fund for a cash flow emergency, benefits are more indirect. Increasing the financial stability and wealth of local governments and furthering trust among state and local officials are long-term endeavors. Nevertheless, these benefits should not be discounted because when municipal fiscal problems become acute, state governments may become involved.

RESULTS

The primary indication of success for any voluntary program is participation. During the first year of the pool's operation in Oregon, local governments maintained an average of approximately \$100 million in the fund. By November 1975, this amount ballooned to nearly \$350 million, and the pool's minimum balance during 1976 was \$230 million. Oregon treasury officials projected a balance of approximately \$450 million by January 1977. Two hundred separate local government units, including 50 cities, 26 counties, and 86 school districts, are participating.

In Wisconsin, the pooled investment fund became effective on March 1, 1976. By December, localities had contributed approximately \$56 million of their funds. Sixty-one local units of government maintained accounts.

Participation in local government pooled funds can be attributed to two causes: improved liquidity, and a superior rate of return over returns from commercial institutions. Local governments in Wisconsin earned 7.44 percent during March and 6.57 percent during April, May, and June. During the period April to June, local governments in the pool earned at least 23 percent more than they could have received from commercial institutions. During the July 1-September 1 quarter, the rate of return was even more remarkable: 7.89 percent. This outstanding return is expected to evoke a major increase in both the amount of municipal assets and the number of municipalities participating in the pool.

The Oregon local pool returned 6.28 percent during the first three months of 1976 and 6.18 percent during the second quarter. This was 20

percent more than commercial institutions were providing in short-term investments. Oregon officials have calculated that for the first eight months of 1976, local governments earned \$2.2 million more by participation in the pool than if normal commercial institutions had been utilized. Direct deposit in the pool account of certain taxes (highway tax, and liquor and cigarette taxes) which are collected by the State but shared with municipalities adds four days' worth of interest by quicker investment. This direct deposit feature alone has provided localities over \$100,000 more in revenues during the first year's operation.

Superior interest earnings are due to higher-yielding short-term investments and minimal costs. In Wisconsin, local governments incur only miniscule costs in transferring funds to the State Treasurer. As stipulated in the legislation, the investment board may deduct a maximum of one quarter of one percent of earned interest for administrative expenses. Officials anticipate actual administrative expenses will be significantly less since no additional personnel were hired. In Oregon the management fees have recently been reduced from 1 percent to one half of 1 percent of earnings. Therefore, if the gross interest earned is 6 percent, localities receive 5.97 percent (.06-.003 which is the product of .06x.005).

IMPLICATIONS

The pooled investment fund benefits both state and local treasuries in Wisconsin. In Oregon there are immediate economic benefits to localities while long-term benefits accrue to the State. Administratively, the pool possesses two attributes: personnel additions may be unnecessary and results are easily evaluated. Therefore, if the program proves unsuccessful, it can be rapidly terminated.

Not all state governments may desire to provide these additional financial services. Given an appropriate investment framework and expertise in short-term investments, however, the pooled investment fund has been a mutually beneficial intergovernmental program.

A program which generates additional revenues for state and local governments without extracting these resources from taxpayers cannot be easily dismissed.

Creation and operation of a pooled investment fund suggest two additional conclusions. First, government investment procedures are definitely amenable to improvement by analysis of private sector investment strategies. Some government activities have no counterparts in private industry, and attempts to install private sector procedures prove counterproductive. Not so with money management.

There are other implications arising from pooled investment funds. Some government activities can be accomplished better at particular levels of government because specialization or economies of scale are available at those levels. The pooled investment fund is one such example. It is significant also because a realignment of functions and duties among American governmental levels might prove most successful if undertaken on a voluntary basis.

When state and local officials seek improvements in government programs, they must not overlook the possibility of their being achieved more effectively on another level. Intergovernmental fiscal cooperation is well under way. State and local cooperation in other fields should prove equally fruitful.

Footnotes

1. The trust fund, conceived primarily for long-term investments, permits localities to establish their own investment accounts and have their funds placed in designated investments for specific periods of time by the investment board. This fund will not be discussed because guidelines have not yet been set by the board.

2. Municipalities also receive interest on state funds: a daily check float averaging about \$3.5 million is invested by the board and investment earning are distributed to all participants in the short-term investment fund.

3. Officials in Wisconsin's Department of Administration discovered that 81 cities and 67 percent of the State's town and village governments received no interest income in calendar year 1974. Oregon officials, in a very rough estimate of uninvested idle funds, thought there may have been nearly \$100 million sitting idle prior to inception of the pool.

4. Oregon officials have placed some of the pool's funds in negotiable certificates of deposit and corporate bonds. The Wisconsin Investment Board has not. Neither invests funds of their pools in common stocks.



The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

February 28, 1983

TO: Senate Ways and Means Committee

RE: SB 218 -- Establishment of a local government investment pool

Mr. Chairman and members of the Committee:

Thank you for the opportunity to appear before the Committee and discuss the provisions of SB 218 which would establish a local government investment pool for the investment of idle funds of local units of government. The bill would allow local governmental units to transfer funds to a pool for local public moneys for investment by the Pooled Money Investment Board (PMIB).

While members of the Kansas Bankers Association would agree with the philosophy of this bill which is to maximize the return on the investment of local government idle funds, we do not agree that the bill is necessary in today's investment environment. Recent changes at the federal level in the types of deposit instruments available to local units of government now make it possible for them to get a money market rate for their investments with a minimum deposit.

As the attached sheet concerning local public funds deposits (which is sent to all Kansas banks by the KBA periodically) shows, any local unit of government has seven different opportunities to invest their idle funds of less than \$100,000 in instruments which pay up to the 91-day T-bill rate or possibly in excess of that rate. The "money market deposit" account which was authorized in December of 1982 and the "Super NOW" account which was authorized in January of 1983 have no interest rate ceiling for any deposit in excess of \$2500. The same is true for the seven to 31-day CD which was first authorized in September of 1982 and further modified by actions of the Depository Institutions Deregulation Committee (DIDC) on January 5, 1983.

When the current availability of these various deposit instruments is weighed against the complications of establishing a centralized investment pool with the accompanying transfer problems, questions of FDIC insurance application, and administrative costs, it would not seem prudent for a local unit of government to use such an investment pool.

The statutes relating to investment of local government idle funds have been carefully drawn over the years and have provided local units with the opportunity for a sound method of investment. Therefore, we do not believe that the establishment of an investment pool for local units at the state level is advantageous or needed at this time.

We appreciate very much the opportunity to discuss this important issue with the Committee and we request that no positive action be taken on SB 218.

March 1, 1983

KANSAS BANKERS ASSOCIATION

(Supercedes mailing of 12/8/82)

LOCAL PUBLIC FUNDS DEPOSITS

IMPORTANT:

Beginning July 1, 1982, only banks and S&Ls which have home offices located in the investing local governmental unit are eligible to receive idle funds time deposits of such units. (The \$100,000 limitation on public funds deposits no longer applies to S&Ls which have home offices within the investing unit.) If no bank has any home office in the investing unit, idle funds may be invested in banks having home offices in the county or counties in which the investing unit is located. If these eligible banks will not pay at least the 91-day T-bill rate or the maximum lawful rate whichever is lower, then the banks which have home offices located in adjacent Kansas counties are eligible to receive such deposits. If no S&L has a home office located in the investing unit, idle funds may not be invested with another S&L.

The eligibility of a bank or S&L to receive deposits of idle funds is determined by the location of its home office. The deposit itself may be received at a facility or branch of a bank or S&L which is an eligible depository.

Demand deposits of a local unit may be carried in any bank which has a home office located in the county or counties in which the unit is located and may be received at any facility of an eligible bank. S&Ls are not eligible depositories of demand funds.

- A. If the deposit is under \$100,000 FDIC, FLSIC, DIDC and Federal Reserve regulations stipulate 8% as the maximum rate which may be paid for public funds with seven exceptions:
- (1) Banks and S&Ls may legally offer a non-negotiable variable rate Money Market Certificate for \$2500 or more with 26-weeks maturity (182 days) at a rate not to exceed the highest rate an S&L may pay.
 - (2) Banks and S&Ls may legally offer a non-negotiable 2½-year Small Savers Certificate at a rate not to exceed the highest rate an S&L may pay.
 - (3) Banks may also offer a negotiable or non-negotiable time deposit of \$2500 or more with a maturity of exactly 91 days at a rate not to exceed 1/4% below the most recent rate (auction average on discount basis) established and announced for 91-day T-bills. S&Ls may offer the most recent rate (auction average on discount basis) established and announced for 91-day T-bills.
 - (4) Banks and S&Ls may offer a time deposit with a minimum maturity of 3½ years with a negotiable rate. There is a required denomination of \$500 but no specified amount for such time deposit.
 - (5) Banks and S&Ls may offer a non-negotiable time deposit of \$2500 or more, with a maturity or required notice period of not less than seven days nor more than 31 days, with no interest rate ceiling.
 - (6) Starting December, 14, 1982, banks and S&Ls may offer the Money Market Deposit Account with an initial deposit of no less than \$2500 and no interest rate ceiling on deposits which satisfy the initial and average balance requirements. No maturity exceeding one month may be established for the account and a bank may not obligate itself to pay any interest rate on this account for a period longer than one month.
 - (7) On January 5, 1983, all local units of government will be eligible to have the "Super NOW" account with a \$2500 minimum.
- B. If the local idle fund deposit is \$100,000 or more neither regulations nor statutes stipulate any maximum allowable rate.
- C. Local units must invest idle funds in banks or S&Ls having home offices located within their boundaries (or if no bank home office is located within the investing unit then in banks having home offices in the county or counties in which the unit is located) so long as one or more of such banks agree to pay at least the current 91-day T-bill rate or the maximum allowed by law, whichever is lower. If the highest rate available from such banks is less than the 91-day T-bill rate or the regulatory maximum, the investing units may:
- (1) Accept the offered rate;
 - (2) Go to banks that have home offices located within the county or in the Kansas counties adjacent to the county or counties in which the investing unit is located;
 - (3) Invest in T-bills with maturities not exceeding 6-months; or
 - (4) Go to another authorized investment such as temporary notes or repurchase agreements.

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Local Public Funds Deposits

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- D. If a bank or S&L has no home office within the investing unit or a bank or S&L is not willing to enter into a repurchase agreement at a rate which is equal or higher than two percentage points below the "average yield" before taxes on the most recent 91-day T-bill auction, then the local unit can go to the home office of any bank or S&L located within the county or counties where the local unit is located. If those bank or S&L home offices are not willing to enter into a repurchase agreement at the above rate then the local unit may go to the home office of any bank or S&L in the state of Kansas.
- E. If the bank or S&L pays the 91-day T-bill rate or less it must pledge an amount equal to the deposit less FDIC or FSLIC coverage times 70%. If the rate paid exceeds the 91-day T-bill rate the bank or S&L must pledge 100% of the deposit in excess of FDIC or FSLIC coverage.
- F. Attorney General Opinion 75-448 and 76-212 stipulate that state law allows a local unit to transfer a portion of its demand deposit account to a savings account and by pre-arranged agreement transfer funds by telephone from savings to checking as needed.
- G. As of October 15, 1982, all local units of government are eligible to have a NOW account.
- H. Under Federal law interest-bearing deposits from local units of government are insured in an amount not to exceed \$100,000 and additionally the demand deposits are also insured in an amount not to exceed \$100,000.
- I. K.S.A. 10-131 regulates investment proceeds for most bond issues. Local units may invest such proceeds in direct obligations of the United States government and its agencies or as authorized for other idle funds in the same manner as such funds are invested under the provisions of K.S.A. 12-1675. Under existing Attorney General opinions maturity and interest rates are negotiable on such bonds.
- J. Security used for pledging on local government public funds must have a MARKET VALUE at any given time which is equal to no less than 70% of the deposit less insurance coverage (100% if paying more than the 91-day T-bill rate.)
- K. Negotiable promissory notes secured by first lien mortgages on Kansas real estate which are used for security for local public funds can be taken for not more than 75% of the security required. Market value of such notes shall be determined by rules and regulations established by the Bank and S&L Commissioners.
- L. There is no longer a minimum period of time for local units to invest in time deposit open accounts and certificates of deposits. Therefore, all local units may invest in 14-day CDs or TDOAs as allowed by federal regulation.