

Approved: 1/31/96
Date

MINUTES OF THE Senate Committee on Financial Institutions and Insurance.

The meeting was called to order by Chairperson Dick Bond at 9:02 a.m. on January 30, 1996 in Room 529-S of the Capitol.

All members were present.

Committee staff present: Dr. William Wolff, Legislative Research Department
Fred Carman, Revisor of Statutes
June Kossover, Committee Secretary

Conferees appearing before the committee: Bud Grant, Kansas Chamber of Commerce & Industry
William Caton, Pooled Money Investment Board
William Lewis, Pooled Money Investment Board
Sally Thompson, State Treasurer
Larry Tucker, Reno County Treasurer
Chris McKenzie, League of Kansas Municipalities

Others attending: See attached list

Bud Grant, KCCI, appeared before the committee to request introduction of legislation to deregulate retail credit. (Attachment #1) Senator Emert made a motion, seconded by Senator Steffes, to introduce this legislation. The motion carried.

The chairman opened the hearing on **SB 476**, concerning the pooled money investment portfolio. William Caton, Consumer Credit Commissioner and member of the Pooled Money Investment Board, provided the committee with an overview of the proposed legislation and the rationale for its introduction. (Attachment #2) Mr. Caton also provided, in his opinion, an explanation of the cause of the \$20 million loss sustained by the Municipal Investment Pool.

Senator Hensley commented on the allegations made by Mr. Caton and requested an opportunity to question Mr. Caton; however, the chairman advised that his intention was to submit this legislation to a subcommittee for thorough discussion and that the time allotted in today's meeting would be spent hearing from all conferees with questioning to follow if time permitted. In response to Senator Lee, Chairman Bond advised that the subcommittee meeting(s) would be published and every attempt would be made to schedule them at a time which would permit as many committee members attending as possible.

William Lewis, PMIB member, spoke of the need for this legislation and gave a summary of the changes the bill would make in the operation of the Municipal Investment Pool and the Pooled Money Investment Board. (Attachment #3).

Sally Thompson, State Treasurer, stated that the management of the Municipal Investment Pool is a job she was elected to do and one that she will not abandon. Ms. Thompson stated that she does support the technical portions of the bill. (Attachment #4)

Larry Tucker, Reno County Treasurer, stated that he opposes the language that would take management of the MIP away from the control of the State Treasurer and would like to see that language removed from the bill. (Attachment #5)

Chris McKenzie, League of Kansas Municipalities, stated that his organization is committed to the principles of the MIP and feels the pool is a vital investment alternative for cities, especially smaller cities, faced with the challenge of earning a reasonable return on the investment of their public funds. He stated that there is nothing radical about separating the PMIB from the operation of the Treasurer. Mr. McKenzie urged the committee to give serious consideration to any arrangement that will provide a better balance between accountability and effectiveness in the management of public funds. (Attachment #6)

Since there were no other conferees, the chair called for questions from the committee for any of the conferees. Senator Hensley asked the State Treasurer for her response to Mr. Caton's testimony and stated his displeasure at this issue being debated in the news media.

CONTINUATION SHEET

MINUTES OF THE Senate Committee on Financial Institutions & Insurance, Room 529-S Statehouse, on January 30, 1996.

Senator Bond stated that, although this has been labeled a political issue, politics are not involved--this committee and the legislature must simply consider what is best for the people of Kansas and that the chair of this committee cannot control what any person would choose to say to the press.

Ms. Thompson spoke to the issue of malfeasance raised by Mr. Caton, stating that there was no indication of such in any of the audits of the MIP or the State Treasurer's office.

Senator Steffes also expressed his concern about the seemingly constant effort by the State Treasurer's staff, as well as others, to discuss this issue in the press, and his hope was that responsibility might be taken and that solutions to the problems could be achieved.

Senator Corbin observed that MIP participants would obviously have a different opinion of the administration and operation of the pool if they had participated in the loss instead of the loss having been covered by state funds.

The hearing on **SB 476** was closed and a subcommittee consisting of Senator Bond (chair), Senator Steffes and Senator Hensley was appointed to consider the matter further.

Senator Praeger moved to approve the minutes of the meeting of January 29 as submitted. Senator Steffes seconded the motion. The motion carried.

The next meeting is scheduled for January 31, 1996.

SENATE FINANCIAL INSTITUTIONS & INSURANCE
COMMITTEE GUEST LIST

DATE: 1/30/96

NAME	REPRESENTING
W. J. Lewis	PMTB
Melissa Wangemann	Hein, Ebert & Weir
Norm Wilkes	KASB
Bill Caton	PMIB
Jim May	KAA
Kelly Kuitala	KTLA
CRAIG HUSTING	JOHNSON County
Roger Trunko	KGC
Andi Schuber	KDIR
Judy Mayo	Self
Sue Bond	
LARRY TUCKER	BEND COUNTY TREASURER
Franky Diron	State Treasury
Sally Thompson	State Treasurer
Kathy Peterson	Prudential Insurance
Lyn Goeking	Attorney General's Office
BOB GRANT	KCC
Anne Spiess	Ks. Assoc. of Counties
Art Griggs	Dept of Admin.

SENATE FINANCIAL INSTITUTIONS & INSURANCE
COMMITTEE GUEST LIST

DATE: 1/30/96

NAME	REPRESENTING
Tom Wilber	Kansas Insurance Dept
Danielle Kloe	KCUA
Jama Wagner	STO
John Hanna	Associated Press

Amendments to the Uniform Consumer Credit Code (UCCC)

Closed End Credit

16a-2-201. (UCCC) Finance charge for consumer credit sales other than open end credit. (1) With respect to a consumer credit sale, other than a sale pursuant to open end credit, a seller may contract for and receive a finance charge not exceeding that permitted by this section.

(2) The finance charge, calculated according to the actuarial method, may not exceed the equivalent of the following:

The total of:

(a) Twenty-one percent per year on that part of the unpaid balance of the amount financed which is \$1,000 or less;

(b) fourteen and forty-five hundredths percent per year on that part of the unpaid balance of the amount financed which is more than \$1,000.

(3) This section does not limit or restrict the manner of calculating the finance charge whether by way of add-on, discount, or otherwise, so long as the rate of the finance charge does not exceed that permitted by this section.

(4) For the purposes of this section, the term of a sale agreement commences with the date the credit is granted or, if goods are delivered or services performed 10 days or more after that date, with the date of commencement of delivery or performance. Differences in the lengths of months are disregarded and a day may be counted as 1/30th of a month. Subject to classifications and differentiations the seller may reasonably establish, a part of a month in excess of 15 days may be treated as a full month if periods of 15 days or less are disregarded and that procedure is not consistently used to obtain a greater yield than would otherwise be permitted.

(5) Subject to classifications and differentiations the seller may reasonably establish, the seller may make the same finance charge on all amounts financed within a specified range. A finance charge so made does not violate subsection (2) if:

(a) When applied to the median amount within each range, it does not exceed the maximum permitted by subsection (2); and

(b) when applied to the lowest amount within each range, it does not produce a rate of finance charge exceeding the rate calculated according to paragraph (a) by more than 8% of the rate calculated according to paragraph (a).

(6) Notwithstanding subsection (2), the seller may contract for and receive a minimum finance charge of not more than \$5 when the amount financed does not exceed \$75, or not more than \$7.50 when the amount financed exceeds \$75.

~~(7) As an alternative to the rates set forth in subsection (2), the seller may contract for and receive a finance charge not exceeding 18% per year on the unpaid balances of the amount financed.~~

(7) Notwithstanding any other provision of this section, with respect to a consumer credit sale other than open end credit, the seller may contract for and receive a finance charge not exceeding that agreed to by the consumer.

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Attachment
#1

Amendments to the Uniform Consumer Credit Code (UCCC)

Open End Credit

16a-2-202. (UCCC) Finance charge for consumer credit sales pursuant to open end credit. (1) With respect to a consumer credit sale made pursuant to open end credit, the parties to the sale may contract for the payment by the buyer of a finance charge not exceeding that permitted in this section.

- (2) A charge may be made in each billing cycle which is a percentage of an amount no greater than:
- (a) The average daily balance of the account, which is the sum of the actual amounts outstanding each day during the billing cycle divided by the number of days in the cycle;
 - (b) the unpaid balance of the account on the last day of the billing cycle; or
 - (c) the median amount within a specified range within which the average daily balance of the account or the unpaid balance of the account on the last day of the billing cycle is included. A charge may be made pursuant to this paragraph only if the seller, subject to classifications and differentiations the seller may reasonably establish, makes the same charge on all balances within the specified range and if the percentage when applied to the median amount within the range does not produce a charge exceeding the charge resulting from applying that percentage to the lowest amount within the range by more than 8% of the charge on the median amount.
- ~~(3) If the billing cycle is monthly, the charge may not exceed 1.75% of that part of the amount pursuant to subsection (2) which is \$1,000 or less and 1.2% on that part of this amount which is more than \$1,000. If the billing cycle is not monthly, the maximum charge is that percentage which bears the same relation to the applicable monthly percentage as the number of days in the billing cycle bears to 30. For the purposes of this section, a variation of not more than four days from month to month is "the last day of the billing cycle."~~
- (3) *With respect to a consumer credit sale made pursuant to open end credit, the parties may contract for and the seller or holder may receive a finance charge in an amount not exceeding the rate or rates specified in the agreement governing the account.***
- (4) Notwithstanding subsection (3), if there is an unpaid balance on the date as of which the credit service charge is applied, the seller may contract for and receive a charge not exceeding \$.50 if the billing cycle is monthly or longer, or the pro rata part of \$.50 which bears the same relation to \$.50 as the number of days in the billing cycle bears to 30 if the billing cycle is shorter than monthly.
- ~~(5) As an alternative to the rates set forth in subsection (3), the parties to the sale may contract for and the seller may receive a finance charge not exceeding 18% per year on the amount determined pursuant to subsection (2).~~

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TESTIMONY
SENATE BILL NO. 476
BILL CATON, MEMBER
POOLED MONEY INVESTMENT BOARD
JANUARY 30, 1996

Thank you very much for the opportunity to testify before you today on Senate Bill No. 476. It is my desire to provide you with a broad overview of this proposed legislation and the rationale for its introduction. I would also like to set straight the events leading to the introduction of this proposal.

Do not make the mistake of believing that rising interest rates caused the \$20 million trading loss in the Municipal Investment Pool ("MIP"). The investment strategy used by the Treasurer to invest in securities that had longer maturities than MIP deposits caused a liquidity problem when the MIP could no longer compete with other investment vehicles available to MIP participants, because the portfolio's earnings lagged behind the then current market rates. Also, the Chief Investment Officer invested heavily in callable securities, betting that interest rates would not rise, or perhaps not considering interest rates would rise, and the securities would consequently be called on the call date. Instead, these securities were not called, and the MIP was left holding bonds yielding less than market rates that generally had another year to maturity. **These investment strategies did not fit the board policy or market conditions.** The Pooled Money Investment Board ("PMIB") had an investment policy that required safety first, liquidity second, and yield third. The Treasurer's investment strategies, formulated with erroneous assumptions, reversed liquidity and yield. The board, on numerous occasions, questioned the Treasurer regarding the disparity between investment and deposit maturities. The Treasurer consistently responded that "core deposits" in excess of \$500 million allowed her to utilize this investment strategy to increase yield. This incorrect assumption, and the investments in callable securities left no choice but to sell securities and sustain huge losses when liquidity problems set in during December of 1994 and January of 1995. Any other explanation for these losses is incorrect!

The PMIB has worked diligently this past year to formulate a plan to address the \$20 million trading loss in the MIP. Many alternatives were considered. It became obvious the following concerns would dictate what action might provide a reasonable solution to this problem:

- Due to contractual and statutory limitations, it is highly improbable that current and past MIP participants can be required to repay earnings already distributed.
- The size of the MIP limits its capacity to offer competitive rates with the drag of this \$20 million loss, and the scheduled withdrawal of State idle funds in July, 1996 will further erode its earning capacity. The MIP will probably collapse, and the loss will still need to be addressed.
- Keeping the MIP viable is the best possible option, because it insures that municipalities will participate in recouping the loss by allowing the State to recover a portion of the loss through deferring a small portion of MIP earnings to offset it.

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Attachment #2
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- The State will most likely be the ultimate bearer of the majority of the loss. The only way to mitigate the effect of the loss is to maximize earnings within a conservative investment policy that allows only appropriate risk assumption. Expanded investment powers to include high grade commercial paper, banker's acceptances, and negotiable bank CDs would be appropriate to help offset earnings deferred to the loss

The PMIB has concluded that: 1) maintaining the MIP as a viable and desirable alternative investment vehicle for municipalities; 2) managing the State idle funds and the MIP in one investment pool; and 3) amortizing the loss by allocating a small portion of the future earnings of the combined pool to the loss, will cause the least amount of financial burden to the State. The PMIB is also proposing legislative approval of expanded investment powers, which should enhance earnings capacity, to help enhance investment income that will be dedicated to the loss recovery. Because the additional investment tools requested have additional income potential, as you would suspect, they carry some additional risk. However, the additional risk is manageable, and I believe appropriate for public funds. These expanded powers will benefit the State of Kansas long after the loss has been amortized.

There is another concept incorporated in this proposal that I would like to address. I wish to make it clear that a majority of the PMIB support this proposed bill. The Treasurer, who is statutory chairman of the PMIB, has refused to recognize and carry out official actions of the PMIB. There has been increasing concern by some PMIB members that administrative functions are inadequate to properly manage the investment of public funds. These concerns have also been confirmed in the independent audit recently completed, and in the report of the Legislative Post Audit.

At the January 2, 1996 PMIB meeting, the board took official action to request the Legislature to consider the separation of PMIB administrative functions from the State Treasurer's office. This action was duly noted in the minutes of that meeting which have been officially adopted. However, at the January 15, 1996 meeting, the Treasurer refused to acknowledge a proper motion and second regarding this subject, citing that she was chairman of the PMIB and did not have to acknowledge any action on this subject since it was not on the agenda and not officially a part of the "legislative plan," which was on the agenda. It is obvious that the Treasurer has failed to properly carry out her duties as chairman of the PMIB in flagrant defiance of board directive.

My perception of the situation is this: the authority of the PMIB is inadequate to effectively manage the assets for which it is statutorily responsible. It is a very basic managerial concept that authority and responsibility need to be balanced; otherwise, the imbalance creates dysfunction. An organization does not function effectively when the responsibility of managing assets and the authority to carry out the policies and directives related to such responsibility are not in balance.

The situation that occurred at the January 2 and 15 PMIB board meetings is only one of several examples that portray this imbalance and misuse of responsibility and authority. This problem is best exemplified by another situation which recently occurred and continues to be unresolved. In April, 1995, the Treasurer decided to begin shaving interest income from MIP

participants to begin offsetting the trading losses. The Treasurer unilaterally decided to retain 2% on the State idle funds and a much smaller amount on other pool participants deposits, and instructed PMIB staff to do so, without advising the other board members. During this time, the PMIB had been discussing a plan to equitably defer some investment earnings to the loss, but was advised by counsel that an immediate plan would not be appropriate, and the board chose not to implement any action until rules and regulations could be implemented and a new participation agreement could be executed between the municipalities and the PMIB. The other board members discovered in late June that the interest "shaving" procedure was in place and at its June 20, 1995 meeting, by majority vote, directed PMIB staff to reverse these unauthorized transactions. It was not until the January 2, 1996 PMIB meeting and after repeated direct questioning, the Treasurer finally revealed that the June 20th board directive had not been carried out. The Treasurer, exercising her authority over administrative functions, defied the PMIB directive and instructed staff to refund only State idle funds earnings that were retained. The Treasurer now contends that this decision was within her administrative authority, and she unilaterally decided the board's plan was not cost effective, even though her decision was contrary to legal counsel and appropriate board directive.

The situation described above occurred because of the imbalance of responsibility and authority, and perhaps malfeasance. The statutes do not help clarify how much, if any, authority the PMIB has concerning administrative decisions. The Treasurer can claim, and has often maintained, that actions and decisions fall under her administrative responsibilities. To rectify this imbalance, it is proposed to place the administrative functions in the PMIB by separating the operations of the PMIB and the Treasurer. Alternatives would be to diminish the statutory responsibilities of the PMIB by making it strictly an advisory board (which is how the Treasurer would like to perceive it now) or to abolish the PMIB completely. I do not believe either of these alternatives would be the prudent course of action to take.

I truly believe the Office of State Treasurer, acting as the guardian or trustee of public funds, is an important office. The cash management function has two elements: 1) cash flow maintenance; and 2) investments. The State Treasurer should be a part of both elements. If the Legislature determines that the PMIB should have responsibility over the investment function, the proposed changes will allow the PMIB to execute its duties to the best of its abilities. If not, I would suggest the alternative recommendations noted earlier. Taking no action on this matter will continue the current irresponsible operations which are undesirable for the State of Kansas.

I am sure the issue of accountability will be raised, and rightfully so. It is a difficult issue, and one that should be carefully considered by the Legislature. The PMIB, other than the Treasurer, is appointed by the Governor. Questions that need to be answered are: Does placing the administrative function under the PMIB weaken the public accountability? Should the State Treasurer have the ultimate responsibility of the investment function? Who should be responsible for risk management? These are public policy issues that need to be resolved by the Legislature. I believe the proposal before you makes the best business sense and provides a better structure to manage the risks involved in investing public money. Risk management is by far the most critical investment function, and we must do a better job of risk management in the future.

I believe the legislative proposal currently before you will provide good financial management by matching responsibility and authority. As an independent agency, the PMIB can effectively and objectively manage the investment of State monies. To point out the existing imbalance, I would like to again relate a situation which occurred at the January 15, 1996 meeting. A PMIB board member requested the independent auditor to research a past situation. The Treasurer's legal counsel was quick to point out the PMIB had no authority to request this information, because the PMIB had no funds to pay for this request as the Treasurer has the statutory administrative control over the PMIB budget. The board member had to rescind the request, and the Treasurer was once again successful in obstructing the board from obtaining pertinent information.

It is obvious to me the administrative function is lacking proper oversight and accountability. I envision hiring a top-notch executive director with managerial skills to direct PMIB staff, carry out board directives, strictly adhere to investment policies and strategies, and provide a high degree of accountability to the PMIB as well as the public by utilizing finance professionals for performance evaluation and strategic planning. Risk management, not yield emphasis, is the most important function of the PMIB, and this proposal provides the clear authority to carry out that responsibility.

In conclusion, Senate Bill No. 476 addresses the most practical and least painful solution to recover the trading losses and provides the proper balance of responsibility and authority within the PMIB. It is imperative that you take action of some kind; either increase authority of the PMIB or remove responsibility. The current imbalance will promote continued mismanagement and hinder the board's attempts to manage the assets that have been entrusted to the PMIB by the people of Kansas.

January 30, 1996

TESTIMONY - SENATE BILL NO. 476
SENATE FINANCIAL INSTITUTIONS AND INSURANCE COMMITTEE

WILLIAM E. LEWIS, MEMBER
POOLED MONEY INVESTMENT BOARD

On January 16, 1996, on behalf of the Pooled Money Investment Board (PMIB), I outlined legislation for this committee that would improve the efficiency and the effectiveness of the investments of State idle funds. This legislation, now represented by Senate Bill No. 476, outlines a change in the organization and the operation of the Pooled Money Investment Board which, by statute, manages the investment policies for State funds. Since the Board's authorization of this recommendation, it has been represented by the Treasurer as a move fostered by politics, greed and one which expands bureaucracy in state government. Before I discuss the merits and reasons for this bill, I would like to briefly address these remarks.

1. Politics - Only one member of this board is running for election this year. That is the State Treasurer. When the motion was made, on January 2, recommending a change in administration be legislated, no one to my knowledge knew of the Treasurer's intent to run for office. In addition, to my knowledge, no one that approved this motion was approached by anyone outside of the board to make this change. The recommendation was made based upon past operational shortcomings, current operational weaknesses verified in independent audits, and the need to improve controls and basic operations. The recommendation was based upon sound business practices.
2. Greed - With respect to greed, only two members of the Board receive a stipend of \$35 per meeting. This amount would hardly satisfy any type of greed.
3. Increased bureaucracy - There is no additional bureaucracy. The Board and its staff are and have been in place. It is the administration that is in question. The definition for bureaucracy is - *An administrative system in which the need or inclination to follow complex procedures impedes effective action.* This bill actually reduces bureaucracy.

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attachment #3

The Board has recommended this bill and brought it to the committee for the following reasons:

- Resolution of a \$20 million loss in the Municipal Investment Pool(MIP)
- Expansion of investment opportunities to improve yield without unreasonable additional risk
- The need for improved investment operations that utilize necessary control mechanisms

At the end of September 1994, there was a \$25 million unrealized loss in the MIP portfolio. \$21.6 million of this loss was realized in the last quarter of 1994 and the first half of 1995 due to liquidity problems. Because of these losses the Board has implemented several improvements within the PMIB. These items include but are not limited to the:

- Clarification of participation agreements
- Adoption of rules and regulations
- Development of concise useable board reports
- Correction of improper Swap calculations and journal errors(Legislative Post Audit 4th Quarter 1994)
- Approval of a stop-gap policy of no sales of securities at a loss(MIP portfolio)
- Development of Senate Bill No. 476.

These items reflect the Boards intent to look ahead to develop an operational system that will result in an effective, accountable investment operation and one that will have a system of checks and balances to reduce the possibility of unnecessary losses in the future.

Senate Bill No.476 addresses:

- Combined investment pools
- Expansion of investment powers for improved yields without unnecessary risk
- Amortization of the \$20 million loss utilizing up to a .25% per annum administrative fee on assets invested(25 cents per \$100)
- Reorganization of administrative responsibilities.

Combined investment pools - The combining of investment pools into one consolidated pool of approximately \$2 billion, will reduce liquidity risk and provide efficiency of scale in investing activities that is not currently enjoyed.

Expansion of investment powers - Additional investment options to the PMIB would be high quality Commercial Paper, Bankers Acceptances, and Negotiable bank CD's. Currently 34 states approve the use of Commercial Paper as an investment vehicle. The increased yield of approximately .25 - .4% is expected to provide additional estimated investment income of \$2.5 million.

Amortization of \$20 Million loss - An investment fee of up to .25% per annum of invested assets would be credited to the loss. (Currently participants in the MIP are paying 1% of earnings in their pool.) This credit is estimated to be as high as \$4 million per year.

Reorganization of operations - In order to implement the above plan effectively and to have adequate controls, it is recommended by the Board to match authority, responsibility, and experience by transferring the administrative and operational duties to the Board.

The above changes represented in Senate Bill No. 476 are relatively transparent to the depositors in the pool. The investment rate at which funds are offered to local banks is unchanged. The allowable length of maturity of investments is unchanged. MIP depositors will have more flexibility and competitive rates. There are no perceived shortcomings.

In summary the effects of Senate Bill No. 476 are:

Change in operational basis of pool

- One investment pool for all State funds (excluding KPERS, KDOT and other special funds)
 - ◊ Economy of scale
 - ◊ Reduce liquidity risk
 - ◊ Simplify risk management
- Municipal investment Pool will be an account(s) within the pooled money investment portfolio
- Expand investment powers to include high-grade:
 - ◊ Commercial Paper
 - ◊ Bankers' Acceptances
 - ◊ Negotiable bank CD's
- Fee of up to 25 basis points (.25%) per annum on all dollars invested will be assessed and utilized to amortize \$20 million loss

Separation of responsibilities from State Treasurer

- PMIB Chairman to be designated by the Governor (State Treasurer to be a statutory member)
- Administrative and operational duties to be managed directly by the PMIB (authority matching responsibilities)
- Minimal additional operating costs projected due to:
 - ◊ Adequate staffing
 - ◊ Proper training of personnel
 - ◊ Implementation of appropriate operating systems for a \$2 billion portfolio
 - ◊ Improved Board communications and development

Testimony of Sally Thompson, State Treasurer
Senate Bill No. 476
Senate Financial Institutions and Insurance Committee
Tuesday, January 30, 1996

Mr. Chairman, members of the committee,

Thank you very much for the opportunity to appear before this committee in regard to Senate Bill No. 476. As will become apparent from my comments I both support and oppose provisions of this bill. My support is very strong for the technical part of this bill which addresses the undistributed loss of the municipal investment pool and provides for combining, for investment purposes, the municipal investment pool and the state idle funds pool, while maintaining separate fund accounting between the state and local moneys. All five members of the pooled money investment board (PMIB) worked very hard in a bi-partisan way on this part of SB 476 over the last three months. This part of the bill represents the board's plan for addressing the loss, as requested by the legislature last summer and fall.

The combined portfolio will allow for amortization of the undistributed \$20 million loss within an estimated five to 10 years. (See attached "Amortization of Loss Model.") Up to this point in FY 96 there has already been a recovery in excess of \$465,000.

It is very important that **everyone** realize that the legislature has but two realistic options for dealing with the loss this session:

- a. The loss can be amortized as proposed, thus insuring that neither the state general fund nor units of local government will incur the loss.
- b. Or, the legislature can fail to act, resulting in Kansas taxpayers needlessly having to suffer a \$20 million loss.

Amortize the loss or force Kansas taxpayers to realize the loss. Clearly, the best option for the future is to amortize the loss, thus paying it off over a period of time. There is absolutely no reason for anyone to sustain this loss. What happens this session will determine which option is exercised.

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Attachment # 4

In regard to the second component of SB 476, this part of the bill is nothing short of an effort to strip away authority from a statewide elected official who is accountable to the people of Kansas, and to give that power to a group of political appointees who are seeking to create a new state bureaucracy. This is, of course, where the PMIB's bi-partisan efforts went by the wayside. It is also evidence that supporters of this bill have little faith in the voice of Kansas voters who elected me.

The price tag to the taxpayers of Kansas for this new bureaucracy is conservatively estimated at almost \$1 million per year, a 50% increase over the cost of my administration to perform the exact same function.

This proposal is contrary to the Governor's mandate for less government. It is contrary to my ongoing effort to create a more efficient state government. The purported rationale for this expensive new layer of bureaucracy is because now, after a successful and lengthy career in private sector finance, along with five years as the Treasurer of the state of Kansas, I am being portrayed as incapable of handling the investment of state and local moneys. As this committee is aware, the loss resulted from the necessity to sell some securities prior to maturity in order to meet cash flow demands. The law did not allow allocation of losses to pool participants. There was no fraud or mismanagement; no investment in derivatives or exotic securities; no investment in junk bonds; no investments which went belly up.

Let's go beyond the generalized name calling of this board and look at some of what I have done with the bi-partisan help of the legislature for the people of Kansas during my tenure as State Treasurer and PMIB chair:

- In 1992 I worked with the legislature for the passage of SB 480, a major piece of legislation which brought much needed reform to our local and state moneys laws.
- As a result of SB 480 I have earned in only three years under my leadership as PMIB chair an **additional \$30 million** for the state, over and above what would have been earned had it not been for this legislation. (See attached chart.) This figure significantly underestimates the overall positive fiscal impact to Kansas taxpayers as it does not include the additional interest earned when funds were withdrawn and reinvested, or even the additional earnings of local units of government who have not used the pool but who have nonetheless received increased earnings from local banks due to the pool's existence.
- During the last three years under my leadership as chair of the PMIB the state and its cities, counties and school districts have received over **\$544 million in interest**

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earnings - more than one-half billion dollars in three years. It is because of increased interest earnings on public funds that the people of this state have not had to suffer tax increases or diminished public services during the past few years. I have already taken responsibility for the loss, now it is time to give me credit for the \$544 million gain.

- During the last three years under my leadership as PMIB chair the municipal investment pool has earned in excess of **\$105 million** for, primarily, our cities, counties and school districts. I am certain that most of you have heard from local officials expressing their support for the municipal investment pool and my administration of the pool. (Letters of support attached.)
- During fiscal year 1995 - when the municipal investment pool suffered the loss - the municipal investment pool actually grossed \$41 million, with net earnings for the year of \$21 million.
- Under my leadership as PMIB chair the municipal investment pool has provided an investment alternative for local communities that was not available before 1992. Even those who do not use the pool will tell you that they now receive market rate for the public's money because they now have an alternative for deposit of taxpayer funds. (Letters attached.)
- Under my leadership the PMIB provided a liquidity facility for the final bond issue of the KDOT Comprehensive Highway Program. This creative financing arrangement has saved Kansas taxpayers millions of dollars in taxes and fees. The program created an initial savings of 2.825% on the rate of the bonds (average rate for FY 95 was 3.8%) and saved an estimated \$6 million to \$12 million in fees to New York banks.

At the present time participation in the municipal investment pool is solid. (See attached December 1995 MIP cover sheet.) The current number of participants is 171, an increase of seven over the number of 12 months ago. The balance of deposits in the pool as of January 26, 1996, is \$627,676,822.39. From December 1, 1995, through the 19th day of January, the net increase in **local** deposits exceeded \$165 million. The fact that participation in the pool has actually grown in number is impressive in light of ongoing political pressure applied to local non-political financial managers, along with constant pressure by many local bankers.

The technical part of SB 476 - that which I support - will improve our ability to invest taxpayer dollars into the future and to insure that, after addressing the foremost concerns of safety and liquidity, the best yield possible will be received. At the present time 32 states authorize investment of idle funds in commercial paper, while bankers' acceptances and

negotiable certificates of deposits are an authorized form of investment in, respectively, 25 and 14 states. (See attached map, "State's Authorized to Invest . . .") One-third of the states (16) provide for combining of local and state idle fund portfolios. (See attached map, "State Sponsored Municipal Pools.") Upon passage of this bill any future loss within the municipal investment pool may be passed through to pool participants, a provision that was not specifically incorporated into the original law.

In regard to the proposal to remove my authority to oversee investment of the public's funds, the members of this committee should be aware of what they are being asked to create. Transfer of administrative authority over the investment staff does not merely entail a change in who provides day-to-day direction. Transfer of this authority will require replacement of the personnel and payroll function; replacement of accounting and budgeting, as well as purchasing responsibilities; provision for new office space and equipment; and, technical support. All of the foregoing is now provided by my staff. We all know, as elected officials, that the last thing Kansas want at this time is more government.

Even the proponents of this new bureaucracy admit that it will cost the taxpayers. As Mr. Lewis of the board stated in the summary to his January 16 written comments to this committee, "[n]o projected cost savings with an increase envisioned . . ."

In my opinion, the new agency will require at least four additional employees but will provide no greater safety over the public's funds than is now provided; there will be no greater return on the public's money, unless risky investment strategies are pursued; and, all of this will cost the taxpayers more than \$300,000 per year. In contrast, while state agency spending has increased by 15% since I took office in 1991, the overall spending of my office has **decreased** by 4% for the same period of time.

In summary, I stand before you both in support of and in opposition to parts of this bill. I believe, as elected officials, we share a common goal. A goal of creating good public policy. Policy that makes sense, is cost effective and addresses the future wants and needs of all Kansans.

Kansas voters want someone who is accountable to them. Kansas voters want us, as elected officials, to make sure their tax dollars are not being wasted on the creation of additional bureaucracy. Finally, it is our duty to Kansas voters to take care of this situation in a common sense and bi-partisan manner.

Thank you.

TO : HONORABLE SENATOR DICK BOND, CHAIRPERSON
MEMBERS OF THE SENATE FINANCIAL INSTITUTIONS &
INSURANCE COMMITTEE

FROM : LARRY TUCKER, RENO COUNTY TREASURER
HUTCHINSON, KANSAS

TESTIMONY REGARDING S.B. 476

As Reno County Treasurer, past chairman of the MIP advisory committee and treasurer of the Kansas County Treasurer's Association, I wish to thank you for the opportunity to present testimony regarding senate bill no. 476, in particular as it pertains to the proposed changes in the structure and management of the Municipal Investment Pool (MIP).

Since its creation, the state municipal investment pool has benefitted the taxpayers and citizens of all counties across the state of Kansas. With competitive rates, safe investment opportunities and providing local municipalities the flexibility to improve their cash management techniques, the MIP has provided the taxpayers of Kansas an invaluable public service.

As a pilot participant, I have seen first hand the evolution and growth of the municipal investment pool. Through my office alone, the MIP, since 1992, has paid out over \$ 1.1 million, earning Reno County taxpayers an additional \$ 300,000, which would not have been available if the pool had not been in existence.

With this bill, I applaud the committee's efforts in continuing to work with the State Treasurer's office to fine tune the mechanics of the MIP. Such things as to set aside a fee for unrealized gains and losses, combining state and local pool portfolios and expanding investments to include discount bankers acceptances and other safe securities are positive steps in making the MIP an even stronger option for local governments.

However, as an elected local official, I must oppose the language in this bill which would take the management of the municipal investment pool away from the control of the office of the State Treasurer. Let me state several reasons why I believe this would be a mistake.

1. The deposits that go into the MIP come from taxpayers. The citizens of Kansas have placed the trust and accountability of taxpayer deposits into various elected treasurer positions, separate from the Governor, the legislature and local government officials.

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To now suggest, that such tax dollars deposited at the state level be removed from the responsibility of the elected State Treasurer, without a state wide vote of the people, would be a violation of this special trust put in place by the citizens of Kansas.

2. Placing the responsibility of taxpayer deposits into the hands of another state or private agency does not guarantee more efficient government. Private agencies must operate at a profit, while state agencies, under a bureaucratic process layer, are slow to respond to the needs of those being served. Consequently, the costs and delivery to provide such service is in fact more costly to taxpayers.

As a participant in the MIP, I can testify that the state treasurer's office, has not only the ability to respond quickly to the needs of municipalities, but due to the nature of being an elected office, is closer to the concerns of Kansas citizens. With the creation of the MIP and the demands of more efficient government, electors are now seeking more, not less qualified candidates to serve as State Treasurer.

3. Finally, if the management of public tax dollars invested in the MIP is removed from the office of the State Treasurer, and in effect away from the people of Kansas, this will create a division between other local government officials across the state. Already being tested at the local level, this will provide new cause for county officials to follow suit to remove various duties from not only from the office of the county treasurer, but from the office of county clerk, register of deeds and county sheriff.

May I remind the committee, that Kansas law has already taken this into account, by refusing to allow this process to occur, without a vote of the people at the local level. The same should be true at the State level as well. The rights of the people of Kansas should not be abridged by a handful of legislators in Topeka.

The municipal investment pool has served taxpayers well. Do not pass legislation that in effect would remove trust and accountability demanded by the people of Kansas. For these reasons, I ask that the committee remove the language from S.B. 476, which would take the control of managing the municipal investment pool away from the office of the State Treasurer.

Respectfully submitted,

Larry R. Tucker
Reno County Treasurer

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**League
of Kansas
Municipalities**

PUBLISHERS OF KANSAS GOVERNMENT JOURNAL 300 S.W. 8TH TOPEKA, KS 66603-3912 (913) 354-9565 FAX (913) 354-4186

TO: Senate Financial Institutions and Insurance Committee
FROM: Chris McKenzie, Executive Director
DATE: January 30, 1996
SUBJECT: SB 476

Thank you for the opportunity to appear today in general support of SB 476 as a result of action by the League's Legislative Policy and Finance and Taxation Policy Committees. The League worked with the Committee last year on SB 9 to deal with the consequences of the losses experienced in the Municipal Investment Pool (MIP) in 1994. We appreciated the cooperative efforts of the Legislature and the State Treasurer to address what was and is an extremely delicate question.

Today the member cities of the League are even more committed to the principle underlying the MIP than when it was established in 1992. Despite the setbacks of 1994, the MIP is a vital investment alternative for cities, especially smaller cities, faced with the challenge of earning a reasonable return on the investment of their public funds.

Fundamentally the MIP is based on a partnership with Kansas state government in service to the taxpayers of Kansas. That partnership depends first and foremost on our joint commitment to an investment philosophy that emphasizes safety over liquidity and return.

While many of us worked diligently last year to devise legislation that would address the challenges of that time, it is now clear the losses of 1994 are still largely with the MIP despite efforts by the PMIB to offset them with a partial allocation of MIP interest earnings. This is clearly a situation that must be addressed, and I want to applaud the PMIB for formulating this proposal to allow for joint management of municipal and state funds in a single portfolio. I understand this is an approach that has been used widely in other states and would seem particularly well-suited to Kansas.

The League also endorses the recommended expansion of investment options for the pooled money investment portfolio. This common sense part of the proposal recognizes the need for state and local leaders to pull together and support a package that will deal with the 1994 losses in a systematic way in the future. This part of the proposal makes sense if we are committed to our partnership without unduly burdening any member of the partnership. If we insist on ending the partnership and allocating the losses now, none of us is likely equipped with the wisdom to fashion an acceptable exit or allocation plan.

The final part of the proposal which deserves careful consideration is the change in management of the PMIB. From time-to-time the U.S. Supreme Court abstains from deciding complicated matters by

President: John Divine, Mayor, Salina * Vice President: Ralph T. Goodnight, Mayor, Lakin * Past President: Harry L. Felker, Mayor, Topeka * Directors: Donald L. Anderson, Mayor, Lindsborg * Chris Cherches, City Manager, Wichita * Yvonne Coon, City Administrator, Clearwater * Ed Ellert, Mayor, Overland Park * Rod Franz, Finance Director, Salina * John Golden, Mayor, Goodland * Richard Jackson, Commissioner, Ottawa * Carol Marinovich * Mayor, Kansas City * Tom Martin, Mayor, Dodge City * Marguerite Strange, Commissioner, Leavenworth * Melvin Williams, Councilmember, Mission * John Zutavern, Commissioner, Abilene * Executive Director: Christopher K. McKenzie

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referring to them as "political questions" that should be resolved only by elected bodies. In other words, the Court does not decide thorny political issues that do not have legal significance. That may indeed be what we have with this question.

Under current law, the PMIB is the decision maker in establishing investment policies, appointing employees, and taking such other actions as shall be consistent with the management of state funds and the MIP. Section 19 of SB 476 simply provides that the PMIB may provide for office space, equipment, supplies, etc. separate from the State Treasurer's office to carry out the functions of the PMIB. Even more importantly the statement in subsection (b) declaring the state treasurer is chairperson of the board is stricken. Section 18 would empower the governor to appoint the chairperson.

Outside of its political context there is nothing radical about a legally separate agency (with the independent ability to hire its own staff) acquiring office space, equipment, materials and supplies to house and equip those staff. Despite the political nature of this question, I would respectfully submit that the challenge facing this Committee and Legislature is to select an organizational arrangement that effectively balances accountability and effectiveness in managing the assets of the state and its local units of government. That arrangement may be one of the two options laid before you, but it actually may be a third or a fourth option you have not yet been asked to consider.

As you know, the formation of the MIP was due in no small measure to the tenacity and support of our State Treasurer, and the city officials of our state continue to be grateful for her support and efforts. On the other hand, this Committee and the Legislature have a duty to consider whether the public interest will be better served by an alternative organizational arrangement that will provide a better balance between accountability and effectiveness in the management of public funds.

I have learned from over 20 years in government that most taxpayers don't really care how we get the job done, but they want assurances that it will be done well. We would respectfully suggest that you ask yourselves whether the current arrangement strikes a sound balance between accountability to the public and effectiveness in investment. If the evidence you receive indicates otherwise, we strongly recommend you consider the arrangement contained in SB 476 or the many other alternatives you may hear in the days to come.

Thank you for your consideration of our views. Please let me know if you have any questions.

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