

MINUTES OF THE MEETING
STATE ADMINISTRATION COMMITTEE
MONTANA STATE SENATE

January 15, 1985

The fifth meeting of the State Administration Committee was called to order at 10:00 a.m. on January 15, 1985, by Chairman Jack Haffey in Room 331 of the Capitol Building.

ROLL CALL: All members were present.

CONSIDERATION OF SENATE BILL 10: SENATOR TED NEUMAN, Senate District 21, was the sponsor of this bill. A bill entitled, "AN ACT TO SUBMIT TO THE QUALIFIED ELECTORS OF MONTANA AN AMENDMENT TO ARTICLE VIII, SECTION 13, OF THE MONTANA CONSTITUTION REMOVING THE RESTRICTIONS ON INVESTMENT OF PUBLIC FUNDS AND PROVIDING THAT THE "PRUDENT EXPERT" PRINCIPLE GOVERN THE INVESTMENT OF PUBLIC FUNDS." SENATOR NEUMAN said that Senate Bill 10 would allow for the investment of Montana's unified investment program as a "prudent expert" would. They would remove the so-called laundry list of permissible investments and replace it with a broader range of investment opportunities that more accurately reflect today's investment climate under the prudent expert rule. The investment objective of the Board of Investments is to maximize the total return within proper risk tolerance and preserve the purchasing power of the funds during periods of high monetary inflation. Public Employees Retirement System and the Teacher's Retirement System return their investment and earnings income to their respective funds, but most of the other funds' income and earnings are only partially returned to the investment pool. The remainder goes to the general fund of the state and is appropriated by the legislature. In years when inflation exceeds the rate of return, the purchasing power of the funds is eroded. SENATOR NEUMAN further stated that the most reasonable approach to preserve the purchasing power of the separate funds is to maximize the total return by investing to receive the highest possible return within proper risk tolerance. The laundry list of permissible investments under current law prevents us from maximizing our return to capital by prohibiting all but a small portion of investment of public funds in equities or real estate which would maximize yields during times of high inflation. He then stated that the prudent man rule tends only to preserve the principal of the funds with no great concern to maximize the total return as a prudent expert would do. SENATOR NEUMAN stated that the prudent man rule is like an average man investing his money, whereas, the prudent expert rule, would be an expert investing the same amount of money. (For more of Senator Neuman's testimony, see Exhibit A, 1-15-85, SB's 10 and 11, attached hereto.)

PROPOSERS: SENATOR TOM TOWE stated that this is a constitutional amendment to present to the voters. It would amend Article VIII, Section 13. They would be invested according to use of the boards that received those funds. We are penalizing our funds because we can't invest in equities if it is prudent to do so and it seems

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wise for the state to do so. Most of the things listed on the laundry list have a set rate of return. We can't invest in anything at the present that does not have a set rate of return. This further inhibits our investment board in what it can invest in, and we miss out on better investments. The "prudent man" investment is how an ordinary man would look after his investments. There are not too many ordinary men with investments of 2.2 billion dollars. Therefore, the prudent man rule is not prudent any more. We need an expert.

Jim Howeth, Board of Investments, stated that these two bills are related to yesterday's bills. I think any investment manager who can take into account the economic times and conditions can perform better than one that is restricted. For the past two years, the inflation rate has not been too much of a concern, but it may be later. The restrictions that are contained in the Constitution are strangling us. We support these bills.

Dale Harris, Economic Development Board, supports the two bills with a couple of small changes. He felt that the new prudent expert rule does not contain the language regarding the trust. They do not want the Reber Bill (Page 7, lines 9-14) removed and they think we should lean toward in-state investments. SENATOR HAFLEY reminded him that we are only referring to SENATE BILL 10.

OPPONENTS: There were no opponents.

SENATOR HAFLEY next opened the hearing to questions from the Committee. SENATOR CONOVER asked SENATOR NEUMAN why he would delete lines 7 and 8 which reads, "bonds of the United States or other securities, ..." or could they still invest in that under this? SENATOR NEUMAN replied that they could. SENATOR MOHAR asked if this had been before the legislature before. SENATOR TOWE replied that it had been before the voters twice before but that this prudent expert language was all new and would make a difference. He said he had been trying for years to get rid of the laundry list of investments and finally most of the people agreed with him. SENATOR FARRELL then asked if it was possible with this new language that we might get involved in a WPPSS. SENATOR NEUMAN replied that thanks to Jim Howeth's good sense, the state did not have even one WPPSS bond, but the way the language reads right now that it was possible, since this was one of the few investments that the Board of Investments could make. SENATOR MOHAR asked if the prudent expert and prudent man were well defined. SENATOR NEUMAN said that the language is from ERISA and from California and is used there. SENATOR HAFLEY asked if it would be necessary to establish floors or parameters with regard to the funds being managed. SENATOR TOWE said that Jim Howeth invests the money according to the type of fund in the safest types of investments. The prudent expert will go from fund to fund to determine what is the best investment for each fund.

Jim Howeth further told the Committee that the prudent expert rule is a step up rather than an alternative. It is an expert managing the money rather than an ordinary man. SENATOR HAFLEY then said that it was his understanding that if SENATE BILLS 10 and 11 do pass, it will give the board of investments more rights rather than equal rights. Mr. Howeth agreed. SENATOR NEUMAN closed by saying that he feels that this is an important piece of legislation and that the committees looked at the whole process and this was the best answer. SENATE BILL 10 is closed.

SENATE BILL 11: SENATOR NEUMAN said this is a bill entitled, "AN ACT CONFORMING THE UNIFIED INVESTMENT PROGRAM WITH CONSTITUTIONAL AMENDMENTS IN SENATE BILL 10, WHICH AMENDMENTS REMOVE RESTRICTIONS ON INVESTMENT OF PUBLIC FUNDS AND PROVIDE A 'PRUDENT EXPERT' STANDARD FOR INVESTMENT OF PUBLIC FUNDS; AMENDING SECTIONS 17-6-201, 17-6-211, and 17-6-324, MCA; AND PROVIDING A DELAYED EFFECTIVE DATE." SENATOR NEUMAN further stated that this bill implements Senate Bill 10 if it is passed. The bill will require amendment on page 8, line 15, a small amendment to change "banks" to "Financial institutions," which will include savings and loans as well as banks. If the amendment passes, it will allow up to 100% investment that is up to the expert, and this will be better for Montana.

PROPOSERS: SENATOR TOWE, Chairman of Investments Subcommittee 3, said the mechanics are to put into place California language and take out prudent man. We then felt it was not necessary to have the laundry list. I have been saying for a long time that the laundry list is not important and it is with great pleasure that everyone has concluded that we should get rid of the laundry list. He further stated that they had thought about repealing the whole section but decided that some of the language was still needed. We liked the idea of investing in Montana when prudent. If you think we need further language regarding dealing with Montana, we will put it in. That is no problem.

Carol Daly, Montana Economic Development Association, stated that they support the adoption of the amendments and the bills. If these are passed, it will give them more flexibility. I would assume you will include language regarding in-state investments.

Jim Howeth supports SENATE BILL 11.

OPPOSERS: There were no opposers.

SENATOR LYNCH stated that he was going to support the bills regardless of amendments, but he felt there should be stronger language regarding Montana investments. SENATOR NEUMAN felt that that would be like putting the laundry list in again and that they had tried to include that in the Build Montana Program of 25%. SENATOR TVEIT agreed with SENATOR LYNCH. Mr. Howeth felt that a prudent investor would have to take that into account when making an investment decision. There was more discussion involving investing in Montana. SENATOR TOWE was to work up some language for an amendment.

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SENATOR HAFHEY told the Committee that the members would work on some language regarding SENATOR LYNCH's proposal and that they would have executive action on Friday. SENATOR HAFHEY closed SENATE BILL 11.

SENATE BILL 78: SENATOR TVEIT presented SENATE BILL 78 saying, it is an act entitled, "AN ACT TO EXEMPT FIRE DEPARTMENT RELIEF ASSOCIATIONS HAVING ANNUAL RECEIPTS OF LESS THAN \$20,000 FROM AUDIT BY THE DEPARTMENT OF COMMERCE; AMENDING SECTION 2-7-503, MCA; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE." I have been told that in order to make it consistent, we have to amend page 3, line 2 following \$20,000 to read, except for audits as provided under 19-11-206. We wish to relieve fire department relief associations from having to pay for an audit by the Department of Commerce.

PROPOSERS: Art Korn, Montana State Volunteer Fire Association, said that they thought the 1983 amendment which exempted fire districts from the audit requirement would cover relief associations as well, but the Department of Commerce felt relief associations were still covered. He felt that someone with a small budget should not have to pay \$600.00 to be audited, such as ~~West~~by and Froid. He says there has never been an incidence of a volunteer fire department misappropriating funds. Some place like ~~West~~by he said only writes about 12 checks a year and it shouldn't have to be audited.

OPPOSERS: There were no opposers.

SENATOR LYNCH wanted to know if this had any effect on the legislative audit. Mr. Korn said it did. SENATOR LYNCH asked if they were getting audited twice. Mr. Korn said yes. SENATOR HAFHEY asked where they got their money, and Mr. Korn said they got part of the fire premiums that the cities paid and some contributions. SENATOR HIRSCH wanted to know if \$20,000 is a realistic figure and SENATOR TVEIT said yes.

SENATOR HAFHEY asked the Committee to act on SENATE BILL 78. SENATOR MANNING made a motion that SENATE BILL 78 be amended as suggested. SENATOR HIRSCH called question and it was passed unanimously. SENATOR MANNING made a motion that SENATE BILL 78 DO PASS AS AMENDED, and it was unanimously passed.

SENATE BILL 8: SENATOR HAFHEY read the amendments so everyone would understand them. SENATOR MANNING made a motion that this bill pass as amended. It was unanimously passed with SENATOR TVEIT voting no on SENATE BILL 8. SENATE BILL 8 was PASSED AS AMENDED.

SENATE BILL 9: SENATOR LYNCH moved that SENATE BILL 9 DO PASS. SENATOR MANNING called question and the bill was passed unanimously.

SENATOR HAFHEY announced that we would have executive action Friday on SENATE BILLS 10 and 11.

The meeting was adjourned at 11:20



DATE Jan. 15, 1985

COMMITTEE ON

VISITORS' REGISTER

[illegible]

(Please leave prepared statement with Secretary)



The Big Sky Country

Exhibit A
1-15-85
S B's 10 & 11

MONTANA STATE SENATE

HELENA, MONTANA 59601

January 15, 1985

TESTIMONY-Senate Bill 10 & 11

Members of the committee, my name is Ted Neuman. I am a senator representing the people of Senate District #21. I offer today for the committee's consideration senate bills 10 & 11 which, if enacted, would allow for the investment of Montana's unified investment program as a "prudent expert" would. They would remove the so-called laundry list of permissible investments and replace it with a broader range of investment opportunities that more accurately reflect today's investment climate under the prudent expert rule.

Before I begin discussion of the specifics of the bills, I would like to present you with a brief background of how the unified investment program functions. The unified investment program was established in the 1972 Montana Constitution under Article VIII Section 13. The unified investment program directs the Board of Investments and the Montana Economic Development Board to invest the public funds of the state, defines the duties of the Board of Investments, enumerates the separate funds to be

administered and lists the permissible investments of the separate funds.

The investment objective of the Board of Investments is to maximize the total return within proper risk tolerance and preserve the purchasing power of the funds during periods of high monetary inflation. Public Employees Retirement System and the Teacher's Retirement System return their investment and earnings income to their respective funds, but most of the other funds' income and earnings are only partially returned to the investment pool. The remainder goes to the general fund of the state and is appropriated by the legislature. In years when inflation exceeds the rate of return, the purchasing power of the funds is eroded. As an example, the coal trust fund lost 11.3% or 13.1 million dollars for the period 1978 thru 1983 adjusted to the Consumer Price Index, even though the trust fund generated 23 million dollars of general fund revenue during that same period.

In an effort to preserve the purchasing power of the trust and to offset some withdrawals to subsidize interest under the Water Development Program, the 1983 legislature required that 15% of the earnings and interest be returned to the trust fund. However, if we assume a 3% inflation rate and a 12% yield on investment, allocation of 15% of the earnings to the trust over a three year period, 1981-1983 would still

result in a loss of purchasing power of 1.3 million dollars to the coal trust.

It is easy to see that a greater share of the investment income must be returned to the funds, or investments of higher yield must be considered to preserve the purchasing power of the investment program. .

The legislature and the people of Montana have become accustomed to appropriating these investment earnings. A significant return of investment earnings to preserve capital would result in severe general fund shortages and probable tax increases or significant budget reductions.

Both possibilities are rather unpleasant to contemplate. The most reasonable approach to preserve the purchasing power of the separate funds is to maximize the total return by investing to receive the highest possible return within proper risk tolerance.

The laundry list of permissible investments under current law prevents us from maximizing our return to capital by prohibiting all but a small portion of investment of public funds in equities or real estate which would maximize yields during times of high inflation. At the same time, the prudent man rule tends only to preserve the principal of the funds with no great concern to maximize the total return as

a prudent expert would do. The prudent expert discharges his duties as any other expert would do with the same resources and familiar with like matters. This change would then require the board to act as other experts in the investment field to maximize the return in the interest of and for the benefit of the funds forming the unified investment program.

Since the Montana Economic Development Board is also charged with investing a portion of the unified investment program (i.e. 25% of coal trust) for economic development, it is only fair that they be compared to experts in the area of economic development -- not experts in the area of investments, as would be the comparison of the Board of Investments.

The constitutional amendment would appear on the Nov. 1986 ballot. If it passed, the statutory amendments would become effective January 1, 1987. Thank you Mr. Chairman and members of the committee.

Ted Neuman

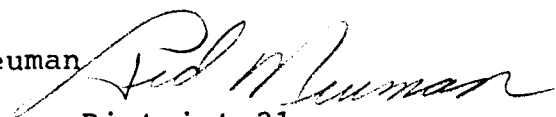

Senator - District 21

Exhibit "C")

SB-78

1-15-85

SB78

1. Page 3, line 2.

Following: "\$20,000"

Insert: ", except ~~as provided~~ for audits
as provided under 19-11-206"

Exhibit B
S B-8
1-15-85

SENATE BILL 8, introduced (white), be amended as follows:

1. Page 2, lines 1 and 3.

Following: "members,"

Insert: ", appointed by the governor as prescribed in 2-15-124"

2. Page 2, line 3.

Following: "shall"

Strike: ", in accordance with 2-15-124,"

3. Page 2, lines 9 and 10.

Following: "2-15-1010" on line 9

Strike: The remainder of lines 9 and 10 through "senate"

PLEASE LEAVE ANY PREPARED STATEMENTS WITH THE COMMITTEE SECRETARY

STANDING COMMITTEE REPORT

January 15

1985

MR. PRESIDENT

We, your committee on **STATE ADMINISTRATION**

having had under consideration

SENATE BILL No. **8**

first reading copy (white)
color

RETIREMENT SYSTEMS' REPRESENTATION ON BOARD OF INVESTMENTS

Respectfully report as follows: That

SENATE BILL No. **8**

be amended as follows:

1. Page 2, line 1.

Following: "members,"

Insert: ", appointed by the governor as prescribed in 2-15-124"

2. Page 2, line 3.

Following: "shall"

Strike: ", in accordance with 2-15-124,"

3. Page 2, lines 9 and 10.

Following: "2-15-1010" on line 9

Strike: The remainder of lines 9 and 10 through "senate"

AND AS AMENDED

~~DO PASS~~

~~DO NOT PASS~~

Chairman.

STANDING COMMITTEE REPORT

January 15

19 85

MR. PRESIDENT

We, your committee on **STATE ADMINISTRATION**

having had under consideration **SENATE BILL** No. **9**

first reading copy (**white**)
color

ADDING FOUR EXEMPT POSITIONS FOR BOARD OF INVESTMENTS

Respectfully report as follows: That **SENATE BILL** No. **9**

~~DO PASS~~

~~DO NOT PASS~~

Chairman.

dw

STANDING COMMITTEE REPORT

January 15 19 85

MR. PRESIDENT

We, your committee on **STATE ADMINISTRATION**

having had under consideration **SENATE BILL** No. **78**

first reading copy (**white**)
color

EXEMPTING CERTAIN FIRE DEPARTMENT RELIEF ASSOCIATIONS FROM AUDIT

Respectfully report as follows: That **SENATE BILL** No. **78**

be amended as follows:

1. Page 3, line 2.

Following: **"\$20,000"**

Insert: **", except for audits as provided under 19-11-206"**

AND AS AMENDED

~~DO PASS~~

~~DO NOT PASS~~

Chairman.

dw