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Senate Bills 643 and 644 (as introduced 6-23-05)
Sponsor: Senator Michael D. Bishop (S.B. 643)
Senator Gerald Van Woerkom (S.B. 644)
Committee: Finance

Date Completed: 10-3-05

CONTENT

Senate Bill 643 would amend the Revised School Code, and Senate Bill 644 would amend Public Act 20 of 1943 (which governs the investment of funds of public corporations) to revise the types of instruments in which the funds of school districts and intermediate school districts, or public corporations, may be invested.

The bills are described in detail below.

Senate Bill 643

Under the Revised School Code, the treasurer of an intermediate school district (ISD), if authorized by resolution of the board, may invest general operating funds, general education funds, area vocational-technical education funds, building and site funds, cooperative education funds, and debt retirement funds of the district. Additionally, the treasurer of a school district, if authorized by the board of the district, may invest debt retirement funds, building and site funds, building and site sinking funds, or general funds of the district.

The investments are restricted to the following:

- Bonds, bills, or notes of the United States or obligations of the State.
- Certificates of deposit issued by a financial institution.
- Commercial paper rated prime at the time of purchase and maturing not more than 270 days after the date of purchase.
- Securities issued or guaranteed by agencies or instrumentalities of the United States government.
- United States government or Federal agency obligation repurchase agreements.
- Bankers' acceptances issued by a bank that is a member of the Federal Deposit Insurance Corporation (FDIC).
- Investment pools, as authorized by the Surplus Funds Investment Pool Act, composed entirely of instruments that are legal for direct investment by a district.
- Mutual funds composed entirely of investment vehicles that are legal for direct investment by a district.

A school district also may invest in obligations whose principal and interest are fully guaranteed by the United States, and in share certificates of a State or Federal credit union that is a financial institution.

Under the bill, the investments would be restricted to one or more of the following:

- Bonds, bills, or notes issued directly by the U.S. Department of Treasury.
- United States Department of Treasury bonds, bills, or notes for which the interest and principal had been separated and sold individually as zero-coupon bonds.

- Certificates of deposit issued by a rated financial institution (and, in the case of school districts, share certificates of a rated State or Federal credit union that was a financial institution).
- Commercial paper rated prime at the time of purchase, or short-term corporate obligations rated AAA at the time of purchase, issued by a U.S.-domiciled entity and maturing not more than 270 days after the date of purchase.
- Bonds or notes issued directly from, or guaranteed by, an agency or government-sponsored enterprise of the United States, in the same form as when they were issued.
- United States government agency or government-sponsored enterprise obligation repurchase agreements, reverse purchase agreements, or government lending agreements.
- Bankers' acceptances issued by a rated bank that was a member of the FDIC.
- Mutual funds composed entirely of investment vehicles that were legal for direct investment by an ISD or school district.
- Investment pools, as authorized by the Surplus Funds Investment Pool Act, composed entirely of instruments that were legal for direct investment by an ISD or school district.
- Debt obligations of the State or a political subdivision of the State that at the time of purchase were rated at least AA as determined by at least one recognized standard rating service and having a final maturity date that was within four years of the purchase date.
- Obligations of a political subdivision of another state that at the time of purchase were rated at least AA as determined by at least one recognized standard rating service and having a maturity date that was within 12 months of the purchase date or subject to a redemption that was backed by a letter of credit and that was not greater than 12 months from purchase.
- Agreements to lend bonds, bills, or notes of the United States, an agency of the United States, or a government-sponsored enterprise of the United States.

Agreements to lend bonds, bills, or notes would have to meet all of the following conditions:

- Require that all collateral held in the form of a U.S. Treasury bond or note or other U.S. agency bond or note, or cash, be maintained at a value equal to or greater than 102% of the market value of the securities or cash that had been lent; and require the custodian of the collateral to determine its value at least once per day on days when the New York Federal Reserve Bank was open.
- If the transaction involved a reverse repurchase agreement or a securities lending agreement, require that agreement to be transacted through a qualified lending agent.
- Require that a qualified Michigan custodial bank serve as custodian for that agreement.
- Require that all maturity dates for investments made from cash received as collateral not have a maturity date beyond the final date agreed upon for return of the collateral.
- If a transaction involved a government lending agreement or reverse repurchase agreement, require that the district provide at least three business days' notice to all parties involved in the agreement before selling or transferring its interest in any bond, bill, or note lent during the term of the agreement.

An ISD or school district would have to ensure that an investment was held in custody or safekeeping by a financial institution. The district could not invest money in an investment not specifically listed.

Under the Act, "deposit" includes the purchase of or investment in shares of a credit union. The bill would refer to shares of a rated Michigan credit union.

Under the Act, "financial institution" means a State or nationally chartered bank or a State or Federally chartered savings and loan association, savings bank, or credit union whose deposits are insured by an agency of the United States government and that maintains a principal office or branch office located in the State under the laws of the State or the United States. The bill would delete reference to a principal office and would require a financial institution to maintain at least one branch office located in the State.

The bill would define "government-sponsored enterprise" as a privately held corporation with a public purpose that is created by Federal statute. "Qualified lending agent" would mean an entity that is regulated by the U.S. Securities and Exchange Commission that manages or controls investments, or similar agreements, with market values of at least \$5 billion. "Qualified Michigan custodial bank" would mean a financial institution that has expertise in serving as a custodian for securities lending and reverse repurchase agreements.

Senate Bill 644

Under the Public Act 20 of 1943, a public corporation is a county, city, village, township, port district, drainage district, special assessment district, or metropolitan district of the State, or a board, commission, or another authority or agency created by or under an act of the Legislature.

Except as otherwise provided, the governing body of a public corporation, by resolution, may authorize its investment officer to invest the funds of that public corporation in one or more of the following:

- Bonds, securities, and other obligations of the United States or an agency or instrumentality of the United States.
- Certificates of deposit, savings accounts, deposit accounts, or depository receipts of a financial institution, but only if the financial institution is eligible to be a depository of funds belonging to the State under a law or rule of the State or United States.
- Commercial paper rated at the time of purchase within the two highest classifications established by at least two standard rating services and that matures not more than 270 days after the date of purchase.
- Repurchase agreements consisting of bonds, securities, and other obligations of the United States or an agency or instrumentality of the United States.
- Bankers' acceptances of U.S. banks.
- Obligations of the State or any of its political subdivisions that at the time of purchase are rated as investment grade by at least one standard rating service.
- Obligations described above if purchased through an interlocal agreement under the Urban Cooperation Act.
- Investment pools organized under the Surplus Funds Investment Pool Act.
- Investment pools organized under the Local Government Investment Pool Act.
- Mutual funds registered under the Federal Investment Company Act, with authority to purchase only investment vehicles that are legal for direct investment by a public corporation.

Under the bill, except as otherwise provided, the governing body of a public corporation, by resolution, could authorize its investment office to invest the funds of that public corporation in one or more of the following:

- Bonds, bills, or notes issued directly by the U.S. Department of Treasury or issued directly from, or guaranteed by, a United States sponsored enterprise.
- Certificates of deposit, savings accounts, deposit accounts, depository receipts, or pooled money market funds of a financial institution (as defined in the bill).
- Commercial paper rated prime at the time of purchase, or short-term corporate obligations rated AAA at the time of purchase, issued by a United States-domiciled entity and maturing not more than 270 days after the date of purchase.
- Bankers' acceptances of Michigan banks.
- Obligations of the State or any of its political subdivisions that at the time of purchase were rated at least AA as determined by at least one recognized standard rating service and having a maturity date within 48 months of the date of purchase.
- Obligations of a political subdivision of another state that at the time of purchase maintained a rating of AA as determined by at least one standard rating service and having a maturity date within 12 months of the purchase date.

- Repurchase agreements or reverse repurchase agreements consisting of bonds, bills, or notes issued by the U.S. Department of Treasury or issued directly from, or guaranteed by, a United States sponsored enterprise or U.S. government or agency lending agreements.

Repurchase agreements, reverse repurchase agreements, and U.S. government and agency lending agreements would have to meet all of the following requirements:

- The collateral was maintained in the form of cash, bonds, bills, or notes issued by the U.S. government or a U.S. government sponsored enterprise, and maintained at a level not less than 102% of the market value of the securities or cash; and the collateral was valued at least once each day the New York Federal Reserve Bank was open for business.
- For reverse repurchase agreements and government lending agreements, the agreement was required to be transacted through a qualified lending agent that had at least \$5 billion in securities loans and contracts.
- A qualified Michigan bank served as custodian for the agreement.
- All maturity dates for any investments made from cash received as collateral did not have a maturity date or mandatory put date that exceeded the final date agreed upon for the return of collateral.

Under the Act, "financial institution" means a State or nationally chartered bank or a State or Federally chartered savings and loan association, savings bank, or credit union whose deposits are insured by an agency of the U.S. government and maintains a principal office or branch office located in the State under the laws of the State or the United States.

Under the bill, "financial institution" would mean a State or nationally chartered bank or a State or Federally chartered savings and loan association, savings bank, or credit union whose deposits are insured by an agency of the U.S. government and that meets one of the following:

- Maintains a principal office or branch office located in this State.
- Maintains at least 50% of its branches in this State.
- Serves 5% or more of the State population.

MCL 380.622 & 380.1223 (S.B. 643)
129.91 (S.B. 644)

Legislative Analyst: J.P. Finet

FISCAL IMPACT

The bills would have an indeterminate and potentially significant impact on both the State and local units. The bills generally would both expand the potential investments available as well as limit other types of investments. For example, under both bills investment in bonds issued by the State of Michigan would not be allowed if the State's credit rating were to fall below AA. However, both bills would allow investments in reverse repurchase agreements and participation in securities lending agreements. Other requirements in the bills would place additional restrictions on the institutions or businesses that handle transactions for investments. The impact would depend upon the portfolios of the intermediate school districts, school districts, public corporations, and other local units of government affected by the bills. Depending on the portfolios and the investment strategies, the bills would increase or decrease costs and/or increase or decrease income received from investments.

This estimate is preliminary and will be revised as new information becomes available.

Fiscal Analyst: Joe Carrasco
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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.