

Department of Legislative Services
 Maryland General Assembly
 2006 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 330 (Senator Lawlah, *et al.*)
 (Chairman, Joint Committee on the Management of Public Funds)

Budget and Taxation

Appropriations

State Treasurer - Authorized Investments - Commercial Paper

This bill authorizes the State Treasurer to increase the level of investment or reinvestment in “commercial paper” (drafts, promissory notes, bank checks, and other negotiable instruments for the payment of money) from a maximum of 5% to a maximum of 10% of the total investment portfolio. The commercial paper must have received the highest letter and numerical rating from at least two nationally recognized statistical rating organizations designated by the U.S. Securities and Exchange Commission. The bill also authorizes investment or reinvestment in money market mutual funds with commercial paper holdings. The money market mutual funds must have received the highest possible rating from at least one nationally recognized statistical rating organization designated by the U.S. Securities and Exchange Commission.

The Treasurer must notify local governments that are required to have specified local investment policies of the changes contained in the bill so that they have the opportunity to review, revise, and report any changes in those policies.

Fiscal Summary

State Effect: General fund revenues could increase by \$94,300 in FY 2007. Out-years reflect annualization and assume the size and amount of lendable securities subject to commercial paper investment remain stable.

(in dollars)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	\$94,300	\$125,700	\$125,700	\$125,700	\$125,700
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	\$94,300	\$125,700	\$125,700	\$125,700	\$125,700

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: For those local governments that choose to increase their level of investment in commercial paper or the specified money market mutual funds, revenues could increase. For those local governments that choose not to increase their level of investment, the bill is not expected to have a fiscal impact.

Small Business Effect: None.

Analysis

Current Law: The Treasurer is authorized to invest or reinvest unexpended or surplus money in commercial paper, provided that the level of investment does not exceed 5% of the total investment portfolio. The commercial paper must have received the highest letter and numerical rating from at least one nationally recognized statistical rating organization designated by the U.S. Securities and Exchange Commission. The Treasurer is authorized to invest in money market mutual funds that contain only securities where the United States has pledged full faith and credit, obligations issued by a federal agency or instrumentality, or repurchase agreements by an obligation of the United States, collateralized as specified in statute.

The Treasurer is required to report to the General Assembly annually by January 3 on investment activities. At a minimum, the report must contain the following information for general fund investments and all other investments:

- the inventory of investments with maturity dates and the book and market value as of June 30;
- the earned net income;
- the percentage share of each category of investment in the portfolio; and
- sales of investments prior to the maturity date.

The Treasurer is required to make investments with care, skill, prudence, and diligence. Investments must reasonably match the State's cash flow so that sufficient funds are available to pay obligations as they become due. The Treasurer must also maintain a reasonable amount of cash on hand for unanticipated needs. Investments must be made with due regard for minimizing the risks while maximizing return. Competitive purchasing practices must be used unless impractical. Investments must be made in

accordance with a written investment policy and they must be made so that securities and collateral may be priced on a market-to-market basis. The Treasurer must also avoid the enhancement of his/her personal financial position and avoid enhancing the personal financial positions of employees who are responsible for managing investments with State funds.

Background: This bill was proposed by the State Treasurer during a hearing held by the Joint Committee on the Management of Public Funds on October 25, 2005. The Treasurer asked the committee to sponsor the bill so that the threshold for investment in commercial paper could be increased to allow more diversity in local government investment portfolios.

Each county has an investment policy that is limited by what State law allows. The Treasurer is responsible for oversight of local government investment policies. Currently, local governments may invest a maximum of 5% of their portfolios in commercial paper of only the highest grade. Many local governments do not purchase commercial paper because the 5% threshold is considered too low. Local government representatives who testified at the hearing advised that an increase in the maximum level of investment would provide investment flexibility and allow local governments to acquire additional interest income as interest rates increase, without a major increase in risk. The default ratio for high quality commercial paper is generally negligible. In recent years, there have been only two defaults of commercial paper compared to the trillions of dollars in commercial paper investments that have occurred.

In other states with “AAA” bond ratings, the authority of local governments to invest in commercial paper varies. Some states do not allow local governments to invest in any commercial paper, while others allow as much as 50% of the local portfolio to contain commercial paper.

State Revenues: The Treasurer advises that the State investment portfolio currently contains no commercial paper. However, the Treasurer’s Securities Lending Program uses the full 5% threshold for commercial paper investment as a security (or collateral) for “repurchase agreements” in the Securities Lending Program. A repurchase agreement is an agreement in which a party that owns securities acquires money by transferring the securities to another party under an agreement to repurchase the securities at an agreed upon future date. Increasing the level of authorized commercial paper investment from 5% to 10% is anticipated to free up other securities that are currently used as collateral under repurchase agreements. This could increase revenues, with the assumption of relatively minor risk. Based on this, general fund revenues could increase \$94,307 in fiscal 2007, accounting for the bill’s October 1 effective date. Anticipated general fund revenues for a full year could vary. However, the estimate of \$125,743 annually in the

out-years assumes that the amount of lendable securities in the State Securities Lending Program remains stable.

Local Revenues: For those local governments that invest in commercial paper, the increase in allowable commercial paper investment from 5% to 10% and the authorized investment in money market mutual funds with commercial paper holdings are anticipated to increase revenues. Montgomery County advises that the increase in allowable investments would increase revenues by \$82,000 in fiscal 2007 (\$50,000 from expanded commercial paper investment and \$32,000 from expanded money market mutual fund investment). Montgomery County advises that commercial paper investment incurs only minor risk. As a result, investment revenues are likely to increase an average of about \$80,000 annually.

On the other hand, Harford County advises that although the bill would increase investment opportunity in commercial paper, their investment portfolio has never held the currently authorized 5% threshold due to concerns about the risk associated with these investments compared to those associated with investing in government securities. As a result, the bill is not expected to have a fiscal impact. St. Mary's County also advises that the bill is not expected to have a fiscal impact.

Additional Information

Prior Introductions: None.

Cross File: HB 257 (Delegate Heller, *et al.*) (Chairman, Joint Committee on the Management of Public Funds) – Appropriations.

Information Source(s): Montgomery County, Prince George's County, Harford County, Queen Anne's County, St. Mary's County, Carroll County, Treasurer's Office, Department of Legislative Services

Fiscal Note History: First Reader - February 6, 2006
mll/ljm Revised - Senate Third Reader - March 28, 2006
Revised - Enrolled Bill - April 25, 2006

Analysis by: Karen D. Morgan

Direct Inquiries to:
(410) 946-5510
(301) 970-5510