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October 1, 1976

Alaska State Investment Advisory Committee  
State of Alaska

Dear Committee Member:

In accordance with your request, we have undertaken a survey of domestic, foreign and international development banks, funds and development programs for your use in determining the future structure and objectives of the Alaska Permanent Fund. In performing our survey, we have selected those banks, funds or development programs which are of major importance, as well as those which are particularly relevant to Alaska's situation in that they are either based upon natural resource revenues or confined to a limited geographic area.

Our analysis of domestic permanent funds focused on those states which received income from a finite natural resource and the manner in which that income was expended. The majority of states receiving income from finite natural resources spend that income on a current basis. Those states and the application of income are set forth in tabulation form. States which accumulate natural resource income in a trust fund are set forth individually.

Each state has created programs to assist and encourage economic developments. A description of the Government Development Bank of Puerto Rico and the Pennsylvania Industrial Development Authority has been included in this study. A summary of state general assistance, incentives and special services to industry has also been included. In depth information on each particular economic development program has been requested from each state's development agency and will be sent along, as received, to Mr. Edenso for inclusion in the source file of all background information we are putting together for the Committee.

Substantially all of the less developed nations of the world, and a certain number of the more developed nations, have government owned or controlled entities whose purpose is to participate in the financing of local economic development projects. In most of the small nations, these entities

Alaska State Development  
Advisory Committee

October 1, 1976

function principally as the vehicle through which development funds are dispersed to the economy by the government and are consequently heavily involved in the internal political process. In many cases, these entities also act as the conduit through which development funds provided by the larger international development banks and funds are invested in smaller projects in the country concerned. One of the advantages of the latter process is that the use of the local bank as a vehicle permits the larger institution's loan to receive a government guarantee, which is commonly a prerequisite for the extension, or the initial extension, of credit to the country. In most countries, the development banks and funds that perform the above functions also serve as the means through which internal economic growth is directed and channeled in accordance with national economic policies and are, in effect, extensions of the local economic ministry.

The institutions covered by our survey which fall into this category are the Swedish Investment Bank, Japan Development Bank and National Financiera S. A. (Mexico). All of these entities are government owned institutions which both borrow funds in various capital markets and lend domestically for development purposes. In each case, the institutions are responsible for carrying out national economic policy through their activities and enjoy various degrees of autonomy from the national political process. The most independent is the Swedish Investment Bank and the least is National Financiera S. A. Both National Financiera and Japan Development Bank appear to be heavily involved in the political process in their respective countries, and the former has acted as a conduit for World Bank lending in Mexico.

The larger development banks and funds are international institutions whose memberships consist of several countries and whose purpose is to foster the economic growth and development of a particular region or its members. In general, these entities represent potent world-scale economic forces and tend to be both non-political and commercial in their operations. The financial strength of these entities is typically based on the uncalled capital subscriptions of their members, and virtually all of them borrow heavily, both locally and in the international capital markets. Substantially all of the activities of these institutions consist of direct lending for specific projects in the various countries, and lending policies appear to be determined on social benefit as well as economic grounds. As a result, and to the extent that many major industrial nations are commonly among the larger contributing members of these institutions and receive no benefits, they can be viewed as quasi "foreign aid" banks.

Among such international and regional development institutions covered by our survey, the most significant is the International Bank for Reconstruction and Development (World Bank), both in terms of its worldwide membership and the international scope and significance of its lending activities. Importantly, all of the other international institutions included in our review (Inter-American Development Bank, Asian Development Bank and African Development Bank)

Alaska State Development  
Advisory Committee

October 1, 1976

have been created with the assistance of, or modeled after, the World Bank, both operationally and in financial structure. Of these three derivative institutions, only the African Development Bank is not a significant international borrower and depends heavily on loans from other institutions, such as the World Bank. This characteristic results from the fact that its uncalled capital funds are to be provided by countries that are not viewed as being particularly strong by the world capital markets and that a significant private capital market in black Africa does not exist. Two other institutions which fall somewhat into this category in that their activities are regionalized are the European Investment Bank and the European Coal and Steel Community, both of which are related to the European Economic Community (Common Market). Significantly, while both borrow in various capital markets and re-lend for projects consistent with their purpose, the credit strength of the European Coal and Steel Community is based fundamentally on the strength of the private steel industry in Europe. European Investment Bank is modeled along the lines of the World Bank and depends on the credit of the various EEC member states.

The remaining type of institution is one which functions in a limited geographic area or within a particular industry to promote economic growth and development or to achieve a social objective and is based on local or regional resources. Of the three basic groups of international development institutions, this group contains the smallest number of entities and is, perhaps, the most analogous to the situation in Alaska. These development institutions or funds are new and, to a large degree, based on natural resource revenue. Significantly, only two are international in scope; others are modeled after the World Bank but limited in their activities to a defined geographic region, ethnic grouping or social purpose. The remainder are "national" investment funds. The majority of these funds are based in the Middle East and dependent upon oil related revenues. Those that have an international scope are the Saudi Development Fund and the Arab Bank for Economic Development in Africa, both of which were created after the increase in world oil prices in recognition of the balance of payments and development problems created in the developing states by such increase. The remaining funds (Arab Fund for Economic and Social Development, Abu Dhabi Fund for Arab Economic Development, the Islamic Development Bank and the Kuwait Fund for Arab Economic Development), although created at approximately the same time, reflect in both the source of their capital (member states' subscriptions or allocation of national revenues) and their purposes the Arab nationalism which emerged after the Mid-East wars. Importantly, most of these funds have yet to become fully operational, and it is too early to judge their potential significance. The two "national" investment funds, the two which you may find are the most directly related to the proposed Alaska Permanent Fund, are the Fondo de Inversiones de Venezuela and the Alberta Heritage Savings Trust Fund. The similarities extend to both source and purpose, as can be seen in the studies included herewith.

Alaska State Development  
Advisory Committee

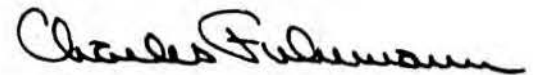
October 1, 1976

It is premature to recommend to the Committee certain key features of any one of these banks, funds or development programs over the others until it has had a chance to digest the information in our survey and to review the source file we are also providing. We are available to detail the differences as we see them and to discuss other alternatives available to Alaska.

Following the Committee's meeting on October 13, which we will be attending, we will want to sponsor visits by Committee members at least to Alberta to meet with their Heritage Savings Trust Fund counterparts. Visits to New Mexico and to New York would also appear advisable.

We look forward to our next meeting in Anchorage.

Sincerely yours,



Charles J. Fuhrmann II  
First Vice President

CJF:yu  
Attachment

## TABLE OF CONTENTS

- I Domestic Permanent Funds
  - Montana Resource Indemnity Fund
  - New Mexico State Permanent Fund
  - New Mexico Severance Tax Bonding Fund
  - New Mexico Severance Tax Permanent Fund
  - New Mexico Severance Tax Income Fund
  - Texas Permanent University Fund
  - Wyoming University Permanent Land Fund
  - Wyoming Permanent Mineral Trust Fund
  - Wyoming Government Royalties Fund
  - Summary of Certain Other States
  
- II Domestic Economic Development Programs
  - The Government Development Bank of Puerto Rico
  - The Pennsylvania Industrial Development Authority
  - Summary of States' General Assistance, Incentives and Special Service to Industry
  
- III National Institutions
  - Swedish Investment Bank Ltd.
  - Japan Development Bank
  - National Financiera S.A.
  
- IV International and Regional Development Institutions
  - International Bank for Reconstruction and Development (World Bank)
  - Inter-American Development Bank
  - Asian Development Bank
  - African Development Bank
  - European Investment Bank
  - European Coal and Steel Community
  
- V Natural Resource Related Institutions
  - Saudi Development Fund
  - Arab Bank for Economic Development in Africa
  - Arab Fund for Economic and Social Development
  - Abu Dhabi Fund for Arab Economic Development
  - Islamic Development Bank
  - Kuwait Fund for Arab Economic Development
  - Fondo de Inversiones de Venezuela
  - Alberta Heritage Savings Trust Fund

**Exhibit I**

Institution: (Montana) Resource Indemnity Fund  
created in 1974

Location: Helena, Montana

Size:

Capital Funds: \$4.5 million

Purpose: The Resource Indemnity Fund was created to accumulate income from a Severance Tax on Coal and other minerals for the purpose of providing moneys to enhance the State ecological environment and rectify damage thereto. Accumulations in the Fund shall continue until the Fund reaches \$100 million.

Source of Funds: Moneys are deposited in the Fund from a severance tax on various minerals and  $2\frac{1}{2}\%$  of the Severance Tax on Coal.

Management Structure: Moneys are collected and deposited in the Fund by the Department of Revenue. Investments in the Fund are made in accordance with guidelines established by the State Board of Investments which is composed of five private citizens appointed by the Governor for 5 year terms.

Management of Funds: Moneys are invested in debt instruments authorized by State Statutes.

Portfolio: Moneys are currently invested in corporate bonds that have been rated A or better by Moody's Investors Service and Standard & Poor's Corporation.

Income: Income from investments remain in the Fund until \$10 million has been accumulated. After the accumulation of \$10 million, income may be used for enhancement or repair of the environment.

Institution: (New Mexico) State Permanent Fund  
created in 1898

Location: Santa Fe, New Mexico

Size:

Assets: 10 million acres  
Capital Funds: \$675 million

Purpose: The State Permanent Fund was established to collect royalties and other income from the lease of State-owned land. Income from the Fund is applied to the New Mexico public school systems and educational and eleemosynary institutions.

Source of Funds: Moneys in the Fund were initially provided from the sale of State land. Currently, revenues to the Fund are provided from royalties and income from State-owned lands under lease. Such revenues include oil and gas royalties and grazing and timber leases. In addition, any capital gains on investments remain in the Fund.

Management Structure: The State Permanent Fund is managed by the State Investment Council. Members of the Council include the Governor, the State Treasurer, the Commissioner of Public Lands, the Finance Officer and four public members who are appointed by the Governor for terms of five years.

Management of Funds: The State Investment Officer is responsible for investing moneys in the State Permanent Fund. Fifty per cent of the Fund must be invested in Federal Securities. The remainder may be invested according to State Statutes.

Portfolio: The Fund is currently invested as follows: 18% equity, 32% corporate obligations and 50% U.S. Government and Federal Agency Obligations.

Income: Income from the Fund is distributed to the public school system (80%) and the remainder to educational and eleemosynary institutions.

Institution: (New Mexico) Severance Tax Bonding Fund, created in 1941

Location: Santa Fe, New Mexico

Size:

Capital Funds: \$9,040,756.02

Purpose: The Severance Tax Bonding Fund was created to secure tax-exempt bonds issued for public capital projects.

Source of Funds: Moneys derived from the levy of the New Mexico Severance Tax on severed natural resources are paid in their entirety to this Fund. Additional sources of income include revenues from projects financed with Severance Tax Bonds and receipts from ground rentals of Public Buildings. Moneys in excess of the next two semi-annual payments on all outstanding Severance Tax Bonds are transferred to the Severance Tax Permanent Fund.

Management Structure: The Fund is managed by the State Treasurer under the supervision of the State Board of Finance. The State Board of Finance consists of the Governor, Lieutenant Governor and three private citizens appointed by the Governor for two year terms. The State Treasurer is responsible for repayment of principal and interest on Severance Tax Bonds.

Management of Funds: Moneys in the Fund are invested in debt instruments authorized by State Statutes.

Portfolio: N.A.

Income: All moneys in the Severance Tax Bonding Fund except an amount sufficient to repay principal and interest on the Severance Tax Bonds on the next ensuing semi-annual payment date is transferred to the Severance Tax Permanent Fund.

Indebtedness Limitation: The State Board of Finance may issue additional Severance Tax Bonds payable from the Severance Tax Bonding Fund provided that aggregate annual debt service on Bonds outstanding including the proposed issue be equal to no more than 50% of previous fiscal year's deposits into the Severance Tax Bonding Fund.

Institution: (New Mexico) Severance Tax Permanent Fund created in 1971

Location: Santa Fe, New Mexico

Size:

Capital Funds: \$103 million, currently accruing at rate of \$4 million per month.

Purpose: The Severance Tax Permanent Fund was created to encourage economic development in the State of New Mexico.

Source of Funds: Moneys in the Severance Tax Permanent Fund are provided from the New Mexico Severance Tax levied for the privilege of severing natural resources including oil and gas, potash, copper, uranium, timber, coal and certain other minerals. Proceeds from the Severance Tax are deposited in the Severance Tax Permanent Fund after the required payments to the Severance Tax Bonding Fund.

Management Structure: The Fund is managed by the State Treasurer under the supervision of the State Board of Finance. The State Board of Finance consists of the Governor, Lieutenant Governor and three private citizens appointed by the Governor for terms of two years.

Management of Funds: Moneys in the Fund may be invested at the discretion of the State Board of Finance. Moneys currently are invested by the State Treasurer in Certificates of Deposit of State banks who in turn make loans for capital projects to the private sector. Loan feasibility and appropriateness of the capital project is left entirely up to the bank. Participation by the Fund in sizeable loans by State banks requires the approval of the State Board of Finance. The principal of the Fund may be used for economic development purposes upon the approval of the State Board of Finance. An amendment to require 3/4's approval of the legislature prior to invasion of the principal of the Severance Tax Permanent Fund is on the November ballot.

Portfolio: Approximately \$94 million of the Fund is invested in Certificates of Deposits of State banks maturing one to five years at a floating rate of short term treasury obligations plus 50 basis points. The remainder is invested under Repurchase Agreements.

Income: Income from the Severance Tax Permanent Fund is transferred to the Severance Tax Income Fund.

Institution: (New Mexico) Severance Tax Income Fund created in 1971

Location: Santa Fe, New Mexico

Size:

Capital Funds: \$2.2 million as of 9/27/76

Purpose: The Severance Tax Income Fund was created to finance public capital improvement projects.

Source of Funds: Income from the investments of the Severance Tax Permanent Fund is deposited in this Fund.

Management Structure: Moneys are invested and disbursed by the State Treasurer under the supervision of the State Legislature.

Management of Fund: Pending appropriation for capital projects, moneys are invested under Repurchase Agreements.

Portfolio: N.A.

Income: Income from the Fund is transferred to the State General Fund.

Institution: Texas Permanent University Fund created in 1881

Location: Austin, Texas

Size:

Assets: 2,100,000 acres of land in nineteen West Texas counties  
Book value 8/31/75 \$781,771,634.49

Purpose: Fund created by provisions of the Texas Constitution in order to enable the State Legislature to carry out the purpose, as declared by the Republic of Texas and later in early State Constitutions, of creating a State University. The Constitutional provisions set aside all lands previously appropriated for the creation of a State University, together with the proceeds of any sale thereof, to create a Permanent University Fund. All moneys available in the Fund are to be invested in securities, the income from which will be appropriated by the Legislature, in order to accomplish the purpose of creating, maintaining, supporting and directing a university for the promotion of literature, and the arts and sciences, including an agricultural and mechanical department.

Source of Funds: Funds are accumulated annually in the Fund from oil, gas and water royalties, gains on investments, mineral lease rentals, lease bonuses, and any proceeds of land sold. The Permanent Fund shall be forever kept intact and all annual income shall become part of the Fund.

Management Structure: The Fund is held by the Treasurer of the State of Texas and invested by direction of the Board of Regents of the University of Texas. The Board of Regents consists of nine members who serve without compensation. They are appointed by the Governor for six year terms subject to approval by the Senate.

Management of Funds: The Fund is invested in permitted securities which are bonds of the United States, the State of Texas, or counties of the State, or in school bonds of municipalities in the State, or bonds of any city in the State, or in bonds issued under the Federal Farm Loan Act. In addition, the Fund may be invested in securities, bonds or other obligations issued, insured or guaranteed in any manner by the U.S. Government, or any of its agencies, and in bonds, debentures, or obligations, and preferred and common stocks issued by corporations, associations, or other institutions as the Board of Regents deem to be proper, provided that not more than 1% of the Fund will

Management of Funds:  
continued

to be invested in the securities of any one corporation nor more than 5% of the voting stock of any one corporation be owned. In addition, stocks purchased will be only in companies incorporated in the U.S. and who have paid dividends for at least five consecutive years and, except for bank or insurance company stocks, are listed on a registered stock exchange.

Portfolio:

Capital Funds (August 31, 1975)	
Securities, cash and equivalent at cost	\$781,771,634.49
U.S. Governments	
Direct Obligations	106,828,987.45
Guaranteed	103,089,999.03
Corporate Bonds	279,571,990.53
Convertible Debentures & Preferreds	16,440,190.64
Common Stocks	254,425,102.52
Short Term Securities & Cash	21,415,364.32
	<u>21,415,364.32</u>
Total	\$781,771,634.49

Income:

The income from Fund investments is appropriated annually by the State Legislature; two-thirds to the University of Texas and one-third to Texas A & M. The income of the Fund may be used only for permanent improvement and not for current expenses. Prior to the distribution of the income of the Fund, provision is made for the expenses of administering the Fund.

Institution: (Wyoming) University Permanent Land Fund created in 1881

Location: Cheyenne, Wyoming

Size:

Assets: 34,492 acres

Capital Funds: \$8,565,000

Purpose: The University Permanent Land Fund was created to receive income from lands granted to Wyoming to be used for the financial benefit of the University of Wyoming. Income from the Fund is used to support capital projects of the University.

Source of Funds: Moneys in the Fund are provided from income received on specific State-owned lands.

Management Structure: The State Treasurer is responsible for investing the Fund. Income from the Fund is transferred to the Treasurer of the University of Wyoming.

Management of Funds: The State Treasurer invests the Fund in debt instruments authorized by State Statutes.

Portfolio: N.A.

Income: Income from the Fund is transferred to the University of Wyoming.

Institution: (Wyoming) Permanent Mineral Trust Fund created in 1974

Location: Cheyenne, Wyoming

Size:

Capital Funds: \$51,250,000

Purpose: The Permanent Mineral Trust Fund was created to retain moneys collected from a Severance Tax on all minerals. Moneys in the Fund may be used for loans to political subdivisions upon legislative approval.

Source of Funds: Collections of a Severance Tax on all minerals are placed in the Fund.

Management Structure: The State Treasurer is responsible for managing and investing this Fund.

Management of Funds: Moneys are invested in debt instruments authorized by State Statutes.

Portfolio: N.A.

Income: Income from the Permanent Mineral Trust Fund is transferred to the State's General Fund.

Institution: (Wyoming) Government Royalties Fund created in 1973

Location: Cheyenne, Wyoming

Size:

Assets: 3.1 million acres

Capital Funds: N.A.

Purposes: Moneys collected in the Fund are applied as follows:

- 50% to Public School System
- 35% to State General Fund
- 9% to University of Wyoming for capital projects
- 6% to counties

Source of Funds: Mineral royalties and lease payments from operators on U.S. Government-owned lands in Wyoming are divided between the U.S. Government and Wyoming. Prior to 1976 the State of Wyoming received 37 1/2% and the U.S. Government 62 1/2%. As of 1976 the U.S. Government and Wyoming divide the mineral royalties and lease payments equally.

Management Structure: Mineral royalties and lease payments are collected by the U.S. Government and disbursed to the State semi-annually.

Management of Funds: Moneys remitted to the State are deposited with the State Treasurer. The Wyoming legislature intends to address the management and application of additional income received pursuant to the State's increased share of mineral royalties and lease payments.

Portfolio: N.A.

Income: N.A.

The following is a summary of States that have not created permanent trust funds to receive income derived from taxation on or royalties from finite natural resources.

STATE

APPLICATION OF SEVERANCE TAX AND ROYALTY INCOME

Alabama

Proceeds of the Timber Severance Tax support State Conservation Department timber restoration activities.

The Coal Severance Tax is used to pay debt service on Alabama State Docks Department, Seaport Facility Revenue and Special Tax Bonds. \$15,000,000 originally issued. \$13,075,000 presently outstanding. No additional bonds may be issued with the Coal Severance Tax as security.

Arkansas

Revenue from severance taxes are returned to the county level after the State deducts all claims against the county, plus a 1 1/2% charge. The 1 1/2% charge is deposited in State General Fund.

California

Fifty-six percent for capital outlay programs in California's Higher Education System.

Twenty-two percent for special projects including irrigation aqueducts and improvement in navigable waterways.

Eight percent to State Conservation Department to support various activities.

Fourteen percent deposited in State General Fund.

Colorado

Severance tax deposited in State General Fund

Idaho

Severance tax deposited in State General Fund.

Kansas

All revenue from Oil, Gas and Minerals Severance Tax is deposited in State General Fund.

All revenue from Sand and Gravel Royalty Tax is returned to counties.

Kentucky

Proceeds from severance tax are placed in short term investments. Semi-annually counties receive money for special projects. All remaining money is deposited in State General Fund.

STATE

APPLICATION OF SEVERANCE TAX REVENUE

Louisiana

Ninety percent of severance tax revenue is retained by the State for general purposes. The remaining 10% is allocated to parishes (counties).

Minnesota

Minnesota deposits 10% of the Taconite Production Tax in their general fund. Ninety percent is returned to districts where taconite is produced.

All proceeds from the Ore Royalty Tax are deposited in State General Fund.

Mississippi

Of the Timber Severance Tax, 50% is allocated to the Forest Redevelopment Fund, 25% is returned to counties and 25% is deposited in State General Fund.

The State levies taxes on gas production with 30% going to participating counties and 70% to State General Fund.

Mississippi also imposes a tax on oil production. Counties receive 30% of the first \$600,000, 10% of the next \$600,000 and 5% thereafter. The balance is deposited in State General Fund.

North Dakota

Thirty-five percent of the taxes which North Dakota levies on coal extraction goes to the Coal Impact Office. The Office then allocates money on the basis of application for public projects in the areas where coal is mined.

Thirty percent is allocated to the Land Board Trust Fund. Two-thirds of this is used to finance environmental studies. One-third is invested with interest proceeds deposited in State General Fund.

Thirty percent is deposited in State General Fund.

Remaining 5% allocated to counties.

Ohio

Seventy-five percent of severance taxes are used for the restoration of orphaned strip mining land.

Twenty-five percent is allocated to replug abandoned oil and gas wells which are deemed as hazards.

Oklahoma

State General Fund receives 85% of severance tax revenue. Fifteen percent is allocated to counties.

Utah

All revenue from severance taxes is deposited in State General Fund. Expenditures are then allocated by State legislature.

**Exhibit II**

Institution: Government Development Bank of Puerto Rico

Location: San Juan, Puerto Rico

Size:

Assets: \$782,101,951 - 1975

Purpose: The Government Development Bank was created in 1948 as an instrumentality and public corporation of the Commonwealth of Puerto Rico. Its two principal functions are to act as fiscal agent for the Commonwealth, its municipalities and public agencies, and to make loans to private enterprises which will aid in developing the economy of Puerto Rico. The Bank Charter provides that no changes in law may be made that impair the obligations of the Bank, that it shall have existence and that it is exempt from Commonwealth Banking Law.

Source of Funds: The Bank was originally capitalized by legislative appropriations. Its capital is received from operations, capital notes (some of which are guaranteed by the Commonwealth) and lines of credit with U.S. and Commonwealth banks.

Management Structure: The governing body is a seven-member Board of Directors who are appointed by the Governor and serve four year overlapping terms. Appointment is subject to approval by the Council of Secretaries of the Commonwealth. The Bank is under the supervision of and subject to examination by the Commonwealth's Secretary of the Treasury.

Management of Funds: N.A.

Portfolio: N.A.

Functions: As fiscal agent, the Bank is responsible for the timing and sale of bonds and notes by the Commonwealth and its agencies, and, during the period 1944-75 it arranged or provided for nearly \$11 billion of borrowings by these governmental units. The Bank also arranges or provides loans for the private sector. From 1944 to 6/30/75 it reportedly has disbursed over \$337 million loans to private business (about 47% for manufacturing, 22% for commercial buildings, 6% for hotels). As of 6/30/76 there were \$165.4 million business loans outstanding (45% industrial, 3.6% hotel and restaurant, 14% commercial buildings, 4% hospital, and remainder interium and other). The Bank also issues its own full faith and credit notes (\$40,000,000 as of 6/30/75 issued to major mainland and Puerto Rican Banks). The Bank is the central clearing house for checks in the Commonwealth. On 9/11/75 the Bank negotiated a \$612 million note purchase agreement (guaranteed by the Commonwealth) with major mainland and Commonwealth Banks to provide a revolving line of credit for the Commonwealth and its various public agencies. This line of credit will decline to \$352 million by 7/15/79.

Institution: The Pennsylvania Industrial Development Authority  
created in 1973

Location: Harrisburg, Pennsylvania

Size:

Assets: \$266,357,736 (as of March 31, 1976)  
Capital Funds: \$226,309,289

Purpose: The Authority was established to alleviate unemployment and economic stagnation within the Commonwealth of Pennsylvania by the promotion and development of industrial and manufacturing enterprises, research and development enterprises and agricultural enterprises in those areas where critical unemployment exists. To accomplish its purposes, the Authority is authorized to make mortgage loans to non-profit Industrial Development Agencies. The Agencies utilize funds borrowed from the Authority to finance industrial development projects on behalf of private industry at below market interest rates.

Source of Funds: Moneys to make mortgage loans have been provided from aggregate legislative appropriations of \$191,140,000 during fiscal years 1956 through 1975, from the proceeds of tax-exempt bond issues in the total principal amount of \$72,500,000 and from repayment of principal and interest on outstanding mortgage loans.

Management Structure: Membership of the Authority consists of the Secretary of Commerce who serves as Chairman, and the Secretaries of Labor and Industry, Community Affairs, Agriculture and Banking. In addition seven members are appointed by the Governor for terms of seven years. The Board meets monthly to review mortgage loan applications.

Management of Funds: Disbursement of mortgage loan proceeds and receipt of mortgage loan repayments are the responsibility of a designated Trustee bank. Moneys held by the Trustee are invested according to State Statute.

Portfolio: As of March 31, 1976 the Authority's portfolio was invested in \$206 million mortgage loans yielding from 7/8 of 1% to 4% per annum. In addition the Authority has \$56.5 million invested in U.S. Treasury Securities.

Income: Income from investments remains with the Authority.

Indebtedness Limitation: Additional tax-exempt bonds may be issued provided that estimated net revenues over the life of all outstanding bonds, including the proposed issue, will equal not less than 200% of the annual principal and interest requirements on all bonds to be outstanding.

# FINANCIAL ASSISTANCE FOR INDUSTRY

	State Sponsored Industrial Development Authority	Privately Sponsored Development Credit Corporation	State Authority or Agency Revenue Bond Financing	State Authority or Agency General Obligation Bond Financing	City and/or County Revenue Bond Financing	City and/or County General Obligation Bond Financing	State Loans for Building Construction	State Loans for Equipment, Machinery	City and/or County Loans for Building Construction	City and/or County Loans for Equipment, Machinery	State Loan Guarantees for Building Construction	State Loan Guarantees for Equipment, Machinery	City and/or County Loan Guarantees for Building Construction	City and/or County Loan Guarantees for Equipment, Machinery	State Financing Aid for Existing Plant Expansions	State Matching Funds for City and/or County Industrial Financing Programs	State Incentive for Establishing Industrial Plants in Areas of High Unemployment	City and/or County Incentive for Establishing Industrial Plants in Areas of High Unemployment
Alabama	•	•			•	• <sup>1</sup>									• <sup>2</sup>			
Alaska	• <sup>4</sup>	•	•	•	• <sup>3</sup>	• <sup>3</sup>	•	•										
Arizona		• <sup>4</sup>			•													
Arkansas	•	•			•	•					•	•						
California		• <sup>5</sup>															• <sup>6</sup>	
Colorado		•			•													
Connecticut	•	•	•	•		•	•	•			•	•			•	•		
Delaware	•		•	•			•	•			•				•			
Florida		•			•													
Georgia		•	• <sup>1</sup>		•													
Hawaii			•		•	•	•	•							•	•		
Idaho		• <sup>4</sup>																
Illinois	•	•			•													
Indiana	•		•		•	•					•	•			•	•		
Iowa		•			•	•												
Kansas		•			•	•												
Kentucky	•	•			•	•	•								•			
Louisiana	•	• <sup>4</sup>			•	•												
Maine	•		•		•						•	•			•		•	
Maryland	•	• <sup>6</sup>			•	•					•	•			•	• <sup>7</sup>	• <sup>7</sup>	
Massachusetts	•	•			•	•		•	•						•	•	•	•
Michigan	•	• <sup>4</sup>	•		•		•				•				•	•	•	•
Minnesota		•	•		•	•	•	• <sup>9</sup>	• <sup>9</sup>						•		•	•
Mississippi	•	•			•	•									• <sup>2</sup>			•
Missouri	•	•			•	•	• <sup>8</sup>								•			
Montana		•			•			• <sup>17</sup>										
Nebraska		•			•										• <sup>2</sup>			
Nevada					•	•											•	•
New Hampshire	•	•	•			•					•	•			•			•
New Jersey	•	•	•	•		• <sup>20</sup>					•	•			•	•	•	•
New Mexico	•	• <sup>4</sup>			•	•									•		•	•
New York	•	•	• <sup>10</sup>	•	•	•	•	• <sup>11</sup>	•	•					•		• <sup>12</sup>	• <sup>12</sup>
North Carolina	•	•			•	•												
North Dakota	•	•		•	•	•	•	•	•	•	•	•			• <sup>13</sup>		•	
Ohio	•	•	•		•	•		•	•	•	•	•			•			
Oklahoma	•	•	•	•	•	•	•	•	•	•					•			
Oregon		•	• <sup>1</sup>		• <sup>19</sup>													
Pennsylvania	•	•	•		•		• <sup>14</sup>	• <sup>14</sup>							•		•	•
Rhode Island	•	•	•		•						•	•			•			
South Carolina	•	•			•													
South Dakota					•													
Tennessee	•			•	•	•		• <sup>15</sup>			•	•			• <sup>15</sup>			
Texas					• <sup>13</sup>		•	•							•			
Utah	•	•	•		•													
Vermont	•	•	•		•		•	•			•	•			•	•	•	•
Virginia	•	•			•													
Washington	•	•			• <sup>1</sup>	• <sup>1</sup>				• <sup>3</sup>							•	
West Virginia	•	•			•		•	•							•			
Wisconsin					•	• <sup>16</sup>												
Wyoming		•			•													
STATE TOTALS	30	35	18	8	43	21	15	13	8	7	14	11	0	0	27	7	13	7
Puerto Rico	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•

Source: Industrial Development  
December 1975





**Footnotes for Tables on pages 12, 13, 14.**

- 1—Permitted only in specified municipalities
- 2—State allows cities or counties to offer financial aid for existing plant expansions. In Louisiana, state financing aid is directly involved only in the case of those port authorities whose obligations are backed by the full faith and credit of the state
- 3—Activity is limited to Anchorage Port Authority in Alaska, to Ports Authority in Georgia and to port districts in Oregon. In Washington, port districts are municipal corporations operating under special state enabling legislation and are the only public bodies authorized to issue either revenue or general obligation bonds to finance industrial development
- 4—Authorized but none is active
- 5—State-sponsored but privately operated non-profit Regional Job Development Corporations may be established in low-income areas to provide loans to small businesses
- 6—State guarantee of loans from privately operated non-profit Regional Job Development Corporations serving low-income areas
- 7—Limited to EDA-designated areas
- 8—Loans also cover working capital, site improvements and inventories
- 9—Permitted for processing products of agriculture, including forestry and timber production
- 10—New York Job Development Authority and New York Urban Development Corp. have the power to issue non-guaranteed bonds
- 11—New York Job Development Authority is empowered to participate in loans for machinery and equipment in new manufacturing plants
- 12—Under the New York Job Incentive Program, a corporate franchise or unincorporated business tax credit is allowed to firms locating, expanding or improving facilities in a low-income section of a city of 50,000 or more population or in a low-income rural county. The firm must create or retain at least five jobs and provide an approved training program. In addition, the largest share of the facility's volume of business must be from outside the eligible area in which it is located, as in manufacturing or wholesaling. The credit is given for up to 10 years. The 2% credit described in footnote 46 may be taken instead of the job incentive credit. Under the Job Incentive Program real property tax exemption is a local option
- 13—Permitted for electric generation and transmission facilities in North Dakota, and for electric generation and transmission facilities and for wastewater treatment facilities in Texas
- 14—State and local program of participation in existing construction
- 15—State loan guarantees of up to \$250,000
- 16—For acquiring and developing sites
- 17—Authorized if a one-mill, multi-purpose tax levy is approved by local voters
- 18—A 15% reduction in assessed valuation of business inventories is allowed. Business inventories include raw materials used in manufacturing
- 19—Exemption is allowed on certain types of equipment, including rail freight cars, certain watercraft and vessels of more than 1,000 tons burden
- 20—Applies only to pollution control equipment
- 21—Law allows reduction in taxes but not exemption. Goods in transit, inventories and raw materials are assessed at 5%
- 22—Corporate income tax credit is allowed only for the cost of pollution control equipment
- 23—Equipment and machinery acquired after the 1973 assessment date is exempt from local property tax
- 24—Delaware and New York do not collect excise tax
- 25—Nevada, Ohio, Texas and Washington do not tax corporate or personal income. Florida and New Hampshire do not tax personal income
- 26—Raw materials are assessed at 25%, while most other tangible personal property is assessed at 100%
- 27—50% of federal tax paid is exempt
- 28—First \$4,500 of assessed taxable value of personal property is exempt
- 29—Inventory is taxed only on the value of raw materials
- 30—Applicable to Industrial Revenue Bond financed property only. A 10-year exemption is allowed
- 31—In Kentucky, Rhode Island and Tennessee, the exemption is applicable at the local level only. In Maryland, the exemption may be applicable at the county or local level. In Virginia, localities have the option of exempting all or part of certified pollution control facilities and equipment from real or personal property taxes.
- 32—Applicable under the tax equalization law only
- 33—Exemption applicable to capital improvements only
- 34—Allowed except for sales/use tax when purchased for use as an ingredient in tangible personal property for sale.
- 35—A 1% tax credit, based on wages paid, is allowed for the first three years to new and expanding industry engaged in the mechanical or chemical transformation of materials or substances into new products. "Expanding" means to expand a present operation so as to increase total permanent jobs by 30%.
- 36—Taxed at 2% instead of usual 4%
- 37—R&D equipment is classified as manufacturers' machinery and equipment and, as such, is eligible for tax exemptions
- 38—Local option, in designated redevelopment areas
- 39—Reduced 79%
- 40—Exemption is allowed on separate, detachable accessory tools and equipment which have a useful life of less than 12 months
- 41—State does not collect sales/use tax
- 42—1976 business inventories are allowed a 50% exemption; 1977 and thereafter, a 62.5% exemption will be allowed
- 43—Applicable to goods stored in bonded warehouses
- 44—New Jersey citizens employed in New York and Pennsylvania are not exempt
- 45—Noise abatement codes recommended by state for adoption by municipalities
- 46—A tax credit equal to 2% of qualified capital invested in new production facilities may be applied against a business corporate franchise, unincorporated business income or personal income tax liability. The tax credit is restricted to investment in buildings, equipment and facilities which have a useful life of at least four years and are used in manufacturing, processing, assembling, refining, mining, agricultural or commercial fishing. Experimental research and development facilities may elect this option in place of the write-off described in footnote 47. A particular investment is not eligible for both the investment credit and other state tax incentives. Corporate franchise taxpayers will continue to be required to pay a minimum tax of \$125 annually. Any credit remaining may be carried forward
- 47—Costs paid or incurred in a taxable year by incorporated or unincorporated business for experimental R&D facilities, for industrial waste treatment facilities and/or for air pollution control facilities may be deducted from net income for tax purposes. The 2% credit described in footnote 46 may be taken in lieu of this credit
- 48—Tangible and intangible personal property is not subject to ad valorem taxes
- 49—New equipment is allowed a preferential rate of 1%, with a maximum tax of \$80 per article
- 50—Leaf tobacco is allowed an exemption of 60% of tax rate; bales of cotton, 50%, and peanuts, 20%
- 51—Exemption extends only to new construction
- 52—Tax credits allowed to manufacturers and processors for property taxes paid on goods in process
- 53—Exemption allowed while facility is under construction only
- 54—Exclusion from sales and use tax on industrial purchases used directly in industrial production and research
- 55—Exclusion of tangible personal property from taxation at local level
- 56—Rhode Island's sales/use tax is being phased out over five years
- 57—In Tennessee, tax credits are allowed for products of state soil. In Florida, tax credit applies only to alcoholic beverages produced from specified Florida-grown agricultural products
- 58—Seven-year annexation or de-annexation exemption
- 59—Allowable depreciation is similar to that which is permitted under federal laws
- 60—Exempt from sales/use tax, but not from business capital tax
- 61—Local governments may classify separately the tangible personal property of research and development firms from that of other taxpayers and tax it at different rates
- 62—Deduction is allowed for sales tax paid on energy
- 63—80% credit
- 64—Reduced rate of 1.5% (1% state and 5% local) applied to industrial machinery, installation and repairs
- 65—Provided only in rare instances. In California, a few cities and counties will lease land they own at nominal rates
- 66—Limited to technical assistance
- 67—Facilities available on a contract basis
- 68—State vocational education program keyed to federally funded program
- 69—Carried out through local development corporations
- 70—Available to industry on a contract and/or consulting basis
- 71—City-owned land only. Cities may not purchase land for purpose of providing free land to industry
- 72—Highway Commission will build first two miles of road into new ski areas
- 73—Maryland Industrial Development Financing Authority will guarantee up to 80% of the mortgages for land and 70% for equipment for recreational projects
- 74—Activity limited to certain units
- 75—State supplies 75% of cost of administering programs; no reimbursement to trainees
- 76—Cities and counties are authorized to use mill levy for industrial development purposes. Speculative buildings and free land have been provided in some instances
- 77—Port districts only
- 78—Funds are from Public Health for solid waste disposal projects
- 79—State matches funds from U.S. Dept. of Housing and Urban Development

2

**Exhibit III**



Institution: Swedish Investment Bank Ltd.

Location: Stockholm, Sweden

Size: 12/31/74

Assets: U. S. \$672.8 million

Capital: U. S. \$270.9 million

Purpose: Swedish Investment Bank Ltd. ("SIB") was established in 1967 by an act of the Swedish Parliament to assist in the financing of industrial and commercial projects in Sweden which encourage economic rationalization, structural adaptation and development. The act establishing SIB contemplated that its lending will be consistent with national economic policies. All of the capital stock of SIB is owned by the Swedish Government. In addition, the Swedish Government has extended a limited guarantee of SIB's obligations.

Source of Funds: Subscribed capital, reserves, net income, cash flow from lending operations and borrowing.

Management Structure: Governed by a Board of Directors (9) and Deputy Directors (9). Ongoing operational responsibility rests with Managing Director and Staff. Total employees: 31, 22 of whom are managerial or professional. In certain loan and credit evaluations, SIB engages special consultants.

Management of Funds: Internal. Bank's staff consists primarily of "lending officers" with previous commercial and investment banking experience.

Portfolio: SIB makes medium (5-10 years) and long-term (10-20 years) loans and guarantees thereof principally to or for private Swedish companies to finance industrial projects in Sweden and, to a lesser extent, Swedish exports. Such financing is not generally available from other sources in Sweden and may involve additional risks especially those related to long-term developments, which would not normally be assured by conventional Swedish lending institutions. SIB is also authorized to make equity investments.

In assessing individual projects, SIB pays particular attention to the commercial viability of the project concerned. SIB also considers the impact of the use

Portfolio:  
(cont'd.)

of proceeds on the Swedish economy. One of SIB's objectives is to earn a satisfactory return on its equity capital and it applies credit standards and negotiates loan terms consistent with this purpose.

At 12/31/74, SIB's outstanding loans totalled U. S. \$517.6 million and its guarantees outstanding totalled U. S. \$15.8 million.

## Capital Structure:

		12/31/74	
Debt	U. S.	\$487.8 million	64.3%
Capital	U. S.	<u>270.9 million</u>	<u>35.7</u>
	U. S.	\$758.7 million	100.0%

## Income:

10% of net income allocated to statutory reserve.  
Substantially all net income to date retained by SIB.  
Income not exempt from taxation.

Institution: Japan Development Bank

Location: Main office in Tokyo. Other offices in 9 cities in Japan and in Washington, D. C., New York City, London and Frankfurt.

Size: 3/31/76

Assets: ¥ 3,521,391 million (\$11,433 million)  
Capital: ¥ 233,971 million (\$759.6 million)

Purpose: Established in 1951 as a Japanese Government financial institution pursuant to the Japan Development Bank Law. Purpose is to supply long-term funds for the promotion of industrial development and economic and social progress. JDB makes loans to provide funds: (1) for acquisition and construction or improvement of plant and equipment; (2) for reclamation of land; (3) for acquisition of land and construction of buildings and equipment for urban redevelopment projects. A related authority (which JDB has not yet exercised) permits JDB to provide funds by subscription to corporate debentures issued to raise funds for above purposes. JDB can guarantee repayments of loans and has authority to make equity investments in large-scale industrial complexes in underdeveloped regions in Japan.

Source of Funds: Principal sources are borrowings from Japanese Government, repayment of loans and internal sources. Outstanding government loans to JDB as of 3/31/76 amounted to \$9.3 billion. Other sources have consisted of foreign currency borrowings from the World Bank, all guaranteed by the Japanese Government. Also, there have been 6 dollar issues (including 5 registered issues publicly offered in U. S.), 1 Swiss franc issue and 1 Deutsche Mark issue of external loan bonds and notes. JDB is authorized to borrow an amount equal to 10x its capital and statutory reserve.

Management Structure: JDB is managed by a Governor, a Deputy Governor and 8 Executive Directors. JDB also has 2 auditors and 6 Counsellors. The Governor, the Deputy and the Auditors are appointed by the Prime Minister for terms of 4 years. The Executive Directors and Counsellors are appointed by the Governor for terms of 4 years and 2 years, respectively. The Governor is the CEO. The Executive Directors exercise various management functions in accordance with delegations from the Governor. Final authority to make decisions for JDB in all matters resides exclusively with the Governor.

**Management of Funds:** JDB makes its loans at fixed rates no greater than rates charged by private financial lenders and in most cases at lower rates. Maximum rate has been 9.2% since 11-75. JDB has limited foreign currency loans to amount of borrowings from the World Bank and charges the same interest rate plus 0.3%. JDB charges 0.2% to 0.3% per annum on outstanding amounts of foreign credits guaranteed by it. JDB makes most of its loans with original maturity of 10 - 15 years. Most of JDB's lending operations involve the financing of projects in cooperation with private financial institutions, with JDB taking the intermediate and longer term maturities and private banks taking the shorter maturities.

**Portfolio:** From inception to late 1960's, JDB's lending activities were directed primarily to electrical power, ocean shipping, coal mining, and the iron and steel industry. In the late 1960's and 1970's, JDB began to become more involved in urban development and pollution control. As of 3/31/76, portfolio was as follows: urban development 16.9%; regional development 12.5%; pollution control 14.2%; quality of life improvement projects 2.8%; resources and energy 15.7%; ocean shipping 21.6%; technological development 7.6%; other 8.2%; foreign currency loans 0.5%.

Capital Structure:	3/31/76	(\$ Millions)	%
Long-term borrowing from government		\$ 9,299	84.4%
Guaranteed long-term borrowing from World Bank		55	0.5
Guaranteed external loan bonds and notes		228	2.1
Capital and statutory reserve		<u>1,437</u>	<u>13.0</u>
Total capital		\$11,019	100.0%

**Income:** For fiscal year ending 3/31/76 JDB earned \$105.6 million. Of net earnings, \$78.9 million were put into the statutory reserve, and \$26.7 million was paid to the Japanese National Treasury.

Institution: National Financiera S.A.

Location: Mexico City, Mexico. Offices in New York and Tokyo.

Size: 12/31/75

Assets: U. S. \$6.1 billion

Capital: U. S. \$555 million (including reserves and special funds)

Purpose: National Financiera S.A. ("Nafinsa") was established in 1934 and is the principal instrument of the Mexican Government for the financing of economic development in Mexico. By law, the Government must own 51% of Nafinsa's capital stock. At 12/31/75, the Government owned, directly and indirectly, 68% of such stock, with the balance owned by other Mexican institutions.

Nafinsa's broad purpose is to assist in the financing of development projects which (1) create employment; (2) improve personal income; (3) expand regional development; (4) centralize industry; (5) promote exports; (5) stimulate capital formation; (6) foster economic independence.

Source of Funds: Capital funds contributed by the Government, borrowings, retained earnings and cash flow from lending operations. Principal source is borrowings. By law, the Government can call up additional capital subscriptions from certain Mexican financial institutions. Nafinsa also administers 209 special purpose development trust funds for the account of the Government.

Management Structure: Managed by Board of Directors (Minister of Finance is Chairman). Director General is responsible for ongoing operations and policy. President of Mexico may veto resolutions of Board under certain circumstances. Total staff approximately 1,600.

Management of Funds: Internal.

Portfolio: Nafinsa may participate in the financing of development projects through direct loans, loan guarantees or equity investments, all of which may be extended to or made in or on behalf of both public and private sector entities. Principal activity is direct lending (U. S. \$4.9 billion outstanding) with public sector borrowers accounting for

**Exhibit IV**

Institution: International Bank for Reconstruction and Development (World Bank)

Location: Headquartered in Washington, D.C., U.S.A. Offices in London, Paris, Tokyo. Missions in 20 countries

Size: 3/31/76  
(000's)

Assets: U. S. \$29.5 billion

Capital: Authorized Capital: U. S. \$30.9 billion  
Paid-in-Capital: U. S. \$3.1 billion

Purpose: Established 6/24/46 pursuant to articles of agreement drawn up at Bretton Woods Conference of July, 1944. Initial membership 29 sovereign states. Present membership 127 sovereign states.

Purpose of World Bank is to function as intergovernmental financial institution to (a) assist in the reconstruction and development of member states by facilitating investment of capital for productive purposes; (b) supplement private foreign investment through guarantees of or participation in private investments; (c) supplement private investment via loans from its own resources or borrowed funds. See "Affiliated Institutions" below.

Source of Funds: Capital provided by subscriptions of member states and borrowings in international and U. S. capital markets. Supplemented by internal cash flow from lending activities and sale of loans.

Management Structure: Governed by Board of Governors composed of one from each member state. Executive Directors (20) appointed by Board function as Board of Directors. President selected by Executive Directors and is responsible for all operations. Operations are organized by geographic area, industry, and function. Total employees: approximately 3,500.

Management of Funds: Internal. All loans to or guaranteed by member states. Loan portfolio monitored with respect to industry and country in relation to worldwide economic conditions. The bank has not suffered any losses on its loans to date and does not take part in debt rescheduling agreements.

- Portfolio: Loans made generally in conformity with 5 principles: (1) loans must be to governments, government agencies or authorities, or if to private enterprises, guaranteed by a government (only member governments eligible); (2) loans must be for productive purposes based on bank analysis; (3) bank must exercise prudence in making loans and consider ability of borrower to obtain foreign exchange necessary for loan service; (4) Bank does not make loans obtainable privately on reasonable terms; (5) use of proceeds supervised by Bank. Since inception, loans totalling \$31.1 billion have been made to 95 countries. Current loans outstanding total \$27.7 billion. Largest borrowers are Brazil, Mexico, Korea, Yugoslavia, Columbia, Iran, Turkey, Philippines and Nigeria. Loans made for extended terms at fixed rates (1/2% above money cost to Bank adjusted quarterly).
- Capital Structure: Debt 73.2%; Capital Stock 26.8%. Capital Stock funds may only be used for lending with consent of each member state; otherwise such funds must be used for administrative purposes or to support guarantees and borrowings only.
- Income: Generally retained by Bank except portion transferred to International Development Association.
- Affiliated Institutions: International Finance Corporation. Makes loans and investments to private enterprises in member countries without government guarantee. 104 governments are members. Sources of funds are members' subscriptions and loans from Bank. Staff is substantially identical to that of Bank.
- International Development Association. Purpose is to promote economic development in less developed member countries. 116 countries are members. Loans generally made for terms of 50 years without amortization. Service charge of 3/4% on outstanding balance levied in lieu of interest. Staff substantially identical to that of Bank.

Institution: Inter-American Development Bank

Location: Headquartered in Washington, D.C., U.S.A.  
Field offices in 23 South American locations

Size: 12/31/75

Assets: U. S. \$2.98 billion  
Capital: Authorized Capital: U. S. \$6.3 billion  
Paid-in-Capital: U. S. \$983 million

Purpose: Established 10/1/60 pursuant to Inter-American Development Bank Agreement of December, 1959. Membership consists of 24 North and South American Governments, plus Belgium, Denmark, Israel, Japan, Spain, Switzerland, U.K., West Germany and Yugoslavia.

Purpose of Bank is to further individual and collective economic and social development of regional developing member countries via: (1) promotion of public and private investment for development purposes; (2) financing, directly or through guarantees, of development and economic growth of members; (3) encouragement and/or supplement of private investment in development projects; (4) co-ordination of members' development, economic growth and foreign trade; (5) provision of technical assistance on development projects.

Source of Funds: Capital provided by members' subscriptions plus borrowings in U. S. and international capital markets, internally generated funds and sales of loan participations. See also "Special Funds" below.

Management Structure: Governed by Board of Governors, one from each member state; executive powers delegated to Executive Directors (11), one U. S., 2 non-regional and 8 regional. Administrative responsibility centered in President, appointed by Board, and Executive Vice President, appointed by Executive Directors. Operations organized by region and function.

Management of Funds: Internal. Loans made directly to or guaranteed by member governments (98%). Loans monitored with respect to country, industry and regional economic conditions. Since inception, defaults have occurred on 2 loans totalling \$11.2 million, resulting in net loss of \$1.8 million. The Bank does not take part in debt rescheduling agreements.

**Portfolio:** Loans made pursuant to 6 principles: (1) loans made only on basis of formal analysis presented to Executive Directors; (2) in evaluating loan or guarantee, Bank must take into account ability of borrower to obtain private financing on terms it believes reasonable; (3) Bank must consider ability of borrower or guarantor to meet loan obligations; (4) in opinion of Bank, interest rate and other loan charges plus amortization schedule must be appropriate for the project being financed; (5) the Bank must receive adequate compensation for risks assumed by guaranteeing loans made by others; (6) loans made for special projects only and directly, except when amounts too small to warrant bank supervision. Since inception, Bank has made or authorized 889 loans aggregating \$8.7 billion. Largest borrowers are Brazil, Mexico, Argentina, and Columbia. Loans made for terms of 10-25 years, including grace periods, at fixed rates. Current lending rate is 8%.

**Capital Structure:** Debt 53.6%, capital funds and reserves 46.4%. Capital subscriptions of member states available for general use unless specifically restricted.

**Income:** Income retained as reserve for loan losses.

**Special Funds:**

**Social Progress Trust Fund.** Administered by Bank from grant provided by U. S. Government. Resources of Fund may be used to improve land use, land settlement, low income housing, water supplies, sanitation or education. Assets consist of 119 loans aggregating U. S. \$537.2 million.

**Special Operations Fund.** Established by Bank from separate contributions by members to finance projects to which special circumstances apply, principally need for loan terms to be more liberal than those normally offered by Bank. Assets consist of 453 loans aggregating U. S. \$4.2 billion.

**Venezuelan Trust Fund.** Administered by Bank from U. S. \$500 million grant provided by Venezuela in 1975. Purpose is to contribute to the financing of projects and programs that would have significant effect on development of Bank's smaller members. Approved loans aggregate U. S. \$83.7 million.

Institution: Asian Development Bank

Location: Principal office in Manila, Philippines

Size: 3/31/76

Assets: U. S. \$2,834,910  
Capital: Authorized Capital: U. S. \$3.3 billion  
Paid-in-Capital: U. S. \$1.1 billion

Purpose: Established in 1966 as an international inter-governmental institution pursuant to an agreement initially signed by 31 countries.

Purpose is to foster economic growth and cooperation in Asia and the Far East (the "region") and to contribute to the acceleration of economic development in the developing member countries in the region, collectively and individually. The Bank's principal functions include: (1) promotion of public and private investment; (2) financing economic growth; (3) assisting in coordination of members' economic growth, plans and policies; and (4) providing technical assistance for the preparation, financing and execution of development projects and plans.

Source of Funds: Capital provided by subscriptions of member states and borrowings in member countries and elsewhere. General principle is that borrowings should be diversified as to country of borrowing. These sources supplemented by internal cash flow from lending activities.

Management Structure: Managed by Board of Governors, Board of Directors, President, Vice Presidents, other officers and staff. All powers are vested in Board of Governors (with certain powers which may be delegated to Board of Directors), with each member selecting a Governor and an alternate Governor. The Board of Directors (12) has responsibility for the direction of the general operations of the Bank.

Management of Funds: Internal. Bank may make, participate in or guarantee loans to the governments of its developing member countries, to any of their agencies or political subdivisions and to public or private enterprises operating within such countries, as well as to international or regional entities

Management of Funds: (cont'd.) concerned with economic development in the region. The Bank has not suffered any loan losses in its ordinary operations to date and follows a policy of not taking part in debt rescheduling agreements.

Portfolio: Loans made generally in conformity with the following principles: (1) the Bank's loans cover only a portion of the total costs of each project financed; (2) goods and services must be purchased in the loan country, with competitive bids to be received on such; (3) realistic economic, technical, and financial feasibility of projects involved; (4) adequate borrowing capacity; (5) beneficial effects on domestic savings and balance of payments; and (6) assistance in expansion of employment opportunities. Loans made for projects in 15 member countries, including industrial development banks (27.3%), utilities (35.7%), transportation and communications (21.8%), agriculture (14.3%) and education (0.9%).

Capital Structure: Debt 46.5%; Capital Stock 53.5%.

Income: Generally retained by Bank.

Institution: African Development Bank

Location: Abidjan, Ivory Coast

Size: Authorized Capital: U.A. 400 million;  
Issued Capital: U.A. 370 million (1 Unit of Account =  
1 special drawing right of the IMF)

Purpose: Established by African Governments in 1964, commenced operations in July 1966. Present membership consists of 39 of 42 countries which are members of Organization for African Unity, including 16 which are included in U. N.'s list of 25 least developed nations.

Purpose of Bank is to promote the economic development of its member countries and social advancement of their peoples through gradual integration of their economies.

Source of Funds: Subscribed capital, borrowings and retained income. Bank also operates African Development Fund, established from grants from 16 non-African exporting countries, which makes 50 year interest free loans and SIDFIDA, a Geneva-based internationally funded organization of private enterprises which assists in the mobilization of international private capital for development projects in Africa.

Management Structure: Board of Governors, one from each member, oversees operations. Management responsibility and policy coordination rests with Board of Directors (9), President and staff.

Management of Funds: Internal. Bank oversees projects for which funds have been dispersed.

Portfolio: Alone or jointly with others, Bank (1) utilizes available resources to finance investment projects or programs consistent with its purpose; (2) promotes private and public capital investment in Africa; (3) provides technical and financial assistance in project evaluation and structure. All loans and investments in private sector must be government guaranteed. Portfolio at 9/30/74 consisted of one or more loans or equity investments in 31 countries totalling U. S. \$192 million. Loan terms keyed to ability of borrower to repay and service debt.

Capital Structure: Believed to be solely members' capital subscriptions, plus retained income. Discrepancy between issued capital and outstanding loans not reconcilable from existing data.

Income: Believed to be reinvested in operations.

Institution: European Investment Bank

Location: Luxembourg

Size: 12/31/75

Assets: U. S. \$6.4 billion

Capital: Authorized Capital: U. S. \$4.1 billion  
Paid-in-Capital: U. S. \$471.9 million  
Capital Subscriptions Due: U. S. \$177.0 million

Purpose: The EIB was established by the Treaty of Rome in 1957 which also established the EEC. The members of the EIB are the nine member states of the EEC. The purpose of the EIB is to contribute to the balanced and orderly development of a common market among the member states. The EIB grants and guarantees long-term loans to finance projects which are related to the development of the less advanced regions of the Common Market or the development of its conversion areas, where traditional activities are being supplanted by newer economic activities which serve the common interests of several member states. By unanimous decision the EIB grants loans for projects outside the EEC.

Source of Funds: The EIB finances its loans from the capital paid in by the member states, from internally generated funds and from borrowings in European and international capital markets.

Management Structure: The EIB is administered and managed by (1) a Board of Governors composed of one government minister (usually the minister of finance) appointed by each member state; (2) a Board of Directors composed of 18 Directors and ten Alternative Directors each appointed by the Board of Governors for a 5 year term on nomination by the member states and the Commission of the European communities; (3) a Management Committee, consisting of a President and four Vice Presidents appointed for 6 years by the Board of Governors on recommendation of the Board of Directors.

Management of Funds: Management of funds is internal, and the EIB has not experienced any defaults on its loans or guarantees.

## Portfolio:

Loans and guarantees are made according to the following policy: (1) for projects that improve less developed regions of the EEC and that are of common interest to the member states (such projects preferably assist in the coordination of markets and the integration of the economies of member states), (2) for projects that are of sufficient size to avoid widespread dispersal of its resources; (3) loans made shall only supplement the resources otherwise available to the borrowers for such projects; (4) special attention is given to projects in which member countries' capital is invested. The EIB does not generally lend more than 40% of the cost of a project. At December 31, 1975 it had loans disbursed as follows: 30.5% energy projects; 24.8% industry; and 17.5% to transportation.

## Capital Structure:

80% Funded Debt, 11% Capital, 9% Statutory Reserves. Subscribed capital is \$4,129.5 million of which \$648.9 is or will be paid in by members. Calls on subscribed capital are required to be in proportion to members' percentage of subscription obligations.

## Income:

Income is appropriated to statutory reserve. EIB's assets and income are exempt from all direct taxes of the member states.

Institution: European Coal and Steel Community ("ECSC")

Location: Brussels, Belgium; Luxembourg

Size: At December 31, 1975, the assets of the ECSC amounted to U. S. \$3.5 billion. ECSC's "capital" is provided solely from retained earnings and reserves.

Purpose: Established 4/18/51 pursuant to treaty. Initial membership of 6 European nations. Present membership 9 European nations. Purpose is to aid the development of the economies of the member states through the creation of a common market for coal and steel. Also, ECSC facilitates the financing of capital investment programs in coal, coke, iron ore, iron, steel and scrap by lending funds which it obtains primarily through its own borrowing. ECSC also responsible for coordinating production in above-named products by methods such as determining general objectives for modernization and expansion of productive capacity, reviewing investment programs, making research grants, enforcing fair competition, fixing prices in emergencies and imposing fines for infringement of ECSC rules. Also active in promoting better living and working standards for workers in the coal and steel industries through housing loans and retraining and research grants.

Source of Funds: Capital provided by: (1) a regular revenue levy collected monthly in the respective currencies of the member states from steel producers. Levy payments to be made in 1976 are expected to be \$104.9 million; (2) borrowings through bonds or notes, both public and private. As of 3/31/76 ECSC had outstanding \$3.3 billion of funds borrowed.

Management Structure: Governed by a Commission comprised of 13 members who are nationals of the member states, not more than 2 of whom may have the same nationality. Over the Commission is a Council consisting of one representative of each member state. Certain actions of the Commission require the assent of the Council. The ECSC is also responsible to a European legislative assembly - the European Parliament, which consists of 198 representatives elected by the legislatures of the member countries. It reviews the ECSC and by a vote of consensus can compel the resignation of the members of the Commission. Also, the Court of Justice of European Communities, comprised of 9 judges, interprets and applies the provisions of the treaty. Decisions are binding.

**Management of Funds:** The Commission has the responsibility of borrowing, financing and managing funds. The primary responsibility for specific capital investment programs rests with the individual borrowers who decide what capital projects they want to undertake and whether to seek the assistance of the ECSC. The criteria applied by ECSC in selection of projects to be financed are based on normal banking practices. ECSC borrows in whatever currencies appear most advantageous to it and under the best conditions prevailing at the time in the capital markets in which the ECSC operates. In order to minimize risks, ECSC matches principal, interest rates, maturities and currencies of loans made with its own borrowings. A general policy is also to secure loans by guarantee of country, banks or industrial concerns or mortgages on the financed projects.

**Portfolio:** Since inception ECSC has granted loans (both from borrowed funds and from its own resources) aggregating \$3.4 billion through 12/31/75, of which, as a result of repayments by the borrowers, \$2.7 billion was then outstanding. Of this amount, about 26% was guaranteed by the member countries, 25% by banks and 18% by industrial concerns, and 27% was secured by mortgages on the projects financed. Since establishment, there have been defaults on 3 loans, totaling \$1.8 million, less than 0.1% of the total amount of loans granted by the ECSC. Rescheduling of principal and interest payment dates and delays in the receipt of loan service charges have been insignificant. Guarantees granted by ECSC since inception have aggregated to \$65.3 million through 12/31/75, of which \$24.3 were outstanding at that date. ECSC's guarantees are secured by guarantees from member countries, banks, industrial concerns or by mortgages on the projects financed. ECSC has never been required to make payment on a guarantee.

**Capital Structure:**

	12/31/75	
Borrowings	\$2,786 million	82.1%
Reserves	338	9.9
Revenue Funds	<u>271</u>	<u>8.0</u>
Total Capital	\$3,395 million	100.0%

**Income:** In 1975 revenues of \$307.96 million; 57.9% from interest on loans; 26.6% from levies and 15.6% from contributions, interest investments and other. 55.3% went to pay interest and fees payable; 6.3% for administration; 7.5% for research; and 14.9% went for other. Most of the 16% excess went to the Guarantee Fund, housing projects, and reconversion, technical and economic research.

**Exhibit V**

Institution: Saudi Development Fund

Location: Riyadh, Saudi Arabia

Size:

Capital: SR 10 billion (Saudi Riyals)

Purpose: Established in September 1974, the SDF participates in financing development projects in the developing states by providing loans.

Source of Funds: Believed to be direct contribution from Saudi Arabian revenues.

Management Structure: The Fund is managed by a six man Board of Directors comprised of a Deputy Chairman, the Minister of Finance and National Economy, and four other members selected for three year terms of office by the Council of Ministers.

Management of Funds: Internal

Portfolio: The Fund will grant loans to projects of economic or social benefit to the recipient state on the condition that the loan is repaid in Saudi Riyals and that any one loan does not exceed 5% of the Fund's capital or 50% of the overall cost of the project being financed. In addition, any one country may not be extended loans totalling more than 10% of the Fund's capital. To date the Fund has extended more than fifty loans to a large cross-section of developing countries including Indonesia, Egypt, North Yemen, People's Republic of Congo and Niger.

Capital Structure: N.A.

Income: Believed to be retained.

Institution: Arab Bank for Economic Development in Africa

Location: Khartoum, Sudan

Size: Authorized and subscribed capital: U. S. \$231 million

Purpose: Established in 1974 under aegis of Saudi Arabia and League of Arab States. Operations commenced in 1975. Membership consists of 18 Arab states which have contributed from U. S. \$50 million (Saudi Arabia) to U. S. \$1 million (Jordan, Bahrain, Sudan, Syria, Egypt, Mauritania, Palestine) to initial capital. Purpose is threefold: (1) assist in financing economic development in African countries; (2) stimulate the contribution of Arab capital to African development; (3) help provide technical assistance required by Africa's economic development.

Source of Funds: Anticipated to be capital subscriptions by member states, plus borrowings (up to a limit of 2x paid in capital and reserves), deposits and retained earnings. Special funds also authorized.

Management Structure: Board of Governors (one from each member country) oversees general operations and policies. Initiation and implementation of policies and direction of management via Board of Directors (12, based on share ownership) through President (Chairman of Board of Directors) and staff.

Management of Fund: Internal policies prohibit disbursement of funds without prior provision for supervision of related project by bank staff.

Portfolio: Operations of bank may take the form of (1) loans and guarantees granted to development financing institutions; (2) participation in financing of major economic projects, especially agriculture and industry, to make up any deficit from external sources of financing; (3) technical and financial assistance aimed at identifying and structuring economic development projects, especially Afro-Arab projects; (4) technical and financial aid with respect to technological development. Eligible recipients limited to (1) African governments and agencies; (2) public and private companies, organizations and projects in African

Portfolio:  
(cont'd.)

countries, majority owned by African governments or citizens; (3) mixed, African or Afro-Arab economic development companies. Present portfolio believed to consist of 20-25 loans in 20 African states. Maximum participation by Bank in any one project to be lesser of U. S. \$10 million or 50%; term of loans to vary based on project; and interest charges to vary from 1% to 6%. All loans and investments must be guaranteed.

Capital Structure:

See "Source of Funds" above.

Income:

Allocated to reserves or members' capital accounts by Board of Governors.

Institution: Arab Fund for Economic and Social Development

Location: Kuwait City, Kuwait

Size: Authorized Capital: KD 400 million (KD = Kuwaiti Dinars)

Purpose: The AFESD was organized by the Arab Council of the Arab League in 1968. Operations did not commence until 1973 at which time the Fund had acquired 21 country members. The purpose of the Fund is to participate in financing economic and development projects in all Arab member states through: (1) financing economic development projects on easy terms to governments and to public or private organizations and institutions, giving preference to economic projects vital to overall Arab development and to joint Arab projects; (2) encouraging directly or indirectly the investment of public or private capital in such a manner as to ensure the development and growth of the Arab economy, (3) providing technical expertise and assistance to the various fields of economic development.

Source of Funds: Believed to be solely member subscriptions at present.

Management Structure: Believed to be internal.

Management of Funds: Internal. Interest rates for loans made during 1975 ranged from 4% - 6%.

Portfolio: Loan criteria emphasizes those projects that (1) assist less developed Arab countries in narrowing existing income differentials; (2) have infrastructures that link Arab countries; (3) facilitate cross-border funds flows; (4) intensify exploitation of agricultural resources; (5) contain new ideas for public and private co-operation investment projects. Since 1973 the Fund has granted loans totalling KD 93.2 million for eighteen projects in nine countries. During 1976 AFESD is planning a major expansion of activities with cumulative loan commitments projected to rise to KD 177 million.

Capital Structure: Of the KD 400 million committed capital, KD 102 million was paid up by the member states as of February 1976. The outstanding balance is to be paid over the next three years.

Income: No information available on disposition of income.

Institution: Abu Dhabi Fund for Arab Economic Development

Location: Abu Dhabi, United Arab Emirates

Size: Authorized Capital: DH 2 billion; Paid-in-Capital  
DH 1 billion (DH - Dirhams)

Purpose: To offer economic aid to Arab countries in support of their economic development through loans, participations, or guarantees. Also economic aid to African, Asian and other Islamic countries.

Source of Funds: Believed to be internal allocation from Abu Dhabi revenues.

Management Structure: N.A.

Management of Funds: Believed to be internal.

Portfolio: Loans outstanding to 11 countries totalling \$500 million at December 1975. Mostly connected with industry and manufacturing.

Capital Structure: Believed to be solely paid-in-capital at present.

Income: No information available with respect to distribution of income.

Institution: Islamic Development Bank

Location: Jeddah, Saudi Arabia

Size: ID = Islamic Dinars (equal to 1 Special Drawing Right  
of the International Monetary Fund)

Capital: Authorized Capital: ID 2 billion  
Paid-in-Capital: ID 755 million

Purpose: Bank established in 1975 based on agreement signed by members of Islamic conference in 1974. Purpose is to foster economic development and social progress of member and Muslim communities in accordance with Islamic principals. Present membership 29 countries.

Bank permitted under agreement to (1) purchase equity in productive projects in member countries, (2) participate in economic and social infrastructure projects in member countries; (3) make loans to public and private sectors for project financing in member countries; (4) establish and operate trust or special funds; (5) accept deposits and borrow funds; (6) assist members in matters relating to development, foreign trade and economic co-operation; (7) invest surplus funds. Bank is to be non-political and governed by economic considerations only.

Source of Funds: Members' capital subscriptions. Leverage permitted, but not yet used. Cash flow and income will also be used to fund activities of Bank in future.

Management Structure: Board of Governors, composed of one from each member state, to appoint Executive Directors and President, to be responsible for operations and selection of personnel. All officers of Bank must be from member states. Executive Directors approve all loans.

Management of Funds: All contracts will provide for internal follow-up and inspection by Bank.

Portfolio:

Selection and determination of investments to be based on the following criteria: (1) due regard to be paid to safeguarding interests of Bank, including obtaining guarantees; (2) the ability of recipient and/or guarantor to meet obligations to Bank; (3) consistency with principles of promotion of complimentary economic development among members, promotion of social and economic well being in member states and enlargement of employment opportunities; (4) avoidance of concentration of loans and investments in one country and maintenance of reasonable relation of loans and equity investments in each country; (5) reasonable diversification of equity investments; (6) in all cases, priority to be given to co-operative economic projects.

Loans to be for terms based on project requirements. In view of interest prohibition under Islamic law, service fee to be charged.

Capital Structure:

Presently all member states' equity.

Income:

May be distributed to members after general reserve equals 25% of subscribed capital.

Institution: Kuwait Fund for Arab Economic Development

Location: Kuwait City

Size:

Capital: Authorized Capital: KD one billion;  
Paid-in-Capital : KD 328 million (KD - Kuwaiti Dinars)

Purpose: To assist Arab and other developing states in implementing development projects by making KD loans. The Fund may also guarantee the obligations of such states or corporate entities. The Fund may not finance more than 50% of non-local project cost.

Source of Funds: 400 million KD's out of government reserves according to the needs of the Fund. 600 million KD's out of public revenues of the State. Amount to be appropriated determined annually.

Management Structure: Prime Minister - Chairman of Board of 9 Directors elected for an initial term of two years. Chairman appoints Director - General of the Fund (upon recommendation of the Board) who has responsibility for financial and administrative matters.

Management of Funds: Net profits of the Fund are credited to a reserve account until reserves equal 20% of capital. Thereafter profits are added to the capital of the Fund.

Portfolio:	(KD Millions)
Cash	5.1
Bank deposits	174.5
Securities	110.4
Loans	62.0
Participations in Arab development institutions	25.9
Accrued interest	6.9
Total	384.8

Capital Structure: The Fund may borrow funds and give guarantees up to twice capital and reserves.

Paid-in-Capital      KD 328 (March 1975)  
General Reserve      KD 56

Income: Financial information limited.

Total Income                      KD 16.6 million  
Income from Investments      14.4  
Income from Loans              2.2

Loan Disbursement: Loans made to 12 countries by sector

Transport and storage	35.6%
Agriculture	23.2
Industry	20.6
Power	20.6
	<hr/>
	100.0%

Institution: Fondo de Inversiones de Venezuela

Location: Caracas, Venezuela

Size: 12/31/75

Assets: BS 22,470,317,537 (1 Bolivar (BS) = U. S. \$0.233)  
Capital: BS 20,532,175,000

Purpose: Fund established by Presidential decree in June 1974 following OPEC's increase in oil prices and consequent increase in Venezuelan government reserves. Stated purposes are fourfold: (1) to create a professionally managed reservoir for public funds that would be kept out of domestic money supply until needed, thereby avoiding inflationary pressures caused by over-rapid money supply growth; (2) to invest in external capital markets funds not immediately needed in Venezuela; (3) to assure a rational and diversified internal investment program designed to reduce Venezuela's dependence on oil revenues; (4) to generate economic growth that creates full employment, redistributes national income and encourages technological independence.

Source of Funds: Yearly allocation of oil revenues, the size of which is determined at the highest level of government and approved by President. Allocations in 1974 and 1975 aggregated slightly in excess of U. S. \$5 billion.

Management Structure: Fund operations overseen by General Assembly (consisting of State Ministers and high level government officials) which has power to dictate policy. Major policy directives typically originate from high level political sources and the Fund's internal Executive Directorate (2 internal and 2 external) and are ratified by Assembly. President of Fund (State Minister) is crossroads for policy and routine management operations. Major investment decisions made by Executive Directorate and all external investments discussed at senior management level committee meetings.

Management of Funds: Internal staff divided into 3 groups by function: International Financial Group (investments in external markets); International Financial Cooperation Group (analysis and monitoring of loans to International and non-Venezuelan Government Agencies); National Investment Group (review and monitoring of debt and equity investments in Venezuelan entities). All groups have specialized sub-groups.

Institution: Alberta Heritage Savings Trust Fund  
Location: Edmonton, Province of Alberta, Canada

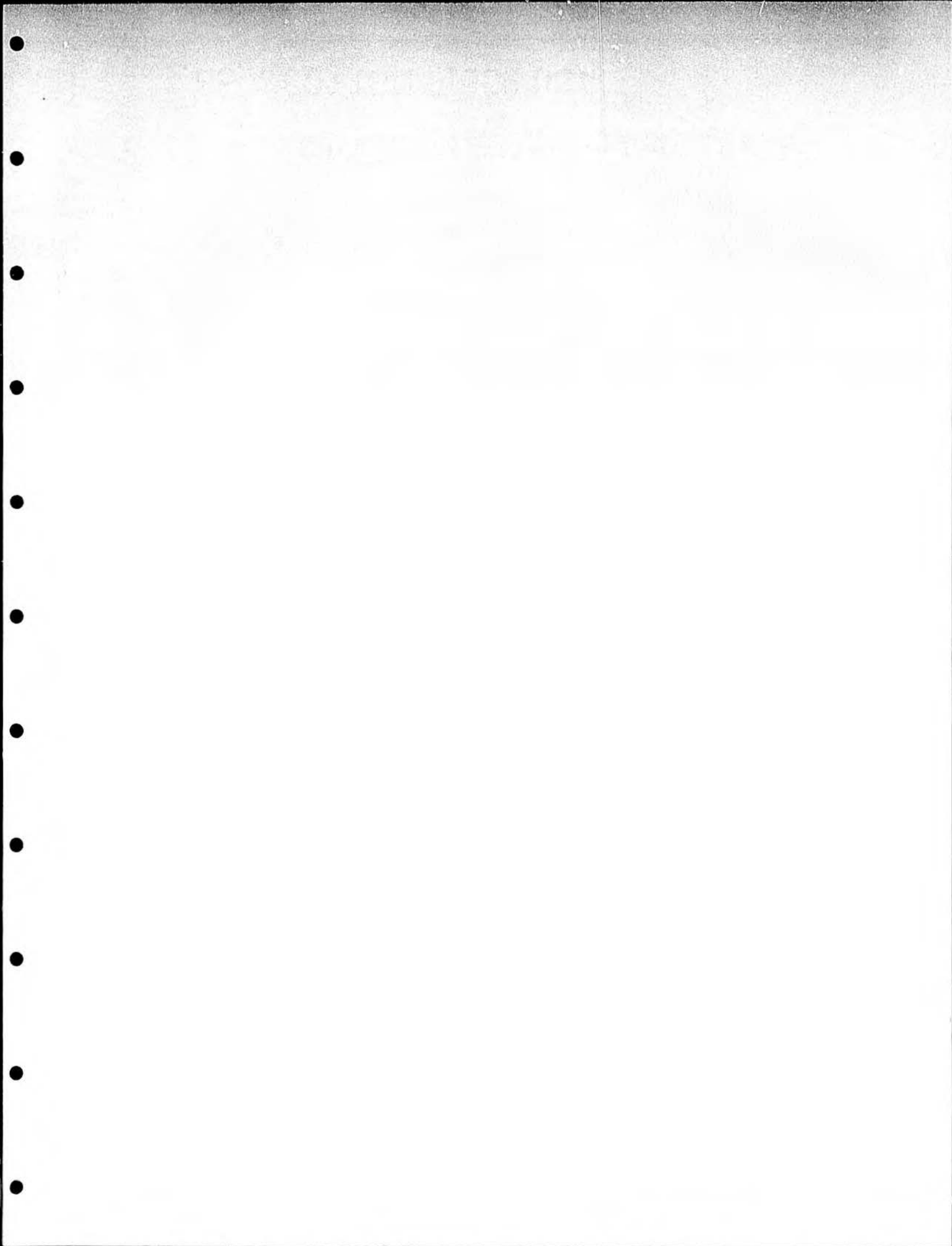
Size:  
Capital: C \$1,500,000,000

Purpose: Fund established in May 1976 to invest a substantial portion of non-renewable resource revenues for the benefit of the people of Alberta in future years.

Fund permitted by Legislative Act to (1) invest up to 20% of its assets in projects which will provide long-term economic or social benefits to the people of Alberta but which will not by their nature yield a return to the Fund, provided the moneys are first specifically appropriated from the Fund by an act of the Legislature; (2) invest up to 15% of its assets in loans to the Crown in right of Canada or of any other province of Canada or in loans guaranteed by the Crown in right of Canada or of any other province of Canada; (3) make investments the Investment Committee, or the Legislative Assembly as expressed in an Assembly resolution, feels will yield a reasonable return or profit to the Fund and will tend to strengthen and diversify the economy of Alberta; (4) invest or reinvest moneys not invested according to 1, 2 or 3 above in any or all of the following: (a) evidences of indebtedness of, or fully guaranteed by, the Canadian Government, any Canadian provincial government, any Canadian municipal corporation, the government of a country other than Canada, a chartered bank or treasury branch, or any corporation if authorized by the Canadian and British Insurance Companies Act; and (b) mortgages or hypothecs of real estate or leaseholds in Canada under certain circumstances.

Source of Funds: Original funding of Canadian dollars \$1,500,000,000 plus 30% of the non-renewable resource revenues to be received in fiscal 1976-77 (and each fiscal year thereafter if the Legislative Assembly enacts a Special Act authorizing such annual transfer from the General Revenue Fund) on a monthly basis.

- Management Structure: Heritage Savings Trust Fund Investment Committee consisting of all 24 members of the Provincial Executive Council (including Provincial Ministers and Treasurer) responsible to the Legislative Assembly in the operation of the Fund. Actually managed in the Provincial Treasurer's Office.
- Management of Funds: The Provincial Treasurer holds and administers the Fund in accordance with the Act. Fund has separate accounting record. The Investment Committee, except when directed by the Legislative Assembly, approves investments and dispositions of investments, although the Provincial Treasurer invests, reinvests and disposes of such with respect to Fund activities in investment category 4 under "Purpose" above. While all funds are managed internally, outside advisors may be used to review and package potential investments.
- Portfolio: As under "Purpose" above. No authority to guarantee the credit of others nor is it intended to allow for other than short-term borrowings from the General Revenue Fund in anticipation of fund transfers (i.e. - no leverage allowed).
- Capital Structure: See "Source of Funds", "Portfolio" and "Income".
- Income: The income of the Fund accrues to and forms part of the Trust Fund.



White, Weld & Co.  
Incorporated

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White, Weld today represents a worldwide group of investment banking and financial service units through which its knowledge of domestic and international financial matters is extended to meet the needs of individuals, institutions, corporations, and government entities.

White, Weld & Co. Incorporated, a wholly owned subsidiary of White, Weld Holdings, Inc., with over \$50 million in capital funds, provides a full range of investor services and investment banking facilities for American and foreign clients. It has over 1,700 employees in 25 offices in the United States and seven overseas and has access to all capital markets of significance.

Société anonyme financière du Crédit Suisse et de White Weld (FCSWW) represents the combined international investment banking vehicle of White, Weld and Credit Suisse, one of the leading Swiss banks. With equity capital in excess of 110 million Swiss francs (U.S. \$42 million) and 280 employees throughout the world, FCSWW offers the full spectrum of international investment banking services.

#### **Our Objectives:**

- To provide a diversified range of financial services in principal capital markets throughout the world.
- To protect and enhance our clients' capital.
- To emphasize quality and ethics in the selection and execution of business.
- To provide a stimulating and equitable working environment and a compensation system that attracts and retains the ablest people.
- To earn a favorable rate of return on the capital invested in the firm.

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White Weld New York





*Frederick S. Wouham, L. Emery Katzenbach, Paul Hallingby, Jr., Henry W. Meers, and Charles C. Lee, Jr.*

## To Our Clients and Friends

In 1975 the economies and financial institutions of the Western world successfully passed their most difficult test of the postwar period. One year ago, a sharp recession was under way. The rate of inflation was dangerously high, profits were dropping, unemployment was rising, and credit problems were multiplying. Pessimism was everywhere. In the United States, monetary policy was eased and a program of strong fiscal stimulation adopted. As a result our economy bottomed in the second quarter, sooner than generally expected, and has since moved ahead at a healthy rate. Liquidity has improved impressively throughout the economy, for consumer, corporate, and thrift institutions. New York City and New York State appear to be gradually surmounting the unexpected crisis in their financial affairs. Abroad, cooperation among governments and central banks did much to ease the financial strains of high inflation caused by the quadrupling of oil prices. Fortunately, the OPEC surplus has proven much smaller than many had feared and is expected to decline further. All of the foregoing was reflected in a sharp recovery in stock prices and lower interest rates.

With the ease in money and the decline in interest rates, our capital markets absorbed a record volume of fixed income securities, \$37 billion of long- and intermediate-term bonds and \$29 billion of municipal bonds. In corporates, interest centered upon issues of high quality, specifically those rated A or better. With the economy improving and profits rising, we expect more interest will develop in Baa credits as 1976 progresses. Equity underwritings increased to \$6.8 billion, more than double the figure for 1974 but still below the level of 1973, as numerous major industrial companies strengthened their balance sheets. Utility offerings accounted for 35 percent of the total, down from 78 percent in 1974.

The improved market conditions and a number of internal developments combined to produce a healthy increase in White, Weld Incorporated's profitability. Our fixed income departments, an area of our business which we have expanded significantly in recent years, benefited strongly from the decline in interest rates and the extraordinarily large volume of U.S. Government, municipal, and corporate debt financings during the year. Our corporate and public finance activities were also aided by the large volume of new debt financings and by the establishment of a record number of new client relationships. Our increasing commitment to the market for individual

investor services resulted in record levels of individual account revenues. While commission rates came under severe pressure in the institutional area, our competitive position in this business improved.

Our international affiliate, Société anonyme financière du Crédit Suisse et de White Weld, experienced a marked advance in revenues and net income in fiscal 1975, despite the detrimental impact of further appreciation of the Swiss franc. This uptrend has continued in the current year and the synergistic effect of the expanded relationship with Credit Suisse has proven beneficial to all concerned.

A number of important changes in organization and personnel took place during the year. Paul Hallingby, Jr., our chief executive officer, was elected chairman of the board, and Frederick S. Wonham was elected president and chief operating officer of White, Weld & Co., Incorporated; Charles C. Lee, Jr., was named vice chairman, and James W. Needham and Thomas C. Pryor were named executive vice presidents. L. Emery Katzenbach, the previous chairman of White, Weld & Co., Incorporated, remains chairman of our parent company, White, Weld Holdings, Inc., and in that capacity will continue to play an active role in our affairs.

The outlook is much brighter than it was 12 months ago, and the year has begun in a very positive fashion. We anticipate a continuing healthy recovery in the United States economy, followed by a recovery in most major economies elsewhere in the world. Inflation should continue to decline, which in turn should benefit long-term interest rates. We expect that corporate profits will record a substantial gain. Notwithstanding the existence of many difficult problems, all of the foregoing could bring about healthier securities markets and a greater degree of investor confidence than have been in evidence the past few years.

*Paul Hallingby, Jr.*

Paul Hallingby, Jr.  
Chairman

*Frederick S. Wonham*

Frederick S. Wonham  
President

February 12, 1976



*Alexander M. White, Jr., George G. Montgomery, Jr., Richard S. Ellwood, Paul A. Downey, and Robert K. Green.*

## Corporate Finance

Internally generated corporate funds have lagged behind capital spending and dividends by increasing amounts over the past decade. The cumulative shortfall exceeded \$82 billion in the past four years alone, reflecting industry's inability to fully offset a rising rate of inflation. While inflation is now moderating, the punitive nature of our present tax structure and the distorted earnings results presented under historic cost accounting seriously impede capital formation.

The year was one of record activity as many corporations, either unwilling or unable to raise long-term capital in 1974, came to market. Despite the large volume of financing, the capital market was not open to all comers, creating problems—and opportunities—for investment banking firms such as White, Weld and our clients.

### Underwriting

During 1975, White, Weld managed or co-managed approximately \$3.5 billion of publicly offered securities in over 70 separate issues in the United States. Major debt issues in 1975 included offerings for such clients as Tenneco Inc., Houston Natural Gas Corporation, Montreal Urban Community, Northern States Power Company, The Cleveland Electric Illuminating Company, Banque Française du Commerce Extérieur, Florida Power & Light Company, Pennzoil Company, and International Minerals & Chemical Corporation. United States Government guaranteed ship bonds were sold for subsidiaries of The El Paso Company and Offshore Logistics, Inc.

White, Weld acted as manager or co-manager for such equity issues as a \$47 million common stock offering for The El Paso Company, a sinking fund preference stock for The Quaker Oats Company, and convertible debenture issues for West Point-Pepperell, Inc., Pizza Hut, Inc., and Wal-Mart Stores, Inc. The firm continued its efforts to help the electric utilities meet their financing needs, managing or co-managing a number of equity offerings including Union Electric Company, Pacific Power & Light Company, Madison Gas and Electric Company, and Florida Power & Light Company. There were a very limited number of initial public offerings during the year. We managed an issue for Oceanering International, Inc., the world leader in underwater diving services.

### Private Placements

The private market continued to provide an important share of permanent capital for American industry in 1975, especially for medium-sized companies for which the public debt market was effectively closed. White, Weld's services to its clients during the year included both the placement of new debt and the revision of terms of existing loan agreements. The firm acted as agent in some 20 transactions aggregating over \$400 million.

Major private placements of securities closed during 1975 included those for St. Regis Paper Company, Keystone Consolidated Industries, Inc., Graniteville Company, Associated Spring Corporation, Southwest Forest Industries, Inc., and Meredith Corporation.

### Specialized Financing

White, Weld's Corporate Finance Department includes groups whose activities are concentrated in real estate, leveraged lease, and pollution control and solid waste disposal facilities financing. These groups endeavor to provide economic choices for the firm's corporate clients and to seek out innovative financing opportunities to fund new projects.

One such project financing, the first of its kind, was a public offering of tax-exempt solid waste disposal revenue bonds for the Town of Saugus, Massachusetts, for a facility built by Wheelabrator-Frye, Inc. In the leveraged lease area, the firm arranged such transactions as the financing of a semisubmersible drilling vessel for a subsidiary of Tenneco Inc.

In what was a continuation of a very difficult real estate market, White, Weld continued to be active in the arranging of equity and permanent debt financing for projects. Transactions during the year included a permanent mortgage financing for Mercantile Stores Company Inc., net lease financings for The Mead Corporation and General Signal Corporation, and private placements of equity interests in a major new office building complex in Atlanta, Georgia, and a residential apartment development in Montreal, Quebec.

### Financial Consulting

White, Weld was active in 1975 in providing specialized financial consulting in connection with clients' merger, acquisition, and divestiture programs. In addition, valuation studies and opinions on the fairness of merger terms were provided to a number

of corporations in a wide variety of industries. Senior officers of the firm also appeared as expert witnesses on behalf of clients in litigation and before various government agencies.

White, Weld completed two major consulting assignments during the year, one of which was to serve as financial advisor to the United States Railway Association in connection with the establishment of the Consolidated Rail Corporation. The other was to render an independent evaluation of the shares of Creole Petroleum Corporation at the request of Exxon Corporation. Other activities included providing an opinion in connection with the proposed conversion of Fidelity Federal Savings and Loan Association to a California-chartered stock company, consulting for Blue Cross/Blue Shield of Indiana, and acting as advisors to the trust department of the Bank of America NT & SA with regard to The Ralph M. Parsons Trust.

#### **International**

Cross-border financial transactions continue to be an important aspect of the business of White, Weld and of Credit Suisse White Weld Limited. Foreign financing in the domestic U.S. market attained record levels in 1975, a year which marked the true reopening of our capital markets for non-Canadian international borrowers. Public financings under the management of White, Weld were completed for Banque Française du Commerce Extérieur (\$100,000,000) and Montreal Urban Community (two financings totaling \$125,000,000). White, Weld assumed a leading position in the secondary market for foreign bonds sold in the United States, complementing the position of our affiliate in the Eurobond secondary market.

The failure of the U.S. Congress to eliminate the withholding tax on long-term debt interest payments to non-U.S. residents was an unfortunate development. Nevertheless, we continued where possible to assist American corporations in raising capital overseas. Offshore financings were arranged for Miles Laboratories, Inc., Tenneco Inc., and Pacific Power & Light Company.

The Canadian government's removal of the withholding tax on corporate interest payments opened up an active Eurobond market for Canadian corporations alongside that for Canadian provinces and governmental agencies, in which the group has for many years played a leading role. Through Credit Suisse White Weld Limited, the White, Weld group

served as a manager in several Eurobond offerings by Canadian borrowers. These included financings for Massey Ferguson, Canadian Pacific Securities Limited, The City of Montreal, Genstar Limited, Quebec-Hydro, and RoyMarine Leasing Limited. In addition two private placements of \$100,000,000 each were arranged in the Middle East for British Columbia Hydro and Power Authority with the guarantee of the Province of British Columbia.

In 1975, the White, Weld group continued among the leaders in the arrangement of acquisitions in the United States by European and Canadian companies. Under our management, tender offers were successfully concluded on behalf of the Nationale Nederlanden N.V., Boehringer Ingelheim GmbH, and George Weston Limited.

#### **Staff**

In a continuing effort to expand White, Weld's Corporate Finance Department capabilities and to improve services provided to our clients, the firm added to its professional staff and made organizational changes.

Robert L. Huston joined the firm as a senior vice president to augment the staff of the energy group serving the industries for which White, Weld has been a major underwriter since the 1930's. Mr. Huston is the former head of the petroleum department of the First National City Bank. In addition, Robert E. Benson and Kenneth N. Davis, Jr., joined the firm as senior consultants in 1975 to assist the Corporate Finance Department in the private placement and new business areas, respectively. Mr. Davis is a former chief financial officer of International Business Machines Corporation and of Syntex Corporation, and Mr. Benson is a former vice president of The Equitable Life Assurance Society of the United States and of International Telephone and Telegraph Corporation.

Other new senior additions to the department included Paul E. Tierney, Jr., and Louis Perlmutter, who joined the firm as first vice presidents. Mr. Tierney, formerly with the United States Railway Association, specializes in the transportation industries, and Mr. Perlmutter, a specialist in mergers and acquisitions, has taken over responsibility for that activity. William P. Donohue, who joined the firm as a vice president, concentrates on international business in Latin America.

Paul A. Downey, senior vice president and director, returned to New York from our San Francisco



*Todd Goodwin, Louis Perlmutter, Jeremiah K. Ross, and John B. Adams.*

office to head the Business Development Group within the department. Nigel S. MacEwan, senior vice president and director, was appointed director of our International Corporate Finance Department. In addition, a number of senior officers, including Charles C. Lee, Jr., Thomas C. Pryor, and Alexander M. White, Jr., assumed corporate finance responsibilities.

As a result of these officer additions and the firm's active recruitment program, the Corporate Finance Department had 70 full-time professionals as of January 1, 1976.

Regional corporate finance officers resident in Chicago, Los Angeles, San Francisco, Atlanta, Bos-

ton, Philadelphia, and Providence combine the advantages of regional knowledge with the advantages of a large staff of specialists and help to bring our full range of services to each client.

## Public Finance

The financing of state and local governments moved out of obscurity and into the headlines in 1975. The New York City financial crisis, the recession's impact on government budgets at all levels, and continued inflation fears through much of the year pushed tax-exempt interest rates to an historic high. In the face of this unfavorable market climate, state and local governments issued a record \$29.2 billion of tax-exempt bonds, 28 percent ahead of 1974. Continuing its leadership role in this key area of finance, White, Weld as a manager or major underwriter underwrote 380 issues with an aggregate par value of \$9.5 billion, or 34 percent of the total. Alone, White, Weld distributed \$1.078 billion in municipal bonds in calendar 1975, versus \$610 million the previous year.

To keep pace with record tax-exempt activity, White, Weld instituted a Retail Customer Service Department and expanded its branch office sales staff and New York trading operations to meet unprecedented demand by individual investors. Our municipal research staff responded to the increasing volume of client inquiries about municipal credit with analyses and evaluations of the nation's tax-exempt issuers.

Highlighting our 1975 investment banking activities was the introduction of three new major issuers into the tax-exempt market: Town of Saugus, Massachusetts Solid Waste Disposal Revenue Bonds; Platte River Power Authority, Colorado; and Gwinnett County Water and Sewerage Authority, Georgia.

In August, White, Weld as sole manager underwrote \$30,000,000 waste disposal revenue bonds to fund a refuse-to-energy facility in Saugus, Massachusetts. The facility, with a 1,500-ton-per-day capacity, will be the largest of its kind in the United States. It is the first major solid waste facility to be constructed from proceeds of tax-exempt revenue bonds secured solely from the revenues of the facility.

The Platte River Power Authority, Colorado, issued \$35,000,000 electric revenue bonds in August. This issue contained a unique provision for intermediate-term debt, providing the Authority with increased financing flexibility.

The \$35,000,000 Gwinnett County issue represented the largest water and sewerage authority financing in the State of Georgia.



*William F. Fuller*

*John A. Butt  
Richard A. Kimball  
Eugene L. Cooke*

*Tod D. Mann  
David K. Sims  
Donald H. Rindlett*

## Investor Services

Our individual client business grew significantly in 1975 and presently accounts for approximately one half of total brokerage revenues. Since we regard our account executives as the critical links between our clients and our research, trading, and investment policy staff, we place great emphasis on the selection, training, and direction of this professional staff. In 1975 these policies continued to result in our achieving substantially higher revenues per broker and per agency transaction than the industry averages.

During the past year, we concentrated greater effort on providing our individual account executives with the full benefits of our institutional research and investment policy talents. We also strengthened significantly our professional capabilities in the options business, a growing area of interest to many of our clients. The placement of tax-sheltered investments, carefully selected by our Corporate Finance Department personnel, has also become a meaning-

ful service for those clients whose circumstances justify the risks involved.

Three additional domestic offices were opened during the year—Washington, D.C.; Seattle, Washington; and Century City, California. This brought the total number of branch offices to 32—25 domestic, four located in Europe, one in South America, one in the Far East, and one in Canada.

### Institutional Equity Marketing

The end of fixed commission rates on May 1, 1975, set in motion forces which have altered dramatically the institutional equity business. As the legal pressures of fiduciaries to seek lowest cost executions increased, and as many securities firms indicated a preference to meet the lowest rates charged by any competitor rather than lose business and market share, commission rates were forced steadily downward throughout the last eight months



of the year. Institutions lost a major portion of the currency which they had formerly used to pay for research and other non-execution services, and several smaller firms which had concentrated solely on the business of providing specialty research services were forced to close their doors.

Our planning for a negotiated commission environment was intensified in late 1974 and brought about many changes in our operations throughout 1975. Greater concentration was placed on the evaluation of account profitability, and significant progress was made on our twin objectives of increasing the value of our professional institutional services and finding more efficient ways of delivering such services to our institutional clients. The results of these efforts have been gratifying—increased market share, higher industry rankings, and, most important, stronger and more productive relationships with many accounts.

#### Research

Despite the dislocations and uncertainties caused by the advent of fully negotiated commission rates, White, Weld increased its commitment to what we believe to be an essential service of a broadly based investment firm. That service cannot be defined in the narrow sense as security analysis alone, but also encompasses economic analysis, technical analysis, and portfolio strategy.

Staff additions and management restructuring in this area during the year were designed to enhance our ability to provide the most effective service to individual and institutional clients alike. Jerome P. Kenney was named manager of the department and appointed a senior vice president. With a combined staff of 35 professionals and an annual budget of more than \$3.5 million in policy, economics, research, and technical analysis, we believe our competitive position is stronger than ever.



*A. Gary Shilling  
Harold W. Janeway  
Jerome P. Kenney*

### Investment Advisory

In 1975, our clients benefited from a stronger bond market and higher stock prices. Our investment policies have been modified in two important respects: we diversified our equity holdings more widely and we made greater use of fixed income securities than heretofore. The latter decision reflected the historically attractive yields available on high-quality intermediate- and long-term bonds, as well as the many political and financial uncertainties still present in the world. The wider diversification of equity holdings is designed to take advantage of the widespread investment opportunities available after the severe and prolonged bear market that came to an end in October 1974. Our Investment Advisory Department was established more than 25 years ago. By December 31, 1975, our advisory staff managed accounts with total assets of \$500 million. During the year, Edward D. Little was named a senior vice president and appointed director of all of White, Weld's asset management activities in New York and Boston.

### International Brokerage and Trading

Through our offices in London, Paris, Zurich, Geneva, Montreal, Hong Kong, and Caracas, White, Weld has long been a leading factor in providing international clients with brokerage, research, and trading services in U.S. securities. The strength in the U.S. dollar and an increasing worldwide interest in debt securities were important factors in the significant volume increase shown by all of our international offices.

White, Weld's trading and arbitrage activities in the international area cover a wide spectrum and include Eurodollar issues, registered foreign government issues, sinking fund trading, and various arbitrage activities in foreign shares, ADR's, Eurodollar convertibles, and U.S. equities. We expect to commence dealing in U.S.-pay Canadian issues early in 1976.



*Thomas C. Pryor  
Edward D. Little  
Frank J. Ritger*



*Frederick L. Gordon, T. A. Lewis, Jr., Nigel S. MacEwan, Richard P. Duffee, and Richard F. Burke.*

### Equity Trading

White, Weld offers our customers large and comprehensive equity trading facilities. Headquartered in New York, specialized equity trading activities are carried on in seven other key cities across the country. The department is staffed by 36 professionals with a wide range of trading, brokerage, options, and arbitrage skills. These men and women are dedicated to providing the liquidity and execution capability required in today's marketplace to facilitate difficult transactions for clients.

Our listed block trading activities underwent a major expansion during the past year in terms of individuals and capital commitment. An immediate result of this expansion has been a meaningful in-

crease in the proportion of New York Stock Exchange volume transacted by the firm. Another benefit is the added depth to our trading expertise, which will improve client service and efficiency as the requirements of trading change with the move toward a centralized marketplace.

Our over-the-counter business was also expanded significantly last year. The firm added to its trading personnel and improved the scope of its dealer market making activities. Principal markets are made in approximately 100 equity securities, including stocks of corporate clients and those that have institutional interest and are followed by the firm's Research Department.

## Fixed Income Trading and Sales

### Corporate Securities

White, Weld's corporate bond and preferred stock trading units, located in New York, work closely with a staff of professional corporate fixed income sales specialists situated in nine of our domestic offices. This network of professionals maintains daily contact with the bond and preferred stock trading desks of many institutions throughout the country. During 1975, the firm's secondary corporate bond and preferred stock market trading volume surpassed all previous records as more institutions came to recognize our important capabilities and dedication of capital in this area. Our new issue distribution also improved—the firm placed \$968 million of new corporate debt and preferred stock issues, 115 percent of our underwriting position. Our ability to provide a broader range of services was enhanced by the addition of an experienced corporate fixed income research analyst to the staff.

### U.S. Government and Agency Securities and Money Market Instruments

The firm's trading and secondary market volume in U.S. Government and agency issues and money market instruments increased more than tenfold in 1975, illustrating the fact that this area is the most rapidly expanding segment of our fixed income activities. Trading in U.S. Treasury bills and notes was commenced in July, continuing our program to provide market making services to our clients in all areas and maturities of the U.S. Government and Federal agencies markets. Trading in domestic certificates of deposit and bankers' acceptances, which commenced in 1974, continued to increase in volume.

### Tax-Exempt Municipal Securities

Trading and underwriting activities are centered in New York, and the firm also maintains local municipal bond trading and underwriting operations in nine other domestic branch offices. These units are supported by a highly specialized sales force of 25 professionals who work directly with institutions and our own individual client account executives throughout the country. Secondary market and new issue volume in the municipal and tax-exempt areas exceeded all previous records in 1975. During the year, staff additions were made to enable the firm to satisfy the increasing demands of our individual clients for more intensive service in tax-exempt securities, including greater effort in advising clients on the relative strengths of specific credits.



*Peter V. N. Philip*



*Richard Edmonds*



*Charles M. Litzel*



*E. Corprew Reed*



*Richard E. Bozsnyak*

## Operations

As is true of many other securities industry activities, the processing of securities transactions and the presentation of relevant customer information to the firm and its clients is undergoing revolutionary change. The steps that are now being taken by the securities industry as a whole and, more directly, by White, Weld will have an important beneficial impact on the services provided by the firm to its clients. For example, we expect major steps to be taken within the next year towards the establishment of a nationwide clearance and settlement system that should promote significant efficiencies and improved client service.

The relationship between data processing, high-speed data communications, and brokerage operation services has grown closer with the broad technological advances that have taken place in each area. Recognizing these developments, White, Weld has installed a high-speed display system to provide information on the status of customers' accounts within its operations division and has extended this system experimentally to a few of its offices. These are preliminary steps towards substantial improvement in White, Weld's advanced communications systems and, in turn, in our ability to serve our clients.



*T. K. Flatley, James E. Bacon, James W. Needham, and John A. McGlynn.*

## International Outlook and Review

The international financial markets experienced a year of record growth and diversification in 1975. At the beginning of the year, short-term yields began to fall and a normal yield curve was reestablished, permitting a meaningful resumption in the flotation of internationally syndicated debt issues. These reached \$7.2 billion in 1975, compared with \$1.8 billion in 1974 and \$5.6 billion in 1972, the next highest year on record. Owing to the weakness of the dollar in exchange markets, particularly in the early part of the year, and to the virtual absence of American borrowers following the renewal of U.S. controls on capital outflows, non-dollar-denominated new issues strongly increased their share of the total volume. The Deutsche mark for the first time overtook the dollar as the most important currency for international issues, and a number of currencies (not surprisingly including certain of the OPEC country currencies) were used for the first time, most significantly the Canadian dollar. Another significant innovation was the flotation of the first bond issues denominated in special drawing rights (SDR's), which Credit Suisse White Weld Limited conceived and managed and which met with an enthusiastic worldwide response. Further issues in SDR's followed despite the calmer state of the foreign exchange markets in the latter part of the year.

Activity in the international bond market was continuing at a high pace at the end of 1975. It was evident that a lengthening of maturities and a lowering of rates was under way, in line with trends in the U.S. domestic market and particularly under the influence of sharp falls in short-term rates in many major domestic capital markets and in the Euro-dollar market. The outlook is for a sizable demand for financing (if for no other reason than to finance balance of payments deficits) which should be accommodated if the markets retain their liquidity and if there is not a sudden resurgence of inflation and short-term interest rates.

### Credit Suisse White Weld Limited

The bank reported a substantial improvement in both the profitability and diversification of its activities during 1975. Its most visible activity remains the management, underwriting, and distribution of internationally syndicated straight debt and convertible security issues. During 1975, Credit Suisse White Weld Limited maintained its position among the top three banks in the management of Eurobond issues denominated in all currencies and was the leading

manager of dollar-denominated issues. The clientele of the bank, on the issuing side, includes a broad range of the most prestigious European, Far Eastern, and American borrowers. Its position in the management group of issues in currencies other than dollars demonstrates its success in developing a non-U.S. clientele, with North American borrowers having generally been less active internationally in recent years. In this regard the bank's operating links with the Credit Suisse have been most valuable. Noteworthy issues brought to market by the bank during 1975 include the SDR issues mentioned above and four issues of floating rate notes for leading international banks. The arrangement of term financing for international banking institutions is a specialty of Credit Suisse White Weld Limited.

The bank has maintained its position of preeminence in the trading of international money market instruments, primarily London dollar certificates of deposit, and has arranged a number of placements of sizable issues of CD's for major international banks. An important factor in the bank's position has been its trading links with White, Weld in New York, which have resulted in substantial transatlantic arbitrage in money market instruments.

Its position in the money market has led to the development of long-standing commercial relationships with a broad spectrum of investors in the Middle East. This has resulted in the formation of important corporate links and the secondment of personnel to various key positions in that area. Credit Suisse White Weld has completed a number of significant investment banking transactions in the Middle East—for example, it was a manager of the first listed security issue denominated in Kuwaiti dinars.

Working with White, Weld, the bank has played an active part in a number of major acquisitions by European companies in the United States, as described previously. On the commercial banking side, the emphasis continues to be placed on generating banking assets of short maturity which are synergistic with the management's investment banking objectives.

### Banque Française de Dépôts et de Titres

In spite of domestic uncertainties and a worldwide recession, the Banque Française de Dépôts et de Titres operated successfully and profitably. The bank originated several sizable international private financings, including issues placed in the Middle East

and the United States. In the Eurobond market the bank participated in 29 underwriting syndicates during fiscal 1975 and, thanks to its expanded organization, contributed substantially to the CS&WW Group's placement capability.

In the French issuing market, the Banque Française de Dépôts et de Titres has likewise developed a placement potential well in excess of its underwriting participations, enabling it to figure in 80 percent of all underwritten issues during the 12-month period in question.

Merger and acquisition activity declined markedly in France during fiscal 1975. Nevertheless the bank's industrial department had an active year, as did its research department. Some of this work was performed in conjunction with Forinvest, the Group's Paris-based financial research organization, which in addition to its investment advisory work in French securities, effected several important consulting studies in France and abroad.

#### **Clariden Bank**

Investment-related services continue as the bank's most important activity. Early in 1975, investment policies were modified and portfolios were progressively shifted from short-term money market instruments towards quality-fixed and variable-rate instruments. Careful attention was paid to keeping a balanced diversification of currencies and to maintaining healthy liquidity.

Investment banking and corporate finance activities were further expanded during the year, and the bank was active in a number of Swiss and international public issues and private placements. This sector became an important contributor to Clariden's revenues. Higher revenue gains and good cost controls enabled the bank to increase its profitability over the previous year.

#### **White Weld Securities**

Thanks to the sharp decline in short-term dollar interest rates which began in August 1974, the Group's bond trading operations improved substantially. The improvement resulted from an increase in the volume of transactions, reduced financing costs and the rise in value of White Weld Securities' trading inventory. The gain in net profits was particularly significant given the continued deterioration of the U.S. dollar/Swiss franc exchange rate; a very large percent of the division's fixed costs arise in Swiss francs, but almost none of its income does.

Prospects for the coming year can thus be considered promising. Until such time as inflationary pressures become excessive once again, the present positive yield differential between long- and short-term interest rates should remain, and active primary and secondary markets in fixed income securities should continue, at least in the stronger currency areas.

#### **White Weld Asia Limited**

The CS&WW Group continued to play an important role in the arrangement of financing for Far Eastern borrowers in the international market. After a prolonged absence, Japanese companies once again became important borrowers, and the Tokyo office of White Weld Asia Limited was instrumental in securing for the Group a top position in the management, underwriting, and syndication of international issues for Japanese borrowers. In addition, a number of private financing arrangements were successfully completed.



*White Weld Paris*

White, Weld & Co. Incorporated  
**Statement of Financial Condition (unaudited)**  
 December 31, 1975

**Assets**

Cash .....	\$ 5,477,000
Receivable from brokers (Note 2) .....	55,227,000
Receivable from customers (Note 3) .....	123,605,000
Securities—at market value (Note 4) .....	130,793,000
Secured demand notes receivable (Note 5) .....	4,125,000
Investment in associated company (Notes 1 and 8) ..	10,477,000
Fixed assets—net (Note 1) .....	7,428,000
Other assets .....	22,541,000
<b>TOTAL .....</b>	<b><u>\$359,673,000</u></b>

**Liabilities and Capital Funds**

Liabilities:

Money borrowed on securities (Note 4) .....	\$133,961,000
Payable to brokers (Note 2) .....	45,460,000
Payable to customers .....	56,996,000
Drafts payable .....	17,388,000
Securities sold short—at market value .....	23,957,000
Other liabilities .....	25,762,000
<b>Total liabilities .....</b>	<b><u>303,524,000</u></b>

Capital Funds:

Subordinated borrowings (Note 5) .....	22,376,000
Common stockholders' equity .....	33,773,000
<b>Total capital funds .....</b>	<b><u>56,149,000</u></b>

**TOTAL .....** **\$359,673,000**

See Notes to Statement of Financial Condition.

## Notes to Statement of Financial Condition

### 1. ACCOUNTING POLICIES

Assets and liabilities relating to securities transactions are reflected in the statement on a settlement date basis. In addition, commissions and related expenses, applicable to transactions executed but not yet settled, are included in other assets and other liabilities, respectively.

Exchange memberships (included in other assets) are carried at cost (\$1,149,000) and, in the opinion of the Company, the current market value (\$567,000) does not indicate a permanent impairment in the value of such memberships.

The investment in associated company is carried at equity in net assets. All of the accounts of the foreign company are translated into United States dollars at the current exchange rate because substantially all the related assets and liabilities are current. Gains or losses on translation due to an official devaluation or revaluation of the United States dollar and losses from unofficial exchange rate variances have been recognized, while gains from unofficial variances have not been recognized. Cumulative unofficial exchange gains were recognized subsequent to the statement date as a result of the sale of the investment to the Company's Parent (see note 8).

Fixed assets, which consist of furniture, equipment and leasehold improvements, are stated at cost less accumulated depreciation and amortization of \$2,613,000. Depreciation is provided on furniture and equipment on the double-declining balance method based on estimated useful lives of ten and five years, respectively. Leasehold improvements are amortized on the straight-line method based on the period of the respective leases or life of the improvement, whichever is less.

### 2. RECEIVABLE FROM AND PAYABLE TO BROKERS

Receivable from brokers includes securities failed to deliver, \$19,630,000, and deposits paid for securities borrowed, \$31,316,000. Payable to brokers includes securities failed to receive, \$14,838,000, and deposits received for securities loaned, \$24,101,000. Securities fails are stated at contract value.

### 3. RECEIVABLE FROM CUSTOMERS

Accounts receivable from customers include amounts due on uncompleted transactions and margin balances. Securities owned by customers and held as collateral for receivables are not reflected in this statement.

### 4. SECURITIES PLEDGED AND LOANED

In the normal course of business, bank loans, cash deposits from other brokers and repurchase agreements are used to finance the purchase of securities by customers and to facilitate the securities settlement process. Securities owned, \$65,374,000, and customers' unpaid securities, \$46,678,000, are pledged as collateral for bank loans. Securities owned, \$1,447,000, and customers' unpaid securities, \$22,639,000, are loaned to other brokers in exchange for equivalent cash deposits. Securities owned, \$47,947,000, are pledged as collateral for repurchase agreements.

Borrowings from banks are on a demand basis and repurchase agreements are for relatively short periods of time; no compensating balances are required under either type of financing. The average interest rate on borrowings and repurchase agreements outstanding is 5.92%. During the preceding six months the highest month-end balance of such borrowings was \$176,942,000 and the average of such borrowings approximated \$117,842,000 at a weighted average interest rate of 6.60%.

### 5. SUBORDINATED BORROWINGS

Subordinated borrowings include senior capital notes, \$9,583,000, subordinated debentures, \$8,613,000 and secured demand notes, \$4,125,000.

The senior capital notes bear interest at 9 $\frac{1}{4}$ % and mature in 1987. The Company is required to prepay, semi-annually, \$416,667 principal amount of the notes. The Company has the option to make additional prepayments subject to certain limitations. The covenants of the note agreement contain restrictions as to minimum capital requirements and, under certain circumstances, certain stock payments, stock acquisitions and the payment of cash dividends.

The subordinated debentures bear interest at 8% and 10% and mature in the fiscal years ending 1977, \$523,000; 1978, \$524,000; 1979, \$500,000; 1981, \$1,466,000; and 1982, \$5,600,000.

The secured demand notes bear interest at 3% and 4% and mature as follows: \$2,000,000, upon six months notice (notice waived and release granted in January, 1976; see note 8), and \$2,125,000, in 1981. The secured demand notes are subject to collateral agreements which provide, among other things, for withdrawal of the collateral and return of the notes at maturity if no prior demand for payment of the related secured demand notes receivable has been

made by the Company. The value of the secured demand note collateral is \$6,566,000.

#### 6. CAPITAL REQUIREMENTS

The Company, as a member of the New York Stock Exchange, Inc., is subject to the "Net Capital Rule (Rule 325)" of such Exchange which requires that "aggregate indebtedness" (as defined) shall not exceed fifteen times "net capital" (as defined). The Exchange may also require a member firm to reduce its business if its net capital ratio should exceed twelve to one and may prohibit a member firm from expanding its business if the ratio exceeds ten to one. At the statement date, the Company's net capital and the "required net capital" (as defined) were \$23,268,000 and \$10,792,000, respectively, and the Company's ratio of aggregate indebtedness to net capital was 6.96 to 1. For purposes of computing net capital, no value is attributable to the investment in associated company (see note 8).

The Securities and Exchange Commission adopted a uniform capital rule effective January 1, 1976 which has been subsequently incorporated in Rule 325. In the opinion of the Company, the new rules are not expected to have a material adverse effect on the Company's regulatory capital requirements.

#### 7. COMMITMENTS AND CONTINGENCIES

The Company's minimum rental commitments, net of sub-lease income, under non-cancelable leases are for the fiscal years ending: 1976, \$7,460,000; 1977, \$7,299,000; 1978, \$6,975,000; 1979, \$6,723,000; and 1980, \$6,116,000; and for the five fiscal years ending: 1985, 23,295,000; 1990, \$18,146,000; and 1995,

\$4,885,000. Included in the foregoing rental commitments are financing leases having a present value at the statement date of \$5,064,000 based upon an approximate weighted average interest rate of 7.37%.

The Company has a contingent liability of \$4,382,000 in respect of a \$5,000,000 irrevocable letter of credit which expires on March 1, 1976 (renewable for six months thereafter) written in favor of certain option clearing associations to satisfy margin requirements. A fee of  $\frac{3}{4}$  of 1% per annum is paid on the aggregate amount of the letter of credit.

The Company has been named in several civil actions in the ordinary course of its business which, in the opinion of the Company, will be resolved with no material adverse effect on its financial condition.

#### 8. SALE OF INVESTMENT

In January 1976, the Company sold its investment in associated company to its Parent Company for cash equivalent to its carrying value plus unrecognized exchange rate gains. Part of the cash paid by the Parent was provided from the repurchase by the Company of a portion of its common stock held by its Parent at book value and the release of the Parent's secured demand note and related cash collateral. The net effect of these transactions was to decrease the Company's Capital Funds by \$5,000,000 and to increase its regulatory net capital by \$5,000,000 due to the decrease in non-allowable assets used in the calculation of regulatory net capital (see note 6). If the sale had been effected at December 31, 1975, the pro forma ratio of aggregate indebtedness to net capital would have been 5.66 to 1.

## Management Directory

Paul Hallingby, Jr.  
*Chairman*

Charles C. Lee, Jr.  
*Vice Chairman*

Henry W. Meers  
*Vice Chairman*

Frederick S. Wonham  
*President*

James W. Needham  
*Executive Vice President*

Thomas C. Pryor  
*Executive Vice President*

### Corporate Finance

George G. Montgomery, Jr.  
*Senior Vice President  
and Director*

Paul A. Downey  
*Senior Vice President  
and Director*

Richard S. Ellwood  
*Senior Vice President  
and Director*

Robert K. Green  
*Senior Vice President  
and Director*

Nigel S. MacEwan  
*Senior Vice President  
and Director*

Alexander M. White, Jr.  
*Senior Vice President,  
Director, and Secretary*

### Senior Vice Presidents

Hiram W. Emery, Jr.

Todd Goodwin

Robert L. Huston

Anthony V. Leness

Wm. Brian Little

David C. Mulford

Jeremiah K. Ross, Jr.

### First Vice Presidents

John B. Adams

Alden S. Bennett  
*(Philadelphia)*

Harrington Bischof  
*(Chicago)*

Jerome J. Clacys III  
*(Chicago)*

Henry C. Clifford

Michael H. deHavenon

Charles J. Fuhrmann II

Keith R. Gollust

William B. Heberton  
*(Atlanta)*

Stephen W. Houghton

Benjamin R. Jacobson

Sumner Kaufman  
*(Boston)*

Robert A. King

John M. Kingsland

Charles A. Lewis  
*(Chicago)*

James A. Martens

C. William Maxwell

David C. McCutcheon

Donald K. Miller

John M. O'Mara

Louis Perlmutter

Donald R. Peterson  
*(Los Angeles)*

David Reid-Scott

Clarke Simonds  
*(Providence)*

James W. Simpson

Robert A. Stanger

Douglas T. Tansill

Paul E. Tierney, Jr.

Gregory H. Turnbull  
*(San Francisco)*

### Vice Presidents

Wallace L. Bennett

Jeffrey L. Berenson

Matthias B. Bowman

William P. Donohue

Joseph F. Huber

Jeffrey C. Neal  
*(Chicago)*

Thomas H. Patrick  
*(Chicago)*

Jeffrey A. Rosen

Theodore D. Sands

Gordon H. Taylor

### Investment Policy

Thomas C. Pryor  
*Executive Vice President  
and Director*

Harold W. Janeway  
*Senior Vice President  
and Director*

A. Gary Shilling  
*Senior Vice President  
and Economist*

John A. Mendelson  
*Vice President*

### Research

Jerome P. Kenney  
*Senior Vice President and  
Director of Research*

### First Vice Presidents

James C. Blair

George H. Cleaver

Allerton Cushman, Jr.

Philip L. Dodge

A. James Donohue

Craig W. Fanning

William R. Gill, Jr.

Marjorie M. Jones

Brenda Lee Landry

H. Carroll Mackin

F. Robert Mayforth  
*(Wilmington)*

Edwin D. Pawling

Milton Schlackman

Jack K. Smith  
*(Wilmington)*

William N. Walling, Jr.

### Vice Presidents

Stover L. Babcock, Jr.

John H. Hayward, Jr.

John A. Jensen, Jr.

John L. Kalmbach

Anthony G. Langham

Robert Margolis

Daniel E. Somers

### Asset Management

Edward D. Little  
*Senior Vice President*

Frank J. Ritger  
*Senior Vice President*

### First Vice Presidents

Charles E. Cane, Jr.

C. Michael Hazard  
*(Boston)*

Walter Maynard, Jr.

### Vice Presidents

John P. Gantly

William R. Gill, Sr.

Thomas Keogh

Emile P. Mettetal  
*(Boston)*

T. Michael Middleton  
*(Boston)*

Deyan Popovic

Guy G. Rutherford, Jr.

Robert L. Sterling, Jr.

James D. Taliaferro

Thomas R. Warfield

### Fixed Income Securities

Peter V. N. Philip  
*Senior Vice President  
and Director*

### Corporates

Charles M. Litzel  
*Senior Vice President*

### First Vice Presidents

Richard E. Bozsnyak

Richard Edmonds

John T. Lewis  
*(Boston)*

### Vice Presidents

Edward J. Burke

Stephen J. Dunn

Robert L. Gray  
*(San Francisco)*

Arthur W. Gregory III  
*(Boston)*

J. Terry Heath  
*(Chicago)*

James Hurlbut, Jr.  
(Dallas)

George J. Kaffl

Hugh Leahy

John A. Locus

Wallace C. Olson  
(Minneapolis)

Patrick E. Phelan  
(Chicago)

Margaret N. Rea

Raymond E. Spence  
(Atlanta)

Clarence H. Taylor, Jr.  
(Atlanta)

Richard S. Wilson  
(Research)

Robert N. Young, Jr.  
(Philadelphia)

#### Governments

E. Corprew Reed  
*First Vice President*

John Hogan  
*Vice President*

#### Municipal

*First Vice Presidents*

William F. Fuller

William M. G. Fletcher

Thomas Sexton

Theodore P. Swick

*Vice Presidents*

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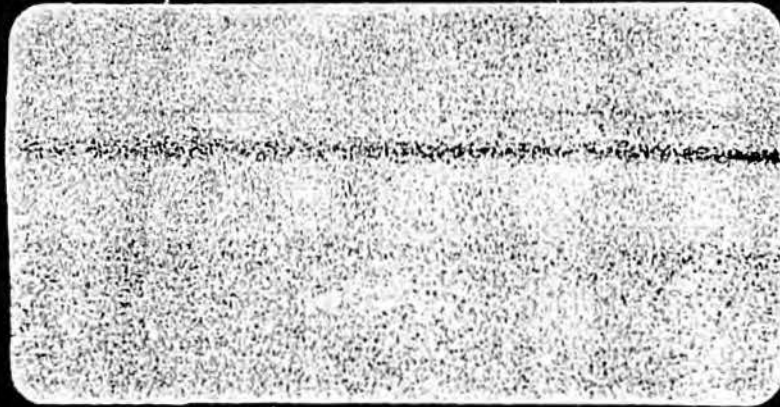
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STATE OF ALASKA

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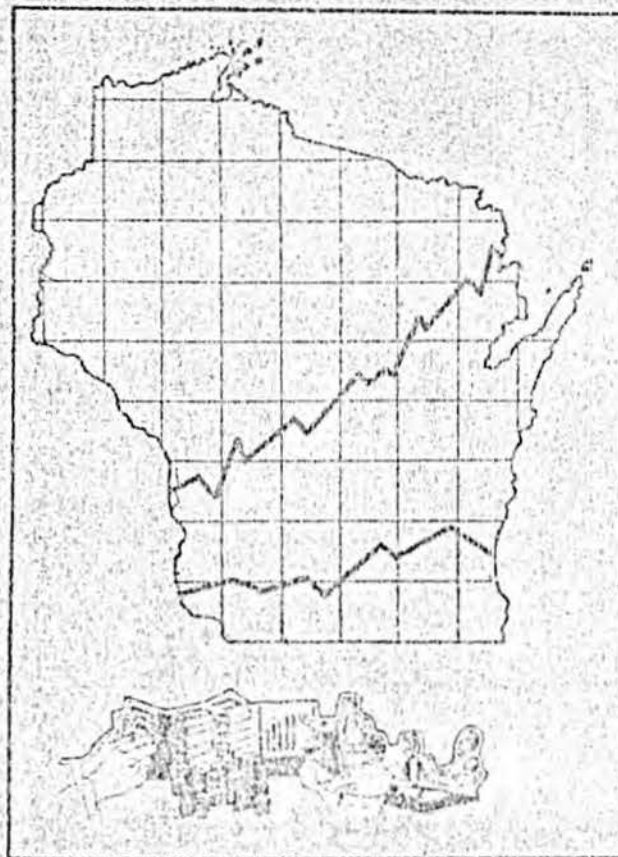
STATE OF ALASKA

<u>Exhibit</u>	<u>Topic</u>
I	Investing State Funds: The Wisconsin Investment Board.
II	August, 1976 Report to the Legislature of the State of Minnesota by the State Board of Investment.
III	State Investment Funds: Excerpt from White, Weld & Co. Inc. Report to the State of Alaska, October 1976.
IV	Organization and Management: Tentative Organizational Structure. Excerpt from White, Weld & Co. Inc. Report to the State of Alaska, December 1976.
V	Investments - Corporate Securities. Excerpt from White, Weld & Co. Inc. Report to the State of Alaska, December 1976.
VI	Investments - Money Market Instruments. Excerpt from White, Weld & Co. Inc. Report to the State of Alaska, December 1976.
VII	Investment Counsel Association of America: Standards of Measurement and Use for Investment Performance Data.
VIII	Criteria for the Selection of Discretionary Fund Managers.
IX	Tables from Stocks, Bonds, Bills and Inflation: The Past (1926-1976) and The Future (1977-2000) by Roger G. Ibbotson and Rex A. Sinquefeld.

**Exhibit I**

# Investing State Funds:

The Wisconsin Investment Board



NOV 16 1976

INNOVATIONS TRANSFER  
New Approaches by the States

## INVESTING STATE FUNDS

The Wisconsin Investment Board

This report was prepared under a grant from the  
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The contents do not necessarily reflect the views of the  
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August 1976  
RM-583  
\$3.00



THE COUNCIL OF STATE GOVERNMENTS  
Lexington, Kentucky

*"It is one of the happy incidents of the Federal System that a single courageous state may, if its citizens choose, serve as a laboratory and try novel social and economic experiments without risk to the rest of the country."*

Supreme Court Justice Louis D. Brandeis

# CONTENTS

Title	Page
FOREWORD . . . . .	v
PREFACE . . . . .	vii
EXECUTIVE SUMMARY . . . . .	ix
I. INTRODUCTION . . . . .	xi
II. INVESTMENT BOARD RESPONSIBILITIES . . . . .	1
Retirement Funds . . . . .	1
State Investment Fund . . . . .	1
Local Government Investment Funds . . . . .	1
Investing the Float . . . . .	2
State Working Bank . . . . .	2
Development of the Wisconsin Investment Program . . . . .	3
The Politics of Investing State Funds . . . . .	3
III. ORGANIZATION OF THE INVESTMENT BOARD . . . . .	5
Staffing . . . . .	5
Investment Division—Bonds . . . . .	6
Transaction Amortization Account . . . . .	7
Investment Division—Stocks . . . . .	7
Investment Division—Private Placements . . . . .	8
Investment Division—Mortgages and Real Estate . . . . .	9
Investment Division—Short-Term Investments . . . . .	9
Administrative Expenses . . . . .	10
IV. STATE/LOCAL FISCAL COOPERATION . . . . .	12
Background . . . . .	12
Provisions of the Two Local Funds . . . . .	13
How the Pooled Investment Fund Works . . . . .	13
Advantages of the Pooled Investment Fund . . . . .	14
The Investment Trust Fund . . . . .	15
Initial Results of the Pooled Investment Fund . . . . .	15
Implementing the Pooled Investment Fund in Other States . . . . .	16
V. THE STATE WORKING BANK . . . . .	17
Activities of the State Working Bank . . . . .	17
Banks and the Selection Process . . . . .	18
Utilizing the State Working Bank in Other States . . . . .	20
VI. TRANSFERRING THE WISCONSIN PROGRAM . . . . .	22
Legal Issues . . . . .	22
APPENDICES . . . . .	26-31

## FOREWORD

The policy, management, and operations of state government require the application of constantly updated approaches to address changing needs and priorities. This necessity for self-renewal implies innovations in the institutions of state government, in their structure, policies, procedures, and personnel.

Many innovations have occurred in recent years in a number of fields at the state level. However, too little is known about some specific state activities because of the variety of laboratories in which they occur. The innovation process is further complicated by the fact that state government officials rarely have the time or opportunity to share such knowledge which may be applicable in other States. Under day-to-day pressures and constraints, professional administrators and technical experts lack the time to write up or share new approaches that they have developed.

The Council of State Governments, which has been providing a forum for such an exchange for many years, has recently expanded its efforts in this area. The State of Wisconsin Investment Board is one of a series of six innovations being studied by the Council under a grant from the National Science Foundation. Besides this program, the others selected for evaluation during this first year include pension fund consolidation, statewide property tax assessments, a state energy management commission, controlling health costs, and a railroad branch line rehabilitation program. Reports are available on the latter four programs.

The state programs studied were selected by a national advisory panel composed of state legislators and officials. The Council is grateful to these individuals for their assistance: Senator Anthony A. Derezinski, Michigan; Senator John Pat Fanning, West Virginia; Senator Larry Fashbender, Montana; Representative Vera Katz, Oregon; Walter Kicinski, Deputy Secretary to the Governor, New York; Jeffrey Laurenti, Executive Assistant, New Jersey Senate; Attorney General V. Frank Mendicino, Wyoming; Senator Mike O'Connor, South Dakota; Representative Cornelius O'Leary, Connecticut; Dr. Tibor Payzs, Special Assistant to the Governor, Kentucky; Joseph V. Stewart, Deputy Director, Department of Finance and Administration, Arkansas; Daniel W. Varin, Chief, Statewide Planning Programs, Rhode Island; William W. Wilkins, Budget Director, Ohio.

This report on Wisconsin's Investment Board was prepared by Dick Howard, Director of the Council's Innovations Project, and James E. Jarrett, Research Associate.

Lexington, Kentucky  
August 1976

Brevard Crihfield  
Executive Director  
The Council of State Governments

## PREFACE

Inflation, opposition to higher taxes, and taxpayer disenchantment with government generally, are having a serious impact on government financing at all levels. A recent National Association of State Budget Officers' survey showed States' general fund expenditures in fiscal years 1975 and 1976 increased at a faster rate than did general fund revenues. Surpluses built up in previous years have been rapidly depleted. In the aggregate for the 43 States that responded to the budget officers' survey, general fund balances declined from 8 percent of expenditures in 1974 to an estimated 0.3 percent in fiscal year 1976.

The problem is further exacerbated for States by federal funding reductions in some functional areas and federal program requirements for additional state dollars in other areas. All of these factors are beyond control of state government officials.

In a word, state managers should be, and are looking for additional sources of revenue. One obvious source of significant amounts of revenue is to put state dollars to work, and more and more States are taking advantage of investment opportunities. Perhaps no State has a more completely developed investment program than Wisconsin, which has been investing the assets of retirement funds for 65 years.

This monograph is the fifth in the Council of State Governments' current series of reports on innovative state government programs. It probably comes the closest to describing a "model" program. One reason is that the State of Wisconsin Investment Board has had 25 years to evolve.

We are grateful to the many individuals in Wisconsin, especially those associated with the investment board, who were so generous with their time in helping us to understand the agency's activities and responsibilities. In addition to each of the investment directors, we especially want to thank George W. Crownhart, General Counsel for the board and at the time of our visit acting executive director; Gerald T. Mahaffey, Administrator, and Tom Landgraf, Director of State Budget Operations.

Several individuals reviewed earlier drafts and made useful comments: LeRoy Dockter, Audit Director, Wisconsin Legislative Audit Bureau; Peter J. Nelson, Assistant State Treasurer, Wisconsin; George A. Bell, Executive Director, National Association of State Budget Officers; and Carl Vorlander, Executive Director, National Association for State Information Systems.

Further information can be obtained from officials of the Wisconsin Investment Board (telephone 608/266-2384) or the authors of this report (telephone 606/252-2291).

Dick Howard  
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August 1976

## EXECUTIVE SUMMARY

- The State of Wisconsin Investment Board invests the retirement funds of the major government employee units in Wisconsin: Milwaukee teachers, state employees, and Wisconsin teachers.
- The investment board invests idle cash from 34 different state accounts, earning \$56 million on these pooled accounts last year.
- The investment board invests the State's check float, working with the state treasurer and the Department of Administration to ascertain the State's revenue and withdrawals each day.
- The Wisconsin board also has authority to invest the surplus funds of local governments that may deposit such funds with the treasurer.
- The Wisconsin investment program is facilitated by:
  - Use of only one bank for all deposits and withdrawals of state funds. (No state money is deposited or invested in other state banks.)
  - A computerized statewide accounting and reporting system that allows quick and accurate cash flow estimates by the Department of Administration and state treasurer.
  - Use of a custodian bank in New York City that eliminates handling of securities by Wisconsin officials and permits immediate transfers.
  - Great latitude in the types of investment instruments that can be purchased thus permitting the flexibility needed to maximize investment return.
- Almost all aspects of the Wisconsin investment program have been specifically authorized by Wisconsin law.

HOWEVER, other States should consider that *an investment program similar to Wisconsin's*:

- Would reduce the control top elected officials have over the use of surplus state funds;
- Would be opposed by banks which would no longer serve as depositories of public monies, including some local funds in the case of the Wisconsin local government investment pool;
- Would be more difficult to implement if centralized, computerized accounting procedures were not in use;
- Would be almost impossible to implement if the number of bank accounts cannot be kept to a minimum, preferably one or two;
- Would be opposed by agencies which are now managing the assets of retirement funds.

# I. INTRODUCTION

The State of Wisconsin Investment Board manages assets of nearly \$2.75 billion (6-30-75) which earn about \$175 million (based on a reported rate of return of 6.7 percent). Annual gross purchases and sales in fiscal year 1975 approximated \$12.75 billion. In addition to the millions of dollars earned from investing the assets of several retirement funds, the Wisconsin Investment Board earns millions of dollars by investing idle cash balances of 34 pooled accounts, including the general fund. In 1975 the average daily balance in the state investment fund was \$614 million. The return on these particular investments exceeded \$54 million—\$28 million for the state general fund and about \$26.5 million credited to the other pooled accounts.<sup>1\*</sup>

By way of comparison, \$28 million is more than the combined amount appropriated from the general fund to the following Wisconsin agencies: Banking (\$3.5 million), Insurance (\$9.1 million), Regulation and Licensing (\$4.9 million), Local Affairs and Development (\$5.2 million), and the Executive Offices (\$3.4 million).

Not only does state law authorize the investment of almost all state funds, enabling legislation recently authorized the State of Wisconsin Investment Board to invest bank balances upon which the treasurer has written a check, but which from experience the treasurer knows will not actually be paid out by the bank for several days. In other words, Wisconsin invests its "float" in a manner similar to large corporations. In Wisconsin, the check float averages about \$3.5 million per day. If the present 7.44 percent rate of return on short-term investments prevails, the check float would return \$264,000 to the State—a sum equal to about 45 percent of the investment board's budget.

Since March 1976, the State, through the treasurer and investment board, has begun investing idle balances of local governments. Numerous cities are participating in the program. One city reports earnings of \$62,000 on a one-month investment of \$9.7 million.

There are almost no major governmental retirement funds in Wisconsin whose assets are not managed by the investment board. It also is widely believed that there are almost no idle cash balances of state agencies. The budget of the board was \$576,000 in fiscal year 1975 including salaries and benefits of 28 employees, travel, the cost of investment services and outside investment counseling, and various other items associated with housing and supporting the staff. The \$576,500 budget means that the direct administrative expenses of managing \$2.75 billion in assets was a very low .02 percent. This ratio compares favorably with .2 to .4 percent commonly found in private financial institutions.<sup>2</sup>

The investment program in Wisconsin is facilitated by state laws that require centralized disbursements and centralized receipts. All checks are signed by the state treasurer in one form or another. All agencies must deposit receipts at least weekly and an even shorter time lapse prevails in the case of some large amounts.<sup>3</sup>

Another important facilitator is electronic data processing which is used throughout the accounting and reporting process.

The "state working bank" also plays an important role in the investment program. This bank, selected at about six-year intervals, is the

only depository for state money and it provides a variety of services including lock boxes, telegraphic money transfers, messenger deliveries, credit for after hours deposits, daily reports on the collected cash balances, and other specified services. Use of the working bank precludes the existence of idle cash balances in a number of depositories and permits rapid and accurate accounting of the State's cash position. Thus, all public money is working continuously.

Within its various portfolios, the investment board invests in stocks, corporate bonds, short-term and long-term obligations of the U.S. government and government agencies, repurchase agreements, real estate mortgages, commercial paper, and private placements. Bankers may lobby against reductions or elimination of state and municipal demand deposits and some legislators may occasionally insist that Wisconsin companies should get preferential treatment in the board's investments, but in the final analysis the direct, measurable economic benefits of a sound investment program have prevailed. The income from interest and capital gains has been substantial. Furthermore, the results compare very favorably with similar programs in the private sector, both from the standpoint of rate of return and costs to administer the program.

In the following section, the organization, administrative procedures, legal authority, and investment policies of the board are described. Additionally, there are separate sections devoted to the municipal investment pool and the Wisconsin state working bank.

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\*Footnotes for this report appear on pages 24-25.

## II. INVESTMENT BOARD RESPONSIBILITIES

The statutes assign extremely broad investment responsibilities to the board and also give it responsibility for the selection of the state working bank. Section 25.17 (1) (a) through (zm) enumerate the funds over which the board shall "have exclusive control of the investment and collection of the principal and interest of all monies loaned or invested." The only public money not invested by the investment board is under the control of the Board of Commissioners of Public Lands and the University Board of Regents.

### Retirement Funds

The major investment program involves the management of the assets of the State and Municipal Employees' Retirement Fund, the Milwaukee Teachers' Retirement Fund, and the Wisconsin Teachers' Retirement Fund. On January 1, 1975, these three large retirement funds were merged for investment purposes into two categories—a fixed fund and a variable fund. The fund with the fixed retirement benefits has a broad mix of investments that include bonds, stocks, mortgages, and real estate holdings. By contrast, the variable fund is restricted to equities, primarily common stocks. Finally, the board invests the assets of three smaller funds, the State Life Fund, the Insurance Fund, and the Historical Society Trust Fund. Investment of these funds is accounted for separately.

### State Investment Fund

Another important investment activity pertains to the State of Wisconsin Investment Board's exclusive jurisdiction over and management of the State Investment Fund. This fund consists of idle cash balances pooled from 34 individual state accounts, such as the general fund, the conservation fund, the state property insurance fund, and the highway fund. Because of the need for flexibility, the emphasis is on short-term investments—repurchase agreements (usually a short-term investment with a bank which is secured by U.S. Treasury bills), reverse repurchase agreements, commercial paper, certificates of deposit, bonds and notes of U.S. government agencies, and U.S. Treasury notes and bills. At one point in November 1975, the State Investment Fund totaled \$830 million. The average daily balance invested was \$614 million. The high short-term interest rates of FY 1975 permitted returns of 8.89 percent or \$54 million.

### Local Government Investment Funds

Recently a third investment pool has been authorized and responsibility for its management given to the State of Wisconsin Investment Board. This fund consists of money due local governments through tax sharing, but left with the state treasurer for subsequent board investment—usually short-term. See Section IV of this report for a description of this newest aspect in the innovative Wisconsin investment program.

## Investing the Float

In recent years, another important source of investment income to the State has been the short-term investment of "float," that is the difference between the cash on the treasurer's books and the collected cash balance on the working bank's books.

Investing the check float allows checking account balances to earn additional money while outstanding checks are undeposited or are in the process of clearing. Prior to a legislative enactment in 1974, the State of Wisconsin was barred from investing the check float. The attorney general had ruled that all funds disbursed by check had to be payable on demand. Because the State of Wisconsin has an average daily check float of \$3.5 million over and above the balance required for services the stakes of investing the excess float are of considerable economic importance. The procedure for investing the float can be illustrated by an example of state employees' payroll checks. If payroll checks are disbursed on Thursday, it is known from past experience that about 4 percent of the checks will clear the state working bank on the next day; an additional 28 percent will clear on Monday; 40 percent will clear on Tuesday, and the remaining checks will trickle in later. Therefore, about 68 percent of all payroll funds can be placed in short-term investments by the investment board for four days (Thursday to Tuesday). The state treasurer's office, after receiving the state working bank's daily report and computing the check float each day, will include these funds in the amount available for short-term investments and transmit this information to the investment board's short-term division.

There is no danger of overdrafts in the normal sense because the State maintains approximately \$10 million as compensating balance at the working bank. If the compensating balance goes below the minimum requirement, a charge is carried forward the next month against the State's account.

Revenues generated by investing a State's check float will vary depending on the average daily float and short-term interest rates. In Wisconsin, with an average daily float of \$3.5 million, the annual income generated would be as follows based on various short-term interest rates (income computed on 360-day basis):<sup>4</sup>

5 percent	\$177,000
6 percent	\$212,000
7 percent	\$245,000
8 percent	\$283,000
9 percent	\$319,000
10 percent	\$354,000

The most recent return on the State Investment Fund was 7.44 percent which, if maintained for the remainder of 1976, would bring the State nearly \$264,000 this year. As one Wisconsin official noted, "With respect to the over \$3 million per day typically tied up in check float, the situation is simple: either the bank makes money on it or the State of Wisconsin does."<sup>5</sup>

## State Working Bank

One other important, but noninvestment-related, function assigned by the Legislature to the board is the designation of the state working bank. This bank is the depository for all of the State's funds. With few exceptions, it provides the State with all its banking services. See Section V of this report for a description of the state working bank.

### Development of the Wisconsin Investment Program

The 28-person staff, the five investment divisions, and the several investment pools managed by the investment board are the present characteristics of an ongoing investment process that can be traced to 1911 and the creation of the State Annuity Board. Actually the board superseded the Annuity and Investment Board which by 1947 already exercised centralized control of investments, having responsibility for both idle operating funds and retirement trust funds.

At the outset, the Board of Trustees consisted of seven persons including the Governor, who was chairman. The staff numbered three. The investment board had the authority, even then, to invest in real estate, mortgages, common stocks, preferred stocks, and U.S. government securities.

Over the years, many changes have brought additional retirement and operating funds under the jurisdiction of the investment board, streamlined the administrative procedures, expanded the types of investment instruments available to the investment board and reduced the day-to-day role of the trustees vis-a-vis the staff. As the changes occurred and the assets under management increased, the size of the staff also increased although less rapidly.

In 1957 the State Investment Fund was created by the Legislature when it consolidated 19 different operating and temporary reserve funds into one. The Legislature also created the fixed annuity and variable annuity funds for each of the retirement trusts as a response to inflation.

By 1958, the third of the major retirement funds, the Milwaukee Teachers, placed its assets under the board's control.

The actual physical storage and handling of securities by the state treasurer's office ended in 1970 when the Legislature authorized the board to maintain an account at a non-Wisconsin bank. In that year, a custodian account was opened at a New York City bank for equities and a couple of years later an account for bonds was established at the same bank.

In the past three years, the trustees have prepared a policy manual delegating considerable authority to the staff;<sup>6</sup> the State has begun investing its cash float; the local government investment fund also has come into being; investment in longer term U.S. government obligations and unsecured notes of corporations including certificates of deposit has been authorized along with reverse repurchase agreements in a general effort to allow greater earning power and flexibility in short-term investments. The three major retirement funds have been merged for investment purposes greatly reducing the accounting work and enabling the fixed portfolio to be improved by amortizing gains and losses over a period of slightly more than 14 years (see page 00).

### The Politics of Investing State Funds

The investment board is apolitical and most observers agree that political pressures are minimal. However, with this much money, there are always interest groups endeavoring to have the funds benefit them or their causes. Two groups have, in fact, "borrowed" a substantial portion of the General Fund portion of the state investment pool: (1) the board must make available at the request of the Department of Veterans Affairs up to \$16.5 million for the purpose of housing loans to veterans, and (2) upon the request of the higher educational aids board a cumulative total of not more than \$55 million for loans to needy students.<sup>7</sup>

Not surprisingly, some underlying pressure is reflected in some legislators' views—to increase the percentage of brokerage business done with Wisconsin brokers and to give preferential treatment to Wisconsin companies when making loans and investments. In addition to the pressures for geographic preferences, there are from time to time pressures to give preferential treatment to minority businesses, and to avoid investments in companies engaged in "socially undesirable activities."

The independent nature of the board reinforces the individual member's inclination in the role as trustee not to pursue social goals in investment policies, and the Legislature has not mandated that social goals should be an investment consideration. Another factor mitigating against social issue criteria is the inability to agree upon and measure social benefits versus the clearly measurable results of economic decisions. An 8.26 percent return is an 8.26 percent return and it is better than a 7.26 percent return.

Although investment directors do not in fact give weight to social criteria the Board of Trustees cannot and does not take a "public be damned" attitude. It is aware that it operates in a political environment.<sup>8</sup>

### III. ORGANIZATION OF THE INVESTMENT BOARD

The State of Wisconsin Investment Board consists of seven members, six of whom are appointed by the Governor to staggered six-year terms. The seventh trustee is the secretary of the Department of Administration or the secretary's designee. Four "public" members must have at least 10 years of experience in financial matters (Wisconsin Statutes 15.79[2]), and the other gubernatorial appointees are nominated by the Wisconsin Teachers' Retirement and the State Employees Retirement Fund, respectively. The trustees generally meet for two days a month.

#### Staffing.

Actual investments—purchases and sales—are made by the staff acting under general policy guidelines set out by the seven-member Board of Trustees.<sup>9</sup> The staff is headed by an executive director who serves at the pleasure of the trustees. The staff presently numbers 28, and one more position has been authorized for the 1976-77 fiscal year.

Reporting to the executive director are five investment directors, each of whom is responsible for a three- or four-person division. The investment directors are appointed by the executive director with participation of the trustees. The investment director positions are part of the Wisconsin State Civil Service System and incumbents, after a probationary period, can only be terminated for cause. (Poor performance can be cause and investment directors have been terminated on that basis.) In addition to the investment directors, there is an administrative officer who is in charge of office operations such as personnel, accounting, secretarial, and clerical services.

The structure of the organization is in the process of changing. A research division is being created which will consist of a research director and four analysts. Previously, there were two research analysts and they reported to the investment director for stocks. Under the new arrangement, they will continue to analyze industry groups, but as the change suggests, will provide support services to all five investment directors.

Despite the existence of these research specialists, the board primarily relies on New York and selected regional investment banking firms for firsthand research of particular companies.

Salary ranges for top positions are shown below. While it is generally agreed that salaries for comparable positions in the private sector are higher, the investment board is able to fill its positions with competent individuals.

<i>Position</i>	<i>Salary Range</i>
Executive Director	\$31,068 - \$43,500
Investment Directors	\$28,512 - \$39,912
Research Director	\$17,016 - \$23,820
Senior Research Analyst	\$14,316 - \$20,040
Junior Research Analyst	\$10,368 - \$13,896

The day-to-day investment decisions are made by the investment directors with the concurrence of the executive director.<sup>10</sup> Quarterly, the investment directors and the executive director meet to determine how the estimated revenues will be allocated among the divisions: stocks, private placements, corporate bonds, short-term, and mortgages and real estate. Allocation depends on their collective judgment of market and investment opportunities in forthcoming months. Their views are also considered by the Board of Trustees, who retain the services of outside financial advisors.

Some funds such as those earmarked for the variable long-term investment fund, for example, all go to the investment director for common stocks. He decides on the timing and brokers for his purchases and sales, as do other investment directors for the funds allocated to them during the quarter.

Long-term investments for the fixed fund are generally invested by the Bonds, Private Placements, and Mortgages divisions. The short-term investment division is responsible for investing the 34-fund pooled account, the "float" funds, and the new local government investment funds.

Table 1 shows the diversified types of investments managed by the State of Wisconsin Investment Board.

Table 1

State of Wisconsin Investment Board Assets Under Management (June 30, 1975)	
Public Bonds	\$829,000,000
Bonds, Private Placements	322,000,000
Stocks	876,594,000
Mortgages	174,513,000
Real Estate	26,283,000
Short-Term	488,190,000
U.S. Treasury Notes & Bills	40,100,000
Government Agencies	86,670,000
Commercial Paper	105,945,000
Repurchase Agreements	255,475,000

Source: State of Wisconsin Investment Board, *Annual Report* Year Ending 6-30-75

#### Investment Division—Bonds

Bonds are a major part of the fixed fund portion of the long-term investment portfolio. During FY 1975, the Wisconsin board invested \$90.7 million in publicly issued bonds and \$45.2 million in private issues. All bonds account for approximately one-half of the long-term assets managed by the board, \$1,150,955,949 or 51.8 percent on June 30, 1975. The public bonds portion was \$829 million. Interest income on public bonds was \$36 million for the fiscal year.

Investment in corporate and government bonds is not unique to Wisconsin. In Wisconsin, specific authority to invest the fixed retirement investment trust, the state life fund, and the veterans trust fund is contained in Section 25.17 (3) (a) of the Wisconsin code. Statutory limitations on such investments are spelled out in Section 206.34 of the

Wisconsin statutes of 1969. Regarding the bonds of industrial corporations the investment board may not invest more than 2 percent of its assets in any one company nor may it invest in a company that has defaulted in the payment of principal or interest on its indebtedness within the past five years.

In addition, under the policies established by the Board of Trustees, all bonds purchased must be rated by two approved rating organizations. With regard to AAA bonds, no more than 2 percent of the fixed funds assets may be invested in any one issue; for AA or A the limitation is 1 percent and for Bbb or Baa, up to .25 percent. Baa and lower rated credits are reviewed annually.

Excluding portfolio improvement transactions (discussed below) an average of two issues of bonds is purchased each month. There is no policy that places emphasis on the credit issues of Wisconsin companies. However, it is the practice of the Bonds Investment Director to try to give Wisconsin bond dealers 50 percent of the "new issues" business where possible. To give Wisconsin dealers most of the bond business would preclude the division from receiving the research of New York based brokerage firms. The bond portfolio is now computerized by a brokerage house and each month a printout of the bond portfolio is sent to the investment board.

#### Transaction Amortization Account

The 1975 merger for investment purposes of the three major retirement funds facilitated another important change in investment procedures, particularly in the purchase and sale of bonds and stocks. It enabled the board to create a "transaction amortization account" whereby profits or losses from the sale of assets are spread over a 14-year period. Traditionally, most agencies investing public funds have applied profits or losses resulting from the sale of assets to the earnings of the year in which the sale occurred. One result was a certain inflexibility in portfolios since most portfolio managers were reluctant to sell assets resulting in large "book" losses that would be charged to the current year's investment income.

By merging the three retirement fund investments, it was no longer necessary to maintain records on each series of assets held in the portfolio. All gains or losses could be debited or credited to one account. The next step was to amortize all profits and losses at the rate of 7 percent annually, or slightly more than 14 years for the fixed retirement fund.

Among advantages reported are: (1) savings in work load, time and dollar costs by no longer amortizing each security, (2) a smoother, more representative and equitable annual income, and (3) greater flexibility in bond portfolio management. In fact, the Wisconsin board reports that in the first six months after the new accounting procedures were instituted, 24 separate "portfolio improvement transactions" changed the average annual yield on these investments from 7.633 percent to 9.007 percent. The book loss was \$4 million, \$33.4 million par value sold and reinvested in bonds having a \$29.4 million par value.<sup>11</sup>

#### Investment Division—Stocks

Common stocks comprise almost 100 percent of the "variable fund" and a substantial part of the "fixed fund." In FY 1975, for example, 28 percent of the board's fixed fund cash was invested in common stocks. During the fiscal year, common stock purchases totaled \$152 million, and total sales were \$102 million.<sup>12</sup> As of June 30, 1975, stocks accounted for 39.5 percent of the State of Wisconsin Investment Board's long-term assets (variable and fixed funds) and were

valued at \$876.6 million. In the fiscal year, the market value of the stocks in the fixed fund rose 20.8 percent and variable fund, 25.3 percent compared with a 16.1 percent of the S&P 500 Index—the most commonly used measure for evaluating performance of the Stock Division.

Stock transactions are made daily and net purchases average roughly \$30 million a month. Commissions approximate \$1 million annually in return for which the Wisconsin Investment Board receives considerable research.

Wisconsin's law [Chapter 25.17 (3) (a)] specifically provides that funds in the fixed category from the three major retirement programs may be invested in accordance with 1969 statutory provisions [Chapter 206.34]. The statute states that purchases of stocks can only be made from companies whose earnings meet certain specified criteria; no more than 1 percent of the investing agency's assets may be invested in the common stock of one company; nor may the equity position exceed 15 percent of the company's assets.

The Board of Trustees has delegated to the staff (Investment Director—Stocks) authority to purchase or sell stocks. However, stock purchases must be from the trustee-approved list of 206 companies. The investment director must also adhere to the trustees' policy limiting stock portfolio assets in any single industry to 15 percent, and no more than 30 percent may be invested in any one of the following broad categories: basic industry, consumer, technology, government regulated, and financial.<sup>13</sup>

The investment director reports that these constraints cause no particular problems and that the stock portfolio includes ownership in 120 companies.<sup>14</sup> A major criterion of the investment director is that an \$8 to \$10 million equity position will be possible in any company whose stock they might purchase. Because these stock investments usually do not go directly to companies, there is no pressure to buy the stocks of Wisconsin companies.

#### Investment Division—Private Placements

Presently, \$400 million (all from the retirement funds) is invested in private placements. According to the director of the division, "the major reason for inclusion of private placements in the portfolio is to realize an above average return on investments, through assumption of somewhat above average risk plus a premium for lack of marketability."<sup>15</sup>

The division currently has outstanding loans to 300 companies across a variety of industries: railroad, oil, savings and loan, foundry, retail chain, utility, and various manufacturing companies.<sup>16</sup> Loans are not restricted to Wisconsin; the majority of private placements are in other States and Canada.

Criteria for a private placement investment are rather strict. The two most important ratios analyzed are that long-term debt will not exceed 40 percent of total capitalization and that the sum of pretax earnings and fixed charges will be three times the fixed charges for the last two years (a 3 x fixed charge coverage ratio). The minimum loan is \$2 million and no credit rating of less than Baa will be considered. Placements cannot be used as venture capital—no loans can be made to companies in existence for less than five years.<sup>17</sup>

If the application has met this initial set of criteria, placement division staff request additional financial material and check many standard accounting measures such as rate of return on sales, operating margins, tax rates, and cash flow position. Also, the staff will consult

with outside people and solicit opinions on the company and industry, and may make site visits to the company.

There have been instances of legislators criticizing the private placements division for not loaning more money to Wisconsin firms. Concessions in the quality of the company or in the quality of the loan have not been made for placements in Wisconsin, but there are some allowances made for Wisconsin placements in terms of company size and requested loan figures. For companies outside the State, the minimum loan is \$2 million, and only those whose annual sales are at least \$40 million are considered. Wisconsin-based companies may request a loan as small as \$1 million provided their annual sales are at least \$15 million. Recent loan yields have averaged nearly 10 percent and it is estimated that fewer than 10 of the 400 loans outstanding are problems.

#### Investment Division—Mortgages and Real Estate

At present it is the board's policy that mortgages and real estate investments shall comprise between 5 and 25 percent of the fixed-fund portfolio. On June 30, 1975, nearly \$200 million was invested in mortgages and owned real estate. Return on mortgage and real estate investments exceed that of the bond division. The average return on the mortgages division's portfolio was 7.34 percent as of June 30, 1975.

A detailed set of guidelines is used by the three staff members of the division in determining which mortgages and real estate opportunities will be funded.<sup>18</sup> As with the other divisions, all investments of the mortgages division must conform to the broad specifications for investments set forth in the 1969 statutes.<sup>19</sup>

There is a broad diversity of mortgage fundings. In 1975, over \$51 million was loaned to 16 income properties—two shopping centers, eight apartments, two warehouses, a medical clinic, a nursing home, a manufacturing facility, and a participation in a loan on an office building. While there is an emphasis on mortgages and real estate investments in Wisconsin, more than 75 percent of the division's portfolio is placed outside the State.

#### Investment Division—Short-Term Investments

The short-term division has responsibility for investing the state investment fund which consists of 34 separate accounts such as the general fund (including the check float), highway fund, local government pooled investment fund, and cash of the retirement systems prior to its long-term commitment. Assets managed by the two members of the division vary from \$600 million to \$1 billion. As of May 15, approximately \$775 million was invested by the division. Daily purchases and sales average approximately \$75 million, and the short-term portfolio turns over every few weeks.

Return on the state investment fund was 9.02 percent in fiscal year 1974, 8.89 percent in fiscal year 1975, and 7.44 percent in the most recent quarter ending March 31.<sup>20</sup> The 7.44 percent rate of return for the recent period, as other state officials will note, is an excellent return since it was 1-1/2 to 3 percent greater than interest rates generally available to large cities. Declining short-term rates in the last 18 months are attributable to national trends.

A variety of short-term investment devices are used: government agency paper, bank certificates of deposit, open day-to-day and term-repurchase agreements, commercial paper, and reverse repurchase agreements.<sup>21</sup> In mid-May, the assets were distributed as follows: government paper — \$590 million (\$85 million was invested in a single U.S. treasury bill); certificates of deposit — \$55 million; open end repur-

chase agreements — \$60 million; and commercial paper — \$70 million. Usually no investments under \$1 million are considered, or agreements under \$5 million made.

Operationally, the short-term division receives a computer printout every day before 7:30 a.m. listing all current investments and specifying the present value for each discounted security. By 11 a.m. the division will have been notified of the check float level, will have balanced off the State's cash position, and will have checked over vouchers and amounts for individual transactions. After 11 a.m., the division will make trades for the following day, including making sales to cover the State's disbursement needs for the following day.

Investments are selected by the short-term staff from information supplied by brokerage houses and from staff's own knowledge of the short-term markets. The board's in-house research staff is not utilized regularly because forecasting is less useful for short-term investments than for long-term bonds and stocks.

In the future, the short-term division, in hope of increasing its options and of obtaining an even greater return on the investment fund, will request authority to invest in bankers' acceptances and "Eurodollar" certificates of deposit (the debt securities, in U.S. dollars, of overseas branches of U.S. banks). The ability to sell short in the market also is a possible future investment avenue of the division although the board's trustees have not yet given their consent for this more sophisticated and greater risk investment activity.

#### Administrative Expenses

An important feature of the investment board's operations is its low administrative expense. Table 2 compares the board's assets to expense ratio with those of private insurance companies and nonprofit investment operations. The Wisconsin Investment Board's expenses are proportionately lower, and in all but two cases (College Retirement Equities Fund and the Illinois Investment Board) the board's expense ratio is one-fifth that of other organizations.

Table 2  
Ratios of Assets to Expenses, Selected Comparisons, 1973

ORGANIZATION	INVESTMENT ASSETS	INVESTMENT EXPENSES (EXCL. TAXES)	PERCENT
Acacia Mutual Life	\$ 607,881,098	\$ 2,774,004	0.456%
Allstate Life Insurance	357,674,020	415,023	0.116%
Aid Assoc. for Lutherans	1,086,948,891	1,479,078	0.136%
Connecticut Mutual Life	3,116,740,666	57,082,944	1.831%
Continental Assurance	1,818,404,188	4,138,855	0.227%
Equitable Life Ins.	14,971,951,691	57,530,742	0.384%
Franklin Life Ins. Co.	1,433,098,891	2,754,778	0.192%
John Hancock Mutual	10,391,836,359	29,414,166	0.283%
Lincoln Nat'l. Life	2,410,340,286	3,649,828	0.151%
Mass. Mutual Life	4,795,468,874	17,907,492	0.373%
Metropolitan Life Ins.	30,286,075,837	99,071,174	0.327%
Mutual Life of N.Y.	4,044,504,230	16,058,497	0.397%
College Retirement Equities Fund	\$ 2,600,056,231	\$ 1,611,552	0.062%
Teachers Ins. & Annuity Assoc.	3,370,887,045	4,657,944	0.138%
Illinois Investment Board	793,726,994	643,628	0.081%
1974 Investment Board	2,520,303,000	524,468	0.0208%

Source: Wisconsin Investment Board

The investment board's administrative expenses are two cents per \$100 of invested assets. As Table 2 shows, in 1974 administrative expenses stood at .0208 percent of assets. This represents a slight decline over the past decade, during which time assets have tripled while staff has doubled. In 1965, the percentage for administrative expenses was .0289.

Several factors may account for the board's low administrative expenses. First, the number of staff and their salaries are less than comparable to private financial institutions. Second, because most funds managed by the board may be pooled, there are significant benefits achieved by a concentration of capital in terms of broker and trader commissions. Third, the board, by being a large institutional investment operation, receives research and related services as a result of its commission fees, that is, no cash outlay. Fourth, the board, like most state agencies, minimizes expenses for amenities and other perquisites.<sup>22</sup>

## IV. STATE-LOCAL FISCAL COOPERATION

In February 1976, a bill was enacted in Wisconsin which may produce significant economic benefits for local governments in Wisconsin as well as Wisconsin state government. Senate Bill 788 (reprinted in Appendix A) created two local government investment funds to be managed by the investment board—the pooled investment fund and the trust investment fund. The pooled investment fund is already in operation and will receive the bulk of attention in this section.

The pooled investment fund is a voluntary mechanism by which counties, cities, villages, and towns can deposit with the treasurer any state-shared taxes, local revenues, or idle reserves for investment by the state investment board. The interest earned, equivalent to the rate of return for all short-term investments by the board, is credited to the local government, and funds can be withdrawn on one-day notice with no penalties. The trust investment fund permits local governments to establish their own investment accounts with the state investment board and to have their funds managed for a specific period of time.

### Background

Legislation authorizing the pooled investment fund was first introduced by the state treasurer in 1967 but was withdrawn after 11 days because of pressure from the banking community. Because of a temporary (15-day) cash flow problem in Wisconsin state government, the program was revived with modifications in the spring of 1976. The State, which needed cash to disburse real property tax credit payments to local governments, was and is prohibited from borrowing more than \$100,000 for current obligations and is prohibited from interfund transfers. Therefore, local municipalities were faced with receiving a prorated amount of their shared taxes. State officials, however, knowing that Wisconsin municipalities collected their main revenues — property taxes — prior to February 28, reasoned that the temporary cash flow crisis could be averted if enough municipalities would defer receiving their state payment for two weeks. As an inducement for such “loans,” local governments would receive interest equivalent to that received on short-term investments of the investment board. Nineteen local governments left their funds with the State, and the temporary cash flow crisis was solved.

The pooled investment fund passed the Legislature under propitious circumstances. There was a fiscal crisis situation and the State's bankers were unorganized. While conditions in other States may not be similar, the economic benefits produced by establishment of a pooled investment fund might be sufficiently compelling to overcome opposition.<sup>23</sup> A major hurdle in Wisconsin was obtaining the support of local officials who were concerned about allowing the State to retain their funds in the pool. The local treasurers' association went on record opposing the investment pool. Opposition to the pooled investment trust was softened, however, by also providing for an investment trust fund which would require individual accounts for each locality's funds and for a specified time. If used, the trust fund will not offset the State's cash flow problem since these funds will be tied up for specified periods of time and thus be unavailable to the State.

### Provisions of the Two Local Funds

Senate Bill 788 specifies the major similarities and differences between the pooled investment fund and trust investment fund. First, for both funds, local government officials would tell the state treasurer whether they prefer to have their portion of shared taxes paid directly to them or deposited in their account in one of the funds. Secondly, both funds permit local government officials to augment their accounts in the investment board with idle reserves and any other local funds available for investment. Third, for both funds, a maximum of one-fourth of 1 percent of *earned income* will be deducted by the state investment board for administrative costs.

Fourth, local money in the pooled investment fund, while credited to individual local government accounts, would be pooled with state funds for short-term investments. Local money in the pooled investment fund would earn interest based upon the average yield of all short-term investments determined quarterly by the investment board. Local funds in the trust investment fund would not be commingled with other local funds or state funds and unlike the pooled fund, interest on trust investments will be determined by the yield on each separate local government account.

Fifth, local officials depositing funds in the pooled investment fund need not specify on what date they would like their principal and interest returned. Local officials depositing funds in the trust fund must designate the length of investment time for their funds, and incur any financial penalties for early withdrawal of their monies from the trust fund.

### How the Pooled Investment Fund Works

The mechanism for direct transfer of local government funds from the state treasury to the investment board serves two functions: (1) it reduces the amount of time which local government funds would sit idle and not receive interest, and (2) it helps the State handle emergency cash flow problems.

Operationally, the deposit and withdrawal system is quite simple. If a local unit of government is depositing money in the pooled investment fund from its state shared taxes, that government gives the state treasurer written instructions as to the amount which the State should retain. If a local unit of government is depositing idle cash from its own treasury, the local treasurer would ask the local government's commercial bank to transfer the funds to the state treasurer for deposit in the investment pool. The investment board will receive its information from the treasurer's office and it will be included in the daily total cash figure which can be invested. The investment board is not notified by the towns directly.

For withdrawals, the same process would be used. If notice of a partial or total withdrawal of the municipality's funds is made by 10 a.m., the state treasurer's office will issue a check that same day and transfer by telegraph the funds to the working bank of the local government. If the check cannot be issued until the next day, the local government also would be credited with an additional day's interest.

The interest earnings are computed on an average yield for a quarter and are based on the average daily balances of each participant's share of the short-term investment fund. Computer programs are used to determine the balance, deposits and withdrawals on a daily basis for each local government.

### Advantages of the Pooled Investment Fund

Both the local governments and the State should benefit from this investment pool. For the State of Wisconsin, the new arrangement of localities voluntarily leaving their funds will provide a mechanism to help it deal with the periodic, temporary cash flow problems. In turn, the State's credit rating will not suffer because of frequent cash flow difficulties. Local government funds provide additional capital to the state investment fund; therefore, the state agency may experience a better rate of return on investments and realize economies of scale on the cost side. Moreover, any constant flow of new short-term capital from local governments will enable placements in those investments that are providing the best current rate of return—thus possibly raising the overall rate of return on the State's short-term investments.

Increased cooperation between state and local fiscal officials, it is hoped, will reduce the distrust of state government by local government officials. Finally, to the extent localities experience an improved financial status, the State benefits indirectly.

For local units of government, the pooled investment fund will operate as a checking or demand account which pays a higher rate of return than local governments could obtain on their invested funds.

Officials in the Wisconsin Department of Administration conducted a comprehensive analysis of local government investment practices and discovered that 81 cities and 67 percent of all towns and villages in Wisconsin received no interest income in the 1974 calendar year. Many local officials simply placed idle cash reserves in noninterest bearing demand accounts in local banks.

Local governments should get higher returns on their funds because the investment board can invest in high-yielding, short-term investments such as repurchase agreements and commercial paper, because of lower dealer fees and because of the greater expertise of the board's professional staff. For example, because local governments will receive the same rate of return regardless of whether they invest \$2,000 or \$200,000 (that is, there is dollar averaging across investors), smaller towns and villages most likely will receive higher interest than if their accounts were invested separately.

In addition, the pooled investment fund, by providing local officials an alternative investment option, may force banks to provide more services to local governments in order to maintain the locality's operating funds.

For some municipalities the flexibility of the pooled investment fund will permit an integration of local governments' investment policies with their cash flow system. As noted previously, local governments may invest funds for any amount of time—one or two days or much longer periods. This "variable date" provision ensures that municipalities will not be penalized for early withdrawal or caught in a cash flow problem because of illiquid investments. In fact, the liquidity of the short-term investments and the mechanism for rapid transfer of funds from the state treasurer to local treasurer will enable local governments to receive their funds on the same day or one day after their notice of withdrawal.

Costs involved to state and local governments from the local government pooled investment fund are nominal. Local governments, in fact, incur only the costs of a phone call or postage for a letter to the state treasurer. The state investment board, as stated in the legislation, will deduct a maximum of one-fourth of 1 percent of all earned interest for administrative expenses. It is anticipated the actual administrative costs will be significantly less than this amount.

One possible difficulty that could arise for the State involves money left by local governments in the general fund at the request of state officials, for use in temporary cash flow difficulties, which is not invested but distributed to local governments who need their share. Lender local governments will receive interest on these funds just as if they were being invested by the investment board. Since these funds were not invested, there is an interest expense for the State that must later be appropriated from the general fund. It is not clear how much of a problem this will be and state officials do not agree. While there is a cost to the State of Wisconsin associated with operating the pooled investment fund during cash flow difficulties, this cost will be less than through borrowing on the short-term markets which is not legal under present law. Of course, any final solution to the cash flow problem must await statutory changes that spread payments throughout the year rather than require very large payments once or twice a year.

#### The Investment Trust Fund

As established, the local government trust-investment fund will be a vehicle for longer-term fixed investments by local governments. The trust fund, then, is conceived as a different type of investment option than the pooled investment fund.

Unlike the pooled investment fund, capital in the trust fund cannot be used by the State for cash flow purposes because it is in fixed investments. In terms of administrative/bookkeeping costs, the trust fund also is less advantageous—the Department of Administration must set up an individual account for each municipality (potentially 1,400) and maintain records on the type of investment interest earned, compute penalty charges for early withdrawals, and set up procedures for notifying local governments when their investments have become mature. In contrast, for the pooled investment fund, the Department of Administration, in cooperation with the state treasurer's office, needs only to maintain records on the average daily balance of a municipality's account during each calendar quarter as all accounts will receive the same rate of return.

If most local governments use the trust fund for long-term investments (over six months), the administrative task would be manageable, although still an additional burden to the investment board. If local governments wish their funds to be managed and rolled over frequently in short-term investments, the board might be overwhelmed, given present staffing.<sup>24</sup>

#### Initial Results of the Pooled Investment Fund

The pooled investment fund became effective March 1, 1976, with \$61.5 million in deposits from local governments that left their state shared taxes with the State to assist with cash flow problems. After the temporary cash emergency, local governments withdrew over \$45 million. Five cities kept their shared taxes in the investment pool during the month of March and received a 7.44 percent rate of return, the overall short-term investment yield for the first three months of 1976. Madison, Wisconsin, earned approximately \$62,000 on its one-month investment of \$9.7 million.

Overall, the pooled investment fund has been well received, and now, after the initial period of communicating the details of the program to local officials, participation is increasing. In one two-week period in mid-May, 26 additional local units of government invested cash in the pooled fund. As of July 12, 1976, local governments had nearly \$28 million in the fund.<sup>25</sup>

Start-up costs of the pooled fund were minimal as coordination for the program involved no budget and limited staff time. It appears no additional state employee must be hired for investment purposes. One person may be hired to serve as the principal information and resource contact for local governments although a final decision has not been reached.

Few complaints have surfaced to date. One city treasurer who has left shared taxes in the pool and also has transferred an additional \$2.1 million of the city's cash to the pool sees only two needed modifications. First, according to this official, the investment board should disseminate brief biweekly or monthly reports on what types of short-term investments are being made. This information, he suggests, would be useful for his own investment operation and could also be used to inform the elected city officials that the pooled fund will provide a superior economic return.<sup>26</sup>

Secondly, the city treasurer hopes that when local governments withdraw their funds from the pool, the interest will be returned immediately with the original funds. Currently, earned interest will be returned at the end of the next calendar quarter when the investment board computes the rate of return on short-term investments. Local treasurers can, of course, make estimates of their cities' interest income.

#### Implementing the Pooled Investment Fund in Other States

In Wisconsin, the pooled investment fund benefits state and local treasuries. In States without a centralized investment unit, establishing an investment mechanism for local governments would be considerably more difficult. States without financial expertise in short-term investments probably should not initiate a pooled fund until an investment board is operational for several years or until appropriate staff can be hired. States with an existing investment agency will need to consider how a sudden influx of local funds will alter current operations. For instance, computer programs must be developed by the investment agency or treasurer's office for proper crediting of municipal accounts. And, until other States duplicate Wisconsin's rapid deposit and withdrawal system, some mechanism must be established so that local governments do not lose substantial interest income from slow transfer of funds.

Not all States may wish to assume additional functions and not all States would receive as many economic benefits as Wisconsin. If a State is not investing in the short-term area, local government funds would not permit a concentration of capital and higher yields. If a State is not experiencing cash flow problems or distributing large sums of cash to local governments, the pooled fund would be less attractive. If there are many cities with their own investment programs, participation in the pooled fund would be less beneficial.

The pooled investment fund would appear to offer many economic benefits to state and local governments, given an appropriate investment framework. This fund will not solve any major existing problem but it may generate state and local revenues without extracting these resources from reluctant taxpayers. Few programs can be assessed so favorably.

## V. THE STATE WORKING BANK

Another aspect of the overall cash management system in Wisconsin is the "state working bank." The state working bank is selected by the State of Wisconsin Investment Board. Authority for selecting the bank is found in Section 25.17 of the Wisconsin Statutes:

(61) [The Board Shall]. . . designate public depositories for the deposit of public moneys. . . coming into the hands of the state treasurer; allocate the deposits of all public moneys coming into the hands of the state treasurer, and limit the amount of such public moneys, as determined from the state treasurer's records, which may be deposited in any public depository so designated. . . only such banks as have been named by the investment board as working banks shall carry state deposits on which checks are drawn to conduct the daily business of the state, all of which deposits shall be payable on demand.

The Legislature wisely avoided enumerating the selection criteria leaving that task to the board. Although the law would permit more than one working bank, the State of Wisconsin Investment Board has concluded that the operational advantages of using only one bank outweigh any operational or political disadvantages. Thus, there is only one Wisconsin bank serving as a depository for the State's funds. There are both operational and fiscal advantages from having one state bank instead of two. Coordination among a single working bank, the investment board, and the treasurer's office is an easier task because of a single disbursement account. Fewer man-hours are required to resolve any problems or issues when there is only one bank and better service usually results from having a super account with one bank instead of medium-sized accounts with two banks. The use of one bank instead of two has a fiscal benefit as well in that no interest will be lost due to transfer time between banks.<sup>27</sup>

The state working bank in Wisconsin is selected on the basis of proposals submitted by the interested banks.<sup>28</sup> Under the most recently used procedures, there is no ending date—a six-year working arrangement has been normal. It is anticipated that a thorough review of costs and services will occur at two-year intervals. Either the State or bank can terminate the arrangement with 12 months notice.

### Activities of the State Working Bank

As banker for the State, the First Wisconsin National Bank will provide many of the services it provides for its largest corporate customers. In its relations with its banker, the State's objectives are the same as a corporation's: (1) accurate reflection of its cash situation at any point in time, (2) efficiency in the provision of services at a reasonable cost, and (3) rapid and accurate transfer of funds in order that the State can make maximum earnings on its funds.

The state account ranges from \$2 million to \$100 million on any particular day. Thus, the volume of work is considerable. During the year, there will be eight million deposit items to the state account that must be processed. There will be 4.6 million checks and 4.5 million

reconciliation items directly related to the state account.<sup>29</sup> Deposits are made by mail, lock box, wire transfer, and over the counter. All disbursements are made by check with several series currently being used.<sup>30</sup>

Although there may be numerous modifications and refinements in the procedures followed by the State and the working bank, the essential services required by the State are reasonably well defined by the investment board, state treasurer, and Department of Administration. Based on these services and the anticipated volume, the banks bid for the State's account. Among the services needed are:<sup>31</sup>

- (1) The minimum time of credit shall be at least that provided by the Milwaukee Office of the Federal Reserve Bank of Chicago
- (2) The state working bank, if located outside Madison, shall designate a Madison bank to serve as its agent and accept all deposits made on behalf of the state treasurer,
- (3) Special courier runs from the state treasurer's office to the Federal Reserve Bank and to Chicago Loop banks to collect large dollar items,
- (4) Lock box services used by employers for withheld state income taxes and also for motor and special fuel taxes,
- (5) Same-day transfer of funds for settlements resulting from short-term investments,
- (6) Normal checking services plus separate reconciliation for each of several series of checks, microfilms of all cancelled checks and microfiche indices of the microfilms,
- (7) Telegraph transfer services, and
- (8) Foreign exchange services.

In order to facilitate the State's investment program, each working day at 8:15 a.m. the bank must notify the state treasurer of the collected balance in the State's account in order that short-term investments can be made that day. A monthly account analysis will be provided showing the average daily balance and the resulting excess or deficit position in compensating balances.

#### **Banks and the Selection Process**

As noted above, the state working bank is selected by the investment board from among those Wisconsin commercial banks which prepare and submit a proposal for the State's account. Not all banks are anxious to have the State's account. The volume is great and it will have a significant impact on the bank's operations. Obviously only a large bank with a highly computerized transit department could handle the very large volume of work generated by the state account. If the bank doesn't have accurate information about its internal costs, income from this account may not cover the costs associated with servicing it. Another important consideration is what happens when the account is shifted again in 6 to 12 years as seems entirely likely. Since the addition in demand deposits resulting from the State's account are substantial, it may be necessary to increase the bank's capital structure. Finally, potential bidders must consider what, if any, effect serving as the state working bank will have on other large bank customers (e.g., will these customers want banks to bid for their accounts?).

On the other hand, both state officials and bankers believe there is some prestige in being the State's banker. Banks might also see this as an opportunity to make new contacts and possibly as an opportunity to further develop certain banking functions that previously had received too little attention. Undoubtedly, however, the chief reason Wisconsin's banks would consider bidding for the State's account is to increase profits.

Competing banks' proposals are submitted in terms of compensating balances that the State must keep in demand deposits at the working bank. The State provides information on the type and volume of services needed. Each bank details the costs of handling the State's banking business and indicates what compensating balance is required to cover these costs including whatever profit the bank considers appropriate. Appendix B is the proposal form devised by the Wisconsin Investment Board.

Table 3 illustrates the computation of costs and their relationship to compensating balances. In this hypothetical one-month period, the State's balance exceeded the minimum required balance so the resulting excess is credited to the following month. In instances where the State's balance was below that needed to cover the costs of administering the account, the deficit would be made up in the following month.

Again, in the Table 3 illustration, a deficit would occur if the monthly direct charges had exceeded \$52,016 or if the compensating balance had been at a level such that the interest credit (102 percent of the treasury bill rate) was less than \$48,705, or some combination of both.

Table 3  
Example of Compensating Balance Credit Calculations

Total Monthly Direct Charges	\$ 48,705
Average Collected Balance in the State's Account During the Month	10,618,300
Less 12 percent Federal Reserve Requirement	<u>1,274,196</u>
Net Collected Balance	\$ 9,344,104
Interest Credit Computed at 102 percent of the Average Treasury Bill Rate (6.55 percent) for the month <sup>a</sup> (102 percent x 6.55 percent = 6.68 percent x \$9,344,104 ÷ 12) =	<u>\$ 52,016</u>
Excess Credit (\$52,016 - \$48,705) available to apply to subsequent month's charges	\$ 3,311

<sup>a</sup>102 percent of the average treasury rate is the credit rate determined by the State and the bank through the "bid" process.

Source: State of Wisconsin, "Specifications for Proposals to be the State Working Bank," Appendix B, October 15, 1975.

In addition to providing the services listed previously, it is the view of investment board staff that the state working bank should have deposits of at least \$120 million and that its capital, capital notes, surplus, undivided profits, and reserves equal at least \$11 million.<sup>32</sup>

Questions that might be asked are, "Is the investment board the most appropriate agency to select the state working bank?" and "Does the selection procedure insure that the State gets the best possible deal?"

Regarding the first question, it is true that on a day-to-day basis both the treasurer and the Department of Administration have more extensive dealings with the state working bank than the board. The procedures developed will affect these agencies most directly, and the board has no particular expertise in developing the needed cash management, auditing, or accounting systems.

No compelling case can be made for an independent investment board's selecting the state working bank. Nevertheless, in Wisconsin the board's independent status, its arms-length review of proposals, and its generally good reputation lend considerable credibility to the selection process. Moreover, the trustees have financial and investment expertise, solicit the ideas of the treasurer's office and the Department of Administration in developing the specifications, and seek the advice of their custodian bank in New York City in evaluating the proposals.

Whether or not the State is getting the lowest possible costs as reflected in the required compensating balance is not known. However, the bidding procedure would seem to assure a reasonable charge for services. State officials appear satisfied. The response by the Wisconsin state treasurer is believed representative:

"...under the State of Wisconsin philosophy of securing bids to serve as the state depository, we feel that the bidding banks through competition will arrive at a proper cost factor for their services. As a matter of truth we would be very reluctant to impinge our limited knowledge of bank costs upon banks who should bid on the basis of their own particular costs plus a reasonable profit.<sup>33</sup>

Again, this is not to suggest that the investment board is precluded from reviewing the bank's range of services, professional staff, equipment and facilities to ascertain if the bank can provide a proper level of services.

#### Utilizing the State Working Bank in Other States

In most States, the greatest obstacle to implementing the single state working bank concept is political. In Wisconsin the state working bank has been in operation for over 20 years and is generally accepted by Wisconsin's bankers. As taxpayers and businessmen it is difficult for banks and bankers to argue with the substantial efficiency savings and investment earnings.

Needless to say, the State's bankers have not always been so sanguine where the single depository for state money is concerned and as noted in the previous section, they opposed the creation of the local government investment funds. Perhaps the rationale most frequently advanced for maintaining numerous state accounts is the economic development one: these state dollars are used by local banks to generate additional business in the region. The viewpoint expressed by Wisconsin's elected treasurer seems appropriate:

"Up to this time (although I admit there is considerable pressure to the contrary) the State of Wisconsin, the Investment Board specifically, ... subscribes to the philosophy that money is a free-flowing object of trade that ignores political boundaries, and that attempts to promote local or regional business through bank de-

posits is to little avail. We tend to feel that generally such deposits are merely invested by the receiving bank in that form of investment which will realize to that bank the greatest income.<sup>34</sup>

In other words, many investment officials do not accept the economic development argument since local government funds will be used wherever the bank can obtain the highest rate of return—usually not in the local economy unless it is expanding rapidly. Furthermore, a number of States require that banks must put up collateral as security for state deposits. For instance, in Kentucky; banks must post government securities worth 110 percent of the uninsured portion of the deposit. Consequently, the result of these "linked deposits" in Kentucky is that state deposits of public funds in commercial banks may reduce the amount available to promote economic expansion. Recently, South Dakota dropped the collateral requirements on state deposits from 100 percent to 5 percent potentially "freeing up" an estimated \$180 million in South Dakota banks for other investments and loans.

The local economy and town residents, in fact, may benefit precisely because local funds are temporarily withdrawn from local banks in order to obtain a better interest rate elsewhere, such as through investments in the State's local government pooled investment fund.

From the standpoint of being able to engage banks that can provide the necessary services, a State's largest banks probably will bid to become the state working bank. Since the size of state government and the size of banks are both somewhat related to population, it seems likely that within each State there are banks that could handle the State's business. The banks in Wisconsin that bid on the state account have total deposits of \$1,859,678,000 (First Wisconsin) and \$581,525,600 (Marshall & Ilsley). This makes them the 48th and 161st largest banks in the country, suggesting that banks of varying size can handle the state account.<sup>35</sup>

While Wisconsin uses only one bank, it would be possible, if slightly more difficult, to use more than one working bank. For example, South Dakota uses two banks and alternates each month. A thorough analysis of the services required and volume of transactions within various state accounts would reveal the complexity involved.

In branch banking States, it might even be easier to implement the state working bank concept since transactions could be made throughout the State with immediate accounting. Collections and cash disbursements would occur more rapidly.

## VI. TRANSFERRING THE WISCONSIN PROGRAM

Some innovative state government programs are not applicable to many other States. This one is. It is not associated with size or composition of population, rural/urban considerations, size of State, geography, or the State's fiscal condition. All States collect large amounts of money and expend large amounts of money; therefore they have an enormous cash flow. All States have significant amounts of cash that are not needed for payments on any particular day and which, therefore, could be earning interest.

The review of the Wisconsin investment program suggests that the administrative factors are probably less important than the political ones in precluding the transfer of this comprehensive investment program from one State to another. The two groups most adversely affected appear to be bankers and existing boards, agencies, or councils which are responsible for investing various public funds. The latter group simply will not want to have this important investment responsibility transferred from it to a centralized investment board. The reasons are easily deduced and don't require expansion here. Bankers naturally will not like losing the earnings from the deposits of the State. The combination of establishing a state working bank, investing the check float, creating a local government investment pool, and investing idle cash balances are all programs that result in greater earnings for government at the expense of banks. In the case of both centralized banking and centralized investing the benefits to government can easily be measured.

Opposition may also come from the state treasurer since a comprehensive investment program probably will mean the treasurer's loss of some control of these funds. In Wisconsin, for example, the Department of Administration, not the treasurer, operates the computer system and performs the data processing and accounting. The investment board and staff make all the investment decisions.

### Legal Issues

State investment policies are influenced by the institutional setting in which investment policy is developed and by the philosophy and investment goals of various policymakers, but all of these factors are circumscribed by the constitutional, statutory, and administrative guidelines of the individual States.

In numerous States, the laws are silent on many matters affecting the development of a comprehensive investment program. Such was the case in Wisconsin and interpretations of the statutes generally have been strict in findings that necessitate specific statutory provisions authorizing board activities—the municipal investment pool, the investment of float, expanding the types of instruments that can be used for investment purposes, and the use of a custodian bank in New York City to physically hold and transfer securities.

There are other instances where the statutes limit the number and types of securities which may be held in the portfolio, the time periods an investment may be held, or the amount of treasury balances that may be invested. The use of banks as holding institutions for treasury balances when the money is not invested may also be subject to statutory limitation.

Equally as important as the statutes or administrative guidelines are the administrative procedures and policies (sometimes spelled out in law) that greatly affect the potential for cash management. Wisconsin has a system of centralized cash disbursement; rapid and centralized collections through lock boxes; one bank account; regulations requiring agencies to transfer funds immediately to the treasury; a centralized uniform accounting system, and a sophisticated, centralized, computer system. This centralized management capacity is lodged in a Department of Administration which has considerable authority over management systems and reports as well as budgeting and personnel. These factors certainly facilitate the development of a comprehensive state investment program. As the Wisconsin case shows, developing an extensive investment program can occur in stages with an investment board, followed by a working bank(s), and sophisticated accounting and computer systems, flexibility in investment instruments, and a custodian bank.

Another major component in the present program is competent staff to manage over \$2 billion in assets. However, the market for investment professionals is a national one, so it should not be difficult to attract personnel if reasonably competitive salaries are offered. It has been suggested that many state capitals offer pleasant living environments that many prospective employees would find desirable.

An equally important issue is whether outside consultants should manage state investments or whether this important activity should be conducted by state employees. While States may wish to divide investment operations between government and nongovernment employees for a period of time to determine which group achieves greater success, several items suggest that in-house investment may be the preferable course. First, responsibility for state investment operations should be assumed by a state official who can be rewarded or disciplined based on performance. With delegation of this responsibility to an outside firm, there is less control of personnel, and little redress for poor investment performance except dismissal of the firm. Secondly, if state officials invest state funds, they are investing some of their own retirement and tax funds, a procedure which is different than investing someone else's funds. Thirdly, and perhaps most importantly, in-house investment salary costs (for an equivalent level of service) will nearly always be significantly less than private firms' salaries. If this differential in salaries could be offset by higher investment returns from private consulting firms, there would be no problem. Private consulting services, however, have not consistently produced better investment yields than state investment officials. Finally, in-house investing has no administrative marketing or advertising expense.

In sum, if the political obstacles can be overcome and translated into satisfactory legislation, then any State can begin developing the computer and accounting programs and banking relationship needed to pursue an efficient investment program. The State of Wisconsin appears to be managing its cash flow in such a way as to permit maximum investment opportunity. There are no idle cash balances in Wisconsin, only a compensating balance to pay for bank services. There are very few unutilized or unauthorized investment channels.

In conclusion, the modifications described in this report, almost always mandated by specific statute, have resulted in an investment process in Wisconsin that can serve as a model for other state officials in evaluating their investment practices.

## FOOTNOTES

1. Derived from data presented in State of Wisconsin Investment Board

1. Derived from data presented in State of Wisconsin Investment Board *Annual Report* for fiscal year ending June 30, 1975, p. 6.

2. *Annual Report*, p. 8.

3. The Legislative Audit Bureau reports that some state departments have a few small working or contingent checking accounts which are restricted for specific payments.

4. Interdepartmental memo to Pat Hays, Bureau of Budget and Planning, from Peter J. Nelson, Assistant State Treasurer, November 28, 1975.

5. Interdepartmental memo to Pat Hays from Ken Engle, dated December 11, 1973.

6. Investment Board, "Manual of Functions, Goals, Policies, and Procedures," October 15, 1974.

7. Both amounts represent increases provided in 1975 Assembly Bill 222, Sections 256 and 257, respectively.

8. The investment board addresses the social responsibility issue in its *Annual Report* for fiscal year ending June 30, 1975, pp. 19-20.

9. See State of Wisconsin Investment Board, "Manual of Functions, Goals, Policies, and Procedures," October 15, 1974.

10. A number of restrictions have been placed on the private financial transactions of board employees to prevent unethical behavior. No employee, including support personnel, may purchase a new stock or bond offering until it has traded on one of the financial markets. In addition, a board employee cannot buy issues of a company at the same time as the board is adding the issue to its portfolio unless the employee can demonstrate a long-term continuous pattern of purchasing the specific issue. Furthermore, each investment director must file with the executive director a quarterly report listing all equity transactions. Finally, all board employees' federal tax returns must be submitted with the Wisconsin state tax return, and state returns are audited annually.

11. *Annual Report*, p. 13.

12. *Annual Report*, p. 18.

13. "Manual of Functions, Goals, Policies, and Procedures," page 11. It is also policy of the board that "no investment shall be made in stocks of companies which sell as a substantial product line tobacco, liquor, or gambling."

14. Interview with James Severance, May 14, 1976.

15. See "Background and Operations of the Private Placement Division," a paper prepared by Robert Zobel, Investment Director for Private Placements.

16. By policy of the board, no private placements are made in tobacco and alcohol firms or in real estate investment trusts. Few placements have been made in the insurance, finance, and medical fields because of limited staff experience with those areas. Normally preference will be given to loans which generate new jobs through capital expansion if the return is nearly equivalent to other loan applications. No distinctions are made according to characteristics of either the owner or company product line except those noted above.

17. Nor may the placements division entirely own a firm, a policy adopted by the board's trustees. Trustees, however, will permit the division director to sit on boards of directors of various companies. As the largest lender to many smaller firms, it would be appropriate for the investment board to be given a board seat. The current division director has decided not to become a member of any boards because of time constraints.

18. See the 1975 *Annual Report*, pages 9, 10.

19. It is understood that much of this section of Wisconsin law was derived from New York Statutes (Chapter 260, Section 34).

20. The 9.02 percent return on an average daily balance in fiscal 1974 of \$662 million earned \$5.9 million for the State. In fiscal 1975, \$54 million was generated.

21. According to investment agency officials, Wisconsin is one of a few States that uses the reverse repurchase agreement. The South Dakota Investment Council, also a sophisticated state investment agency, has arranged double-reverse repurchase agreements. In contrast to other state governments, the investment board normally does not invest heavily in bank certificates of deposit. Certificates of deposit (CD's) limit investment flexibility because their rates are established for a given time period, thereby preventing investment officials from taking advantage of fluctuating interest rates on other investments. Also, because CD's are not collateralized, CD's are not easily transferred in the national market.

22. Readers should note that the board's tax-exempt status is not the primary reason for its lower administrative expenses. In Table 2 the asset/expense comparison was computed with taxes excluded.

23. The Wisconsin legislation was modeled after a 1973 local government investment program enacted in Oregon. In Oregon the program was available at first only to county governments and larger cities. Presently, the majority of local governments in Oregon are participating in the program, and the level of local funds has expanded from \$100 million to over \$400 million.

24. The investment board has not yet established criteria (such as minimum times for investments, types of investments, and restrictions on number of purchases) for the trust fund.

25. Memo from Peter Nelson, Office of the Wisconsin State Treasurer, July 1976.

26. The Department of Administration anticipates that a monthly letter will be distributed to local officials whose cities have funds in the pool fund. However, it is unlikely that specific investments will be identified.

27. In South Dakota, for example, state accounts are rotated each month between two banks, and a South Dakota official estimates that this costs the State one day's interest on \$5 million each month—or over \$8,000 per year (assuming a 5 percent interest rate and a 360-day year).

28. From 1958 to 1964 the state working bank was First Wisconsin National Bank of Milwaukee; 1964 to 1976 the Marshall & Ilsley Bank (Milwaukee); and in 1976 First Wisconsin is the state working bank. Only these two banks bid on the state account although it has been suggested five or six Wisconsin banks are large enough to handle the State's account.

29. These volume figures are reported in an investment board staff memo to the trustees dated June 17, 1975. The number of deposit items was provided by Peter Nelson, Office of the Treasurer.

30. Washington State adopted a lock box procedure for all state tax remittances in mid-1975. At that time, the Department of Revenue anticipated a reduction in collection costs of \$60,000 annually and increased earnings of over \$340,000 a year based on additional investment through quicker tax collection. The bank involved handles the deposits without charging the State a fee.

31. Taken from a 10-page memorandum (plus appendices) prepared by the State of Wisconsin Investment Board entitled "Specifications for Proposals to be the State Working Bank," dated October 15, 1975.

32. Memo to trustees from the staff's State Working Bank Committee, dated June 17, 1975.

33. Letter from Charles P. Smith, Wisconsin State Treasurer, to Jack Kiley, Administrative Assistant to the State Treasurer of Washington, dated July 19, 1972.

34. Wisconsin State Treasurer Charles P. Smith, letter to Jack Kiley.

35. Based on information compiled by the *American Banker*, 525 West 42nd Street, New York City. Data are for June 30, 1975.

# APPENDICES

	<i>Subject</i>	<i>Page</i>
A.	Legislation Creating Local Government Investment Funds . . . . .	.27-28
B.	Proposal Form to be State Working Bank . . . . .	.29-31

## CHAPTER 164 , LAWS OF 1975

AN ACT to amend 20.906 (1) and (5), 34.01 (intro.), (1) and (b) (s), 59.75 (1) and 66.04 (2); and to create 16.53 (10) and (11), 20.002 (11), 20.855 (8), 20.906 (6), 25.17 (1) (j) and (j2), 25.50, 25.55 and 57.74 (2) of the statutes, relating to state treasury cash flow management, establishing a local government pooled-investment fund and a local government trust-investment fund and granting rule-making authority.

The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:

SECTION 1. 16.53 (10) and (11) of the statutes are created to read:

16.53 (10) PRIORITY OF CLAIMS. If, between the effective date of this act (1975) and 30 days after the publication of the budget adopted for the 1977-79 fiscal biennium, an emergency arises which requires the department to draw vouchers for payments which will be in excess of available funds in any state fund, the secretary, in consultation with the state treasurer and the joint committee on finance, may prorate and establish priority schedules for all payments, including those payments for which a specific payment date is provided by statute. The secretary shall draw all vouchers according to the following preference. All direct or indirect payments of principal or interest on state bonds and notes have first priority and may not be prorated or reduced under this subsection. All state employe payroll shall have 2nd priority. All payments to local units of government which are required by statute to be made on a specific date and all aid payments to individuals have 3rd priority. All remaining payments have 4th priority. The secretary shall maintain records of all claims prorated under this subsection and shall provide written notice to the state treasurer when a potential cash flow emergency is anticipated.

(11) INTEREST ON PRORATED PAYMENTS. Payments prorated under sub. (10) which are payable to local units of government shall earn interest on the daily unpaid balance at the rates of interest earned by the state investment fund during the calendar quarter in which the proration occurred. The interest payments under this subsection shall be credited to the respective local units of government at the end of the quarter in which the proration occurred.

SECTION 2. 20.002 (11) of the statutes is created to read:

20.002 (11) TEMPORARY REALLOCATION OF SURPLUS GENERAL FUND APPROPRIATIONS. All appropriations and special accounts within the general fund may be made temporarily available for the purpose of allowing encumbrances or financing expenditures of other general fund activities which do not have sufficient funds in their account but have accounts receivable balances. The secretary of administration shall determine the composition and allowability of the accounts receivable balances for this purpose and shall specifically approve the use of surplus general funds for use by specified activities or programs. The secretary may assess a special interest charge against the programs or activities utilizing surplus funds under this subsection in amounts not to exceed the daily interest earnings rate of the state investment fund during the period of transfer of surplus funds to other accounts or programs.

SECTION 3. 20.855 (8) of the statutes is created to read:

20.855 (8) PAYMENTS TO LOCAL UNITS OF GOVERNMENT. (a) Interest on prorated payments. A sum sufficient to pay interest on payments to local units of government under s. 16.53 (11).

SECTION 4. 20.906 (1) and (5) of the statutes are amended to read:

\*\*\*\*\*  
 \*Section 195.06, Wisconsin Statutes, Laws and acts) time of going into force. "Every law or act which does not expressly prescribe the time it takes effect shall take effect on the day after its publication."\*

20.906 (1) FREQUENCY OF DEPOSITS. Unless otherwise provided by law, all moneys collected or received by any state agency for or in behalf of the state, or which is required by law to be turned into the state treasury, shall be deposited in or transmitted to the state treasury at least once a week and also ~~at other times as~~ required by the governor or the state treasurer and shall be accompanied by a statement in such form as the treasurer may prescribe showing the amount of such collections and from whom and for what purpose or on what account the same was received. All moneys paid into the treasury shall be credited to the general purpose revenues of the general fund unless otherwise specifically provided by law.

(5) CONDITIONS PRECEDENT TO RELEASE OF APPROPRIATIONS. All appropriations made by law from state revenues for any state agency, are made on the express conditions that such state agency pay all moneys received by it into the state treasury within one week of receipt of ~~the~~ ~~amount~~ ~~of~~ ~~the~~ ~~same~~ ~~as~~ ~~required~~ ~~by~~ ~~the~~ ~~statute~~ ~~and~~ ~~conforms~~ ~~with~~ ~~ss.~~ ~~18.23~~ ~~(1)~~ ~~and~~ ~~20.002~~, both as to program revenue and general purpose revenue appropriations from all funds. Upon failure to comply with the above conditions, the department of administration shall refuse to draw its warrants, and the state treasurer shall refuse to pay any moneys appropriated to the state agency from state revenues until compliance is made with said conditions ~~and upon~~ ~~failure~~ ~~to~~ ~~so~~ ~~comply~~, after due notice received from the department of administration, any appropriations made by law from state revenues to the state agency shall permanently revert to the fund from which appropriated.

SECTION 5. 20.906 (6) of the statutes is created to read:

20.906 (6) DIRECT DEPOSITS. The governor or the state treasurer may require state agencies making deposits under this section to make direct deposits to a bank designated as a depository by the state investment board, if such a requirement is advantageous or beneficial to the state.

SECTION 6. 25.17 (1) (j) and (j2) of the statutes are created to read:

25.17 (1) (j) Local government pooled-investment fund (s. 25.50).

(j2) Local government trust-investment fund (s. 25.55).

SECTION 7. 25.50 and 25.55 of the statutes are created to read:

25.50 Local government pooled-investment fund. (1) DEFINITIONS. In this section:

(a) "Board" means the state investment board.

(b) "Fund" means the local government pooled-investment fund.

(c) "Local funds" means funds under the control or in the custody of any local government or local official that are not required to meet current expenditures or demands.

(d) "Local government" means any county, town, village or city in this state.

(e) "Local official" means each officer or employe of a local government who by law or vote of the governing body of the local government is made the custodian of funds.

(2) CREATION. There is established within the state investment fund a local government pooled-investment fund with a separate and identifiable account within the fund for each local government.

(3) LOCAL GOVERNMENTS AUTHORIZED TO PLACE FUNDS IN FUND. (a) With the consent of the governing body, a local official may transfer local funds to the state treasurer for deposit in the fund.

(b) On the dates specified and to the extent to which they are available, subject to s. 16.53 (10), funds payable to local governments under ss. 20.906 (1) (a), 29.02 (2) (a), 29.03 (1), 29.04 (1), (2) (a) and (3), 29.05 (2), 29.05, 29.06, 29.08, 29.10 (1) and (3) and 29.17 (1) and (3) shall be considered local funds and, pursuant to the instructions of local officials, may be paid into the separate accounts of all local governments established in the local government pooled-investment fund and, pursuant to the instructions of local officials, to the extent to which they are available, be disbursed or invested.

(4) PERIOD OF INVESTMENT, WITHDRAWAL OF FUNDS. Subject to the right of the local government to specify the period in which its funds may be held in the fund, the state treasurer shall prescribe the mechanisms and procedures for deposits and withdrawals.

(5) INVESTMENT POLICIES. The investment board shall formulate policies for the investment and reinvestment of moneys in the fund and the acquisition, retention, management and disposition of such investments.

(6) INVESTMENT BOARD TO INVEST, REINVEST POOLED FUNDS. In the amounts available for investment purposes and subject to the policies formulated by the investment board, the investment

board shall invest and reinvest moneys in the fund and acquire, retain, manage, including the exercise of any voting rights, and dispose of investments of the fund.

(7) REIMBURSEMENT OF EXPENSES. The state treasurer shall deduct quarterly a maximum of 0.25% of the amount of income received from the earnings of the fund during the preceding calendar quarter for all actual and necessary expenses incurred by the state in administering the fund.

(8) SEPARATE ACCOUNTS. (a) The department of administration shall keep a separate account for each local government and shall record the individual amounts and the totals of all investments of each local government's moneys in the fund.

(b) The state treasurer shall report monthly to each local official the deposits and withdrawals of the preceding month and any other activity within the account.

25.55 Local government trust-investment fund. (1) There is created a local government trust-investment fund under the jurisdiction and management of the investment board.

(2) Local governments as defined in s. 25.50 (1) (d), may transfer to the state treasurer for deposit in the local government trust-investment fund excess cash for investment by the investment board. Local governments shall specify the term of investment of moneys transferred. The department of administration shall set up a separate account for each local government. The investment board shall invest such account separately in investments authorized under s. 25.17 (2) (b), (ba) and (dg). All interest accrued as a result of such investment shall be allocated to the account for which it was invested. The investment board shall prescribe rules determining the amounts which may be transferred to this fund for investment and the procedures to be followed for making deposits and withdrawals.

(3) Administrative expenses allocated to the operation of this fund shall be deducted from interest earned by the fund in an amount not to exceed 0.25% per quarter of the interest earned by the separate accounts in the fund.

SECTION 8. 34.01 (intro.), (1) and (8) (a) of the statutes are amended to read:

34.01 Definitions. (intro.) Amended in this chapter:

(1) "Public deposit" shall mean ~~any~~ moneys deposited by the state or any county, city, village, town, drainage district, power district, school district, sewer district, or any commission, committee, board or officer of any governmental subdivision of the state, or any court of this state, in any state bank, savings and trust company, mutual savings bank, or national bank in this state or in the local government trust-investment fund or the local government trust-investment fund, including private funds held in trust by a public officer for ~~public corporations or associations or individuals.~~

(8) (a) "Inactive deposits" shall mean ~~any~~ public deposits which have been deposited subject to the bank's rules and regulations relative to time accounts and the investment board's rules relative to amounts invested in the local government trust-investment fund.

SECTION 9. 59.74 (2) of the statutes is created to read:

59.74 (2) In addition to the depositories specified in sub. (1), the local government pooled-investment fund and the local government trust-investment fund may be designated as depositories for investment purposes.

SECTION 10. 59.75 (1) of the statutes is amended to read:

59.75 (1) Whenever any county board shall have ~~had~~ designated a county depository as ~~depository in accordance with the provisions of section 59.74~~ the county treasurer shall deposit therein as soon as received all funds that come to ~~be~~ the treasurer's hands or that capacity in excess of the sum ~~be~~ the treasurer is authorized by such ~~the~~ board to retain ~~and any~~. Any sum so on deposit shall be deemed to be in the county treasury, and ~~such~~ the treasurer shall not be liable for any loss thereon resulting from the failure or default of such depository, ~~provided that the~~ county board or a committee thereof designated by it may invest any funds that come into ~~the~~ county treasurer's hands in excess of the sum ~~be~~ the treasurer is authorized by the county board to retain for immediate use in the name of the county in the local government pooled-investment fund, in the local government trust-investment fund, or in interest-bearing interest-bearing bonds of the United States, or of any county or municipality in the state, and ~~such~~. The board or committee may sell such securities when deemed advisable.

SECTION 11. 65.04 (2) of the statutes is amended to read:

65.04 (2) Investments. Any county, city, village, town, school district, drainage district, vocational, technical and adult education district, or other governing board as defined by s. 34.01 (4) may invest any of its funds, not immediately needed, in time deposits in any bank, savings bank or trust company which is authorized to transact business in this state, such time deposits maturing in not more than one year, or in bonds or securities issued or guaranteed as to principal and interest of the U.S. government, or of a commission, board or other instrumentality of the U.S. government, or bonds or securities of any county, city, drainage district, vocational, technical and adult education district, village, town or school district of this state, or, in the case of a town, city or village, in any bonds or securities issued under the authority of such municipality, whether the same create a general municipality liability or a liability of the property owners of such municipality for special improvements made thereon, and may sell or hypothecate the same. Any county, city, village or town may also invest surplus funds in the local government pooled-investment fund, in the local government trust-investment fund, Cemetery perpetual care funds, pension funds under s. 62.13 (9) or (10), or endowment funds including gifts where the principal is to be kept intact may also be invested under ch. 481.

SECTION 12. Program responsibilities. (1) In the list of program responsibilities enumerated for the office of the state treasurer in section 14.561 of the statutes, insert reference to sections "25.50" and "25.55".

(2) In the list of program responsibilities enumerated for the department of administration in section 13.101 (intro.) of the statutes, insert reference to sections "25.50" and "25.55".

(3) In the list of program responsibilities enumerated for the investment board in section 13.761 of the statutes, insert reference to sections "25.50" and "25.55".

SECTION 13. Cash flow study. The department of administration is directed to prepare a report on the present statutory and administrative structure and procedure for the payment of local assistance funds to counties, towns, villages, cities and school districts. The report, after review by a 7-member committee consisting of the state treasurer, representatives of the departments of administration and public instruction, and designers appointed by the league of Wisconsin municipalities, county boards association, Wisconsin towns association and the Wisconsin school boards association, shall be submitted to the governor and the legislature no later than February 1, 1977, and shall include but not be limited to:

- (1) The identification of major local assistance payments.
- (2) The identification of payment schedules either required by statute or established by administrative action.
- (3) An assessment of the impact of such payments and schedules on fund balances and the operation and management of the state budget.
- (4) The criteria on the basis of which the current payment schedules were established.
- (5) The impact of current payment schedules on the operation of local and state government.
- (6) Recommendations, if deemed appropriate, for changes in the statute or in administrative procedures concerning such payments and schedules.

PROPOSAL FORM TO BE  
THE STATE OF WISCONSIN WORKING BANK

To: State of Wisconsin Investment Board

The following constitutes our proposal to provide the State of Wisconsin's banking business requirements for the period commencing July 1, 1976, and terminable on our part by giving one year's notice.

It is understood that, should our proposal be accepted, we will be designated as (1) State Working Bank, and (2) a State's depository bank pursuant to the provisions of s. 25.17 (61), Wisconsin Statutes.

It is further understood that the State of Wisconsin Investment Board, in its sole discretion, may reject this or any other proposal.

In addition, this bank agrees that the Investment Board may exclude any specific service or element thereof in any contract which may result from this proposal.

OFFER

This bank offers to provide all of the services outlined in that certain set of specifications dated October 15, 1975 and labeled "Specifications for Proposals to be the State Working Bank."

This bank agrees that it will maintain dormant balances, as directed, in designated banks for the benefit of the state. In consideration, an identical amount shall be subtracted from the net collected balance before applying the compensating balance formula outlined on page 6 of this proposal.

This bank agrees that it will establish and maintain a \$10 million open line of credit and allow draws against such line by the Wisconsin Building Commission on the condition that any draw against the line of credit shall bear interest at the rate of \_\_\_\_\_

of the bank's prime rate as posted from time to time.

-1-

-2-

TIME SCHEDULE UNDER WHICH  
THIS BANK WILL CREDIT THE STATE TREASURER'S  
ACCOUNT WITH COLLECTED FUNDS

This bank agrees that all deposits delivered during any working day to it or its Madison Agent, if any, will be credited to the State Treasurer's account as though they had been delivered to the Milwaukee Branch of the Federal Reserve Bank on that same day.

In addition this bank agrees that it will credit the State Treasurer's account with collected funds earlier than the Milwaukee office schedule on the following:

Its

When Credited  
(Same Day, 1  
day deferred)

This bank will provide the following system for check retrieval and copying for the Treasurer's Office and our time table for making it available is as follows:

1. System Description

2. Time Table

COMPENSATION

This bank agrees to provide the services as specified for the following direct (hard dollar) charge per item:

<u>Item</u>	<u>Dollars per item</u>
<b>1. <u>Deposit Items</u></b>	
(a) Per local deposit item	\$ _____
(b) Per transit deposit item	\$ _____
(c) Per N.E.F. item	\$ _____
(d) Blank Deposit tickets - per 1000	\$ _____
(e) Coupon Interest Collection Service per coupon	\$ _____
(f) Wisconsin I.O. Bond Coupons per presentation	\$ _____
<b>2. <u>Ledger Items</u></b>	
(a) Deposit ticket or credit memo - each	\$ _____
(b) Per check drawn on us	\$ _____
<b>3. <u>Other Checking Services</u></b>	
(a) <u>Blank Checks</u>	
(1) Series A,C,D,E,F,H, and R per 1000 checks	\$ _____
(2) Series B - per 1000 checks	\$ _____
(3) Series G,I, and X - per 1000 checks	\$ _____
(b) Reconciliation - per item	\$ _____
(c) Storage boxes - each	\$ _____
(d) Microfilming checks for Treasurer's use - per check	\$ _____
(e) Microfiche index for Treasurer's use per microfiche	\$ _____
(f) Microfiche images of computer printouts - per microfiche	\$ _____

4. Lockbox Services

(a) Withholding

(1) Employers deposit report form - each \$ \_\_\_\_\_

(2) Microfilming report form - each \$ \_\_\_\_\_

(b) Motor and Special fuel

(1) Motor fuel report form - each \$ \_\_\_\_\_

(2) Special fuel report form - each \$ \_\_\_\_\_

(3) Microfilming report form - each \$ \_\_\_\_\_

5. Wire Transfer Services

(a) Federal Wire - each \$ \_\_\_\_\_

(b) Bank Wire - each \$ \_\_\_\_\_

(c) Telephone advice - each \$ \_\_\_\_\_

6. Securities Clearance Services

(a) Transaction - each \$ \_\_\_\_\_

7. Government Bond Services

(a) per Bond \$ \_\_\_\_\_

8. Transportation Services

(a) Cash pick-up from State Treasurer's Office, Madison - per trip \$ \_\_\_\_\_

(b) Deposit pick-up from Department of Revenue, Milwaukee - per trip \$ \_\_\_\_\_

(c) Pick-up and delivery of various items (checks, deposits, cancelled check, microfilm, etc., no cash) round trip from Working Bank to Madison offices of State Treasurer, Department of Revenue, and Department of Transportation per round trip \$ \_\_\_\_\_

(d) Special Courier run:

(1) Federal Reserve Bank, Chicago - per trip \$ \_\_\_\_\_

(2) Chicago Loop Banks - per trip \$ \_\_\_\_\_

-6-

COMPENSATING BALANCE  
IN LIEU OF DIRECT CHARGE

In lieu of a direct charge for the services referred to above, this bank agrees that it may be compensated by collected balances in the State Treasurer's account.

The bank agrees to credit as payment for such charges an amount equal to one day's interest (computed on a 360-day year) using an interest rate equal to

\_\_\_\_\_ %  
of the monthly average of the 90 (91-92) day U.S. Treasury Bill rat. on each dollar of collected balances (less reserve requirements of the Federal Reserve Bank) left on hand each day during the month in the State's account.

\*as reported in the Moody's Bond Survey

In the event that the application of this formula produces a credit in excess of monthly charges, the bank agrees to apply such excess as credit towards the following month's charges. Conversely, the State will make up any deficit by increasing balances the following month.

Dated this \_\_\_\_ day of \_\_\_\_\_, 1975.

Name of Bank: \_\_\_\_\_

By: \_\_\_\_\_

Title: \_\_\_\_\_

Attest: \_\_\_\_\_

Title: \_\_\_\_\_

**Exhibit II**

# MEMBERS OF THE STATE BOARD OF INVESTMENT

HON. WENDELL R. ANDERSON, GOVERNOR  
HON. ROBERT W. MATTSON, STATE AUDITOR  
HON. JIM LORD, STATE TREASURER  
HON. JOAN ANDERSON GROWE, SECRETARY OF STATE  
HON. WARREN SPANNAUS, ATTORNEY GENERAL

## THE ADVISORY COMMITTEE ON STATE TRUST FUNDS

### Active Members

Franklin Briese, *Chairman of the Board (retired), Minnesota Mutual Life Insurance Company, St. Paul*  
Robert S. Davis, *C.F.A., Executive Vice President of Finance, The St. Paul Companies, Inc.*  
Gaylord W. Glarner, *Senior Vice President, First Trust Company, St. Paul*  
James C. Harris, *Vice Chairman of the Board of Directors, Northwestern National Bank of Minneapolis*  
John M. Harris, *Investment Counsel, Northern City National Bank, Duluth*  
John H. Herrell, *Vice Chairman of Investment Committee, Mayo Foundation, Rochester*  
Donald E. Jondahl, *Executive Vice President, Finance, Northwestern National Life Insurance Company, Minneapolis*  
Laurence R. Lunden, *former Vice President, Business Administration, University of Minnesota*  
Dale R. Olseth, *President, Medtronic, Inc.*  
Norman Terwilliger, *Investment Counsel to the Minneapolis Teachers Retirement Association*

### Members Emeriti

Hermon J. Arnott, *retired Chairman of the Board, Farmers and Mechanics Savings Bank of Minneapolis*  
Francis Hassing, *former Investment Counsel to the Board of Regents of the University of Minnesota*  
Maxwell B. Hight, *Section of Administration, Mayo Foundation, Rochester*

## INVESTMENT DEPARTMENT PERSONNEL

Robert E. Blixt, *B.A., M.S., J.D., C.F.A.*  
*Executive Secretary*

A. Arthur Kaese, *B.A., C.F.A.*  
*Assistant Executive Secretary*

Betty J. Eskuri  
*Portfolio Coordinator*

Margaret I. Conley  
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STATE OF MINNESOTA  
STATE BOARD OF INVESTMENT

Room 105, MEA Building  
55 Sherburne Avenue  
Saint Paul 55155

August 20, 1976

Members of the Legislature of the State of Minnesota:

The Investment Staff of the State of Minnesota is most appreciative of the policies and procedures approved by the State Board of Investment and Advisory Committee on State Trust Funds during the past few years. The results, as detailed in this report, have been very satisfactory by any standard — particularly those which may be considered appropriate for public funds.

Short-term money-market investments, retirement accounts, trust funds and other investment portfolios are often considered to be staid and unimaginative when handled by committees representing the general public. Yet, the Investment Staff has been most impressed and enthusiastic about the encouragement, support and ideas put forth by the Advisory Committee and Board members. The success of the portfolio in calendar 1975 and early 1976 has been due to the support received in implementing an aggressive purchase program in late 1974 and 1975 — at the time many investment experts were all too apprehensive regarding the future of the nation and its economy.

The period covered by this report includes the fiscal year from July 1, 1975 through June 30, 1976. Previous reports are available since the year 1960.

Although there were no significant changes in Minnesota's investment laws during the 1975 and 1976 legislative sessions, various inter-department procedural changes and the use of new types of securities have resulted in an improved investment program — one which, in our opinion, is more pertinent to the needs of the constituents.

One feature of Minnesota statutes which is sometimes misunderstood by legislators and retirement fund beneficiaries is that "market valuations" which determine retirement fund benefits and values in the Variable Annuity Fund and the Minnesota Adjustable Fixed Benefit Fund are based on bi-monthly security prices averaged over a two-year period. Therefore, the results of these two funds for fiscal 1976 will still be dependent, to some degree, on the low prices prevailing on both stocks and bonds in late calendar 1974. Actually, the State accounts were much benefited by this decline in securities values. We were able to increase our holdings significantly at substantially lower prices. Yet, because these prices are still included in the statistical base from which fiscal 1976 year-end results are computed, the investment progress of these two funds appears comparatively minimal for this past fiscal year. It must be emphasized, however, that the computations and ratios already effective for this fiscal year — that ending on June 30, 1977 — indicate substantial future gains for both the Variable Annuity Fund and the Minnesota Adjustable Fixed Benefit Fund.

The Investment Staff is particularly appreciative of the work of the Advisory Committee on State Trust Funds. This group was formed in 1961, at the time the statutes first authorized equity investments in Minnesota's retirement funds. Most of the members originally appointed still serve on the Committee. Their investment expertise, based on their responsibilities and work as leaders of Minnesota's investment community is enhanced by this long period of service and their knowledge of retirement legislation and investment problems during the past 15 years. It is to be noted that, despite the unquestioned expertise of these members, their service is offered without compensation. Every member of this Committee is, or has been, a portfolio manager or research director of a major Minnesota institution.

The accounts supervised by the State Board of Investment are divided into several groups, each governed by individual statutes and managed under different policies. The fund groupings, together with their approximate book valuations as of June 30, 1976, are as follow

**Invested Treasurer's Cash Fund, \$580.9 million.** This fund includes all tax receipts. Since 1969, prime quality corporate notes have been eligible for use in this account, in addition to U.S. Treasury and agency obligations maturing within three years.

**Highway Funds, \$216.9 million.** These accounts include U.S. Treasury obligations, debt instruments issued by U.S. government agencies and short-term corporate notes due within 270 days of the time of purchase. The moneys are used for the building and maintenance of highways, roads and streets throughout the state.

Miscellaneous Welfare, Departmental and Temporary Funds, \$167.4 million. These funds are invested according to the terms of particular statutes or applicable policies, primarily in U.S. Treasury securities. The major portion of these accounts consists of proceeds from bond sales; the moneys will be used within a comparatively short period of time for state building needs. Also included are endowment funds and trust accounts held for various institutions. During the past two fiscal years, these funds have been increased through the investment of bond proceeds from securities issued by the Minnesota Housing Finance Agency. This investment total varies according to the needs of the agency in providing funds to Minnesota's home buyers.

Minnesota Adjustable Fixed Benefit Fund, \$648.8 million. This account, administered by the State Board of Investment, may include a maximum of 50% in stocks with the remainder in debt securities. Retirement benefits are paid to all retired employees from the principal and earnings of this fund. A two-year average "total return" from this fund, in excess of the 5% actuarial assumption, has been used to augment pension benefits. Earnings and market appreciation during the early 1970's resulted in an increase in the pensions paid by the various participating retirement funds of from 2% to 4% at the beginning of the 1972 calendar year; increases of 4½% to 5½% were paid at the beginning of the 1973 calendar year. The Legislature provided for an additional 25% increase which was paid in two installments - in July 1973 and January 1974. This adjustment was made at the time that the statutes applicable to the retirement systems of Minnesota were modified to provide benefits based on salaries paid during the "five-high years" of employment. Because of this complete statutory revision, the reserves accumulated during the early 1970's were used to provide very substantial increases for those previously retired. Despite the lower stock and bond markets experienced in 1973-1975, recent portfolio results indicate additional pension increases beginning in calendar 1978 or 1979.

Basic Retirement Funds, \$1,035.7 million. Six state-managed retirement funds, invested separately for employee groups, include U.S. Treasury, municipal and other governmental securities, U.S. government-guaranteed obligations, corporate bonds, short-term corporate notes, and common stocks.

Supplemental Retirement Fund, \$62.6 million. This fund was established in 1967 for employees of the State College Board and State Junior College Board. The fund consists of three accounts, one of which may be invested up to 100% in equities, emphasizing potential growth with the accompanying market risks. The second includes long-term bonds and stocks oriented toward current income. The third - the Fixed Return Account - was initiated on July 1, 1974, and includes only bond investments; it provides an interest yield over a period of time commensurate with the average life and call protection inherent in the bonds purchased. Legislatures since 1969 have made one or more of these accounts available for use by police and fire fighter relief associations throughout the state, various county employees, those members of the state service who are "unclassified" and do not have the benefits of tenure, and state employees who wish to participate in a deferred income plan through which a portion of their salaries may be taxed at the rates in effect at the time of their retirement.

Minnesota Variable Annuity Fund, \$33.9 million. This fund was established by the 1969 Legislature and was made effective in early summer 1970. The account now includes a diversified list of common stocks, some long-term debt instruments, and reserves in the form of short-term fixed-income securities. The participants are teachers who chose this type of program, which provides retirement benefits based on long-term investment performance. Because of the many advantages inherent in the new "five high year" plan, the Variable Annuity may not now be opted by new teachers but is still available to present members of the State's educational system.

Trust Funds, \$267.6 million. The Permanent School Fund, invested for the benefit of the school children of Minnesota, includes U.S. Treasury securities and government guaranteed obligations, corporate bonds of long and short maturities, and common stocks. The Internal Improvement Land Fund includes only U.S. Treasury obligations.

Because of the differing investment policies applicable to these funds, a short review of the history and needs of the various accounts is provided along with a listing of securities.

#### INVESTED TREASURER'S CASH FUND

This pooled fund reached new highs in size and activity during the past three fiscal years. It represents most tax receipts and other State revenues. In late summer 1974, it was evident that tax accumulations were somewhat greater than the amounts allocated for expenditures during fiscal 1975. After this "surplus" was identified, the State's administration, the Legislature and the Investment Board took action appropriate to increase the earnings from the fund and, yet, maintained the required liquidity due to the economic uncertainties and the anticipated needs of the State during the next biennium.

Because it was evident that a portion of this "surplus" would remain in the account until fiscal 1976 and 1977, securities in an amount exceeding \$100 million were extended in maturity from a few days to a range of from nine months to three years during early autumn 1974. This extension, at a time when interest rates were higher than prevalent for many years, produced significant added income to the account. The 1976 fiscal year-end total investment of \$580.9 million is the second highest in Minnesota's history, it was exceeded only by the \$607.8 million invested at 1975 fiscal year-end.

The Investment Department personnel have been helped by the cooperation and interest of the State Treasurer's office in providing current information - several times per day - regarding the investment needs and possibilities in this fund. The Finance Department, over the past few years, has also led in determining new investment potentials in order to maximize interest earnings for Minnesota State funds.

Interest earnings from this account have fluctuated considerably due to the varying size of the funds invested as well as the wide swings in interest rates applicable to short-term obligations of high quality. Record high earnings of \$14.8 million were reached in 1969 - up from only \$6.0 million in 1966. The small amounts available for investment in 1972 combined with low rates resulted in earnings of only \$4.2 million during that fiscal year. This figure increased to \$7.2 million for fiscal 1973, \$22.0 million for 1974, and a new high of \$37.5 million for fiscal 1975. These earnings declined to \$35.0 million for fiscal 1976 because of somewhat lesser fund totals throughout the year and lower short-term interest rates in effect.

Under the terms of 1973 legislation, the Investment Department buys and sells according to oral certification of cash available by the staff of the State Treasurer and the Department of Finance. In recent years, there has been an increase in the use of repurchase agreements and of short-term instruments so that funds may earn money over the shortest of periods - sometimes one day or over a week-end. Statutes require that securities in the Invested Treasurer's Cash account extend no longer than three years in maturity.

#### THE HIGHWAY FUNDS

The funds held for street, road and highway construction in Minnesota may be invested in bonds eligible for purchase by the Permanent School Fund and commercial paper used in the retirement accounts. At present, these funds own short-term U.S. Treasury and agency securities, repurchase agreements backed by U.S. Treasury or agency obligations, short-term corporate notes, and securities guaranteed by the U.S. government through the Government National Mortgage Association. The Commissioner of Highways certifies the amounts not needed in the immediate future; these sums are invested in maturities approximating the expected disbursement schedule of the highway department. The program includes considerable reinvestment and adjustment of maturity schedules because of the time necessary for planning, purchase of right-of-way, and construction of highways. The amount of highway funds invested fluctuates throughout each fiscal year, they totaled from \$151.0 million to \$208.5 million during fiscal 1974, from \$134.0 million to \$168.0 million during fiscal 1975, and from \$152.1 million to \$216.9 million during fiscal 1976. These accounts show temporary increases after the sale of state highway bonds, until the proceeds are used for construction purposes. The increase in investable moneys during the past fiscal year was due to an increase in the gasoline tax from 7¢ to 9¢ on July 1, 1975, and a revised program of automobile license tax collections so that payments are made at dates throughout the year. Due to these changes in income potential, the Highway Department and the State Board of Investment are reviewing the needs of these funds so as to maximize the income potential from the investment securities.

The earnings from these accounts increased from \$1.7 million in fiscal year 1969 to \$7.7 million in fiscal 1970, \$9.5 million in fiscal 1971, \$9.6 million in each of the two fiscal years 1972 and 1973, and \$13.8 million in fiscal 1974. Earnings were reduced to \$12.5 million in fiscal 1975 and to \$11.0 million in fiscal 1976.

The income earned from these highway fund investments benefits the counties and municipalities in Minnesota directly through the County State Aid Highway Fund and the Municipal State Aid Street Fund. Earnings from the Trunk Highway Fund are used for the overall state highway program.

#### STATE COLLEGES, WELFARE, AND DEPARTMENT OF CORRECTIONS

The State Board of Investment is responsible for the investment of individual and pooled endowment accounts applicable to scholarships and the support of state institutions, certain funds designated for welfare purposes, and patient and inmate accounts in both welfare and correctional institutions. Purchases are limited to U.S. Treasury obligations, except in instances where individual gifts or bequests provide for the use of other investments.

\* \* \* \* \*

Schedule I reviews the short-term corporate notes and the U.S. government and agency obligations held by the Invested Treasurer's Cash Fund, the highway funds, and the miscellaneous departmental funds on June 30, 1976. As has been indicated in previous paragraphs, the Investment Department has substantially increased its activity in the use of these short-term debt obligations in order to maximize yields and, thereby, increase the income to the accounts. The Money Market Securities Division of the Investment Department supervised short-term securities totaling over \$1.1 billion on June 30, 1976. In addition to those listed on Schedule I, there were substantial short-term investments held by the retirement funds and the Permanent School Fund.

#### THE MINNESOTA ADJUSTABLE FIXED BENEFIT FUND

The Minnesota Adjustable Fixed Benefit Fund includes the assets representing the reserves from which pensions are paid to individuals who have retired; these recipients are members of various public funds including the six basic retirement funds managed by the State Board of Investment and the fund administered by the Municipal Employees Retirement Board of Minneapolis. There has been a substantial revision in this portfolio during the past five years because of the many different holdings transferred into the account during the 1969-70 fiscal year. Although substantial reserves were accumulated to make possible the continuation of a high level of pensions during years of stock price downturn, these reserves were distributed to retirees during 1974 to compensate partially for the higher pensions now being paid under the "five high year" plan. Because the 1973 and 1974 downturn in the stock market coincided with a higher rate of inflation, there is some impetus to use the increased yield generated through the price appreciation of both bonds and stocks to provide a basis for adjusting pensions as a compensation for inflationary pressures. In this way, the employer group - the state, municipality, county or school board - would face the risks of long term market fluctuations, whereas the individual would receive benefits more dependent upon actual changes in the cost of living. Concern has been expressed, however, that this account would lose its "complete funding" and become less sound from an actuarial standpoint if long-term benefit improvements were based on the cost of living rather than on actual investment performance.

Under the provisions of 1971 legislation, the net return to the Minnesota Adjustable Fixed Benefit Fund was determined on the basis of income and an average of the market-to-cost relationships taken bi-monthly over a two year period. This interpretation of investment results meant that a substantial contribution toward the cost of the increased pensions in the state managed funds was met from this "total return" during the period through 1973; the portion attributable to the Municipal Employees Retirement Board of Minneapolis was used toward higher pensions and increased reserves. The 1974 Legislature established a "new base" below which pensions may not decline. This figure was established at the level of pensions paid during 1974. The 1975 Legislature granted comparatively modest one-time payments to retirement fund participants in lieu of any increased benefit from this fund. In early calendar 1976, the Legislature appropriated a portion of the high earnings accrued from the investments in the Invested Treasurer's Cash Fund as a supplement to those retirees who were receiving benefits computed on the basis of legislation in effect prior to the "five-high years" statute. This supplement to pensions in Minnesota - to be granted to members of various municipal and teachers' funds as well as those managed by the State Board of Investment - will tend to aid those retirees not benefiting from recent legislative programs.

Benefits accruing from the market action and net yield have not increased during the past two years for several reasons - including the "two year averaging" on rate of return which still includes the lower valuations prevalent in 1974 and 1975. Other factors include a change in the actuarial assumption applicable in the fund of from 3% to 5%, an allocation of certain moneys to pre-1973 retirees and slight adjustments in some cases in order to pay the full increase in benefits legislated during 1973 and 1974.

Common stocks may comprise up to 50% of this portfolio, with convertible debentures limited to an additional 10%. On June 30, 1976, the percentage committed to common stock investments, on a net original cost basis, amounted to 45.26% of the portfolio, declining from 48.92% on December 1975. During the past six months, there have been substantial portfolio revisions due to the recent increases in stock prices with the accompanying opportunity to balance the sales of less successful stocks with those which had shown substantial gains in price during the past 18 months. This portfolio revision, combined with a consolidation of bond holdings and elimination of securities held in smaller quantities, will continue during the months ahead.

This fund increased in value by \$100.6 million during the fiscal year. This sizeable increase is due to the fact that the pensions being paid to present retirees have been raised substantially through recent legislation. The higher value was due to \$94.3 million in net contributions and income. An additional upward adjustment of \$6.3 million was due to higher market valuations.

#### THE BASIC RETIREMENT FUNDS

The State Investment Board manages six accumulation retirement accounts which include both employer and employee contributions during the employee's working period; at the time of retirement, the assets are transferred

to the Adjustable Fixed Benefit Fund. Common stocks may total 50% of these accounts. At the time of this writing, equities comprise approximately 46% of each fund on a cost basis, with the remainder invested in debt securities of the U.S. government, its agencies, Canadian governmental units, and United States and Canadian corporations. Common stock commitments totaled nearly 50% of these accounts on a cost basis on December 31, 1975. Since that date, profits have been taken through the sale of many equities, as the Dow Jones Industrial Average approximated the 1000 level. The Department's research personnel and portfolio managers also have suggested a revision in the composition of the equity portfolios so as to include higher holdings of those stocks showing particular promise - with assured earnings and dividends in the years ahead.

The 1969 Legislature made it possible for each fund to include a small portion of unrealized gains in the income portion of the account through a procedure which applies after the market valuations of equities exceed the original cost price by 15% for six consecutive two month periods - or one year. At such a time, an amount equal to 3% of the cost of the equities could be added to the retirement fund for actuarial and accounting purposes. The first such increase occurred on October 31, 1972; this was followed by a second increase on December 31, 1972. Because of the probability that such market increases would not continue, it was decided that each of these increases would be added to the income accounts in three equal installments during three successive fiscal years. The first increase applied during fiscal 1972, 1973 and 1974, while the second increase was applicable in fiscal 1973, 1974 and 1975.

The 1973 Legislature modified the law to provide for such an increase or decrease whenever the market valuation of equities varied from the revised cost figure by 10% for six consecutive two month periods. The market downturn during 1973 and 1974 resulted in the first 3% downward revision on February 28, 1975. A second decrease applied to several of the retirement funds on April 30, 1975. Because the 1973 statute authorized the computation of such yield declines over a five-year period, it is anticipated that the net effect of such calculations will be minimal when computing fund yield performance on a long-term basis.

By early calendar 1975, because of rising stock prices, it was evident that there would be no further downward adjustment in the statutory valuation of equities for an extended period. Schedule III indicates the net yield accruing to the three largest basic retirement funds during the period from 1957 through 1976. During these 19 years, the yield has increased from less than 3% to nearly 6%. Footnote 14, following Schedule III, explains the effect of the statute tying equity valuations to the stock market.

Schedule IV lists the securities held in the three largest basic retirement funds on June 30, 1976. Because of the identical purpose for which these accounts are established, it has been Investment Department policy to use the same securities in each account, whenever funds have been available. A differing flow of new moneys, however, has resulted in varying cost and a somewhat different overall composition of these three accounts. Because of the recent sales of equities, the net original cost of stocks in the three major accounts increased from \$392.3 million on June 30, 1975, to \$422.6 million on June 30, 1976. The market valuation of these equities showed a greater increase, from \$397.2 million to \$460.9 million.

The Public Employees Police & Fire Fund was established during the early 1960's in order to provide an investment vehicle for the smaller police and fire fighter organizations throughout the state as well as for larger organizations which chose to participate in this retirement plan. Schedule V includes the fixed-income securities in this account on June 30, 1976 and Schedule VII lists the equity portfolio. This account showed a sizeable increase in value - from \$45.3 million to \$56.3 million during the past fiscal year. Although nearly \$2 million of this change was due to higher stock market valuations, most of the increase was derived from the significantly higher contributions.

The Highway Patrolmen's Retirement Fund resulted from a merger, in 1969, of the State Police Officer's Retirement Association and the Highway Patrolmen's Retirement Association. Because the two previous accounts were quite small and had limited and unpredictable flows of new money, the new merged account appears to be more manageable; this has benefited both groups. Schedule VI includes the fixed-income securities in this account on June 30, 1976 and Schedule VII lists the equity portfolio.

State, municipal and school district bonds comprised over 71.0% of total investments in these retirement funds as recently as the late 1950's; such holdings declined to 0.4% by June 30, 1976. This decline was due to the sale and maturity of bonds as well as the placement of all new money in other types of securities. Because most of the remaining "municipals" consist of odd lots that carry either no rating or a low rating by the services, it is presumed that a large portion of these bonds must be held to maturity. In recent years, the municipal bond dealers and fiscal agents of the Upper Midwest area have been most helpful in aiding the State's sales of these securities.

The Judges Retirement Fund was established in 1974; no permanent investments were purchased until the 1975 fiscal year. Because of statutory limitations, the percentage of funds invested in equities may be increased by only 5% of total investments each year. During the 1976 fiscal period, the fund was subject to a 10% equity limitation. Schedule VIII lists the investments as of June 30, 1976.

## THE MINNESOTA SUPPLEMENTAL RETIREMENT FUND

The three accounts of the Minnesota Supplemental Retirement Fund are invested in accordance with three different philosophies in order to meet the individual needs and desires of the participants. The income share account, limited to 50% in common stock, consists primarily of high quality corporate bonds and emphasizes comparatively higher yielding equities of well-known companies. The growth share account, on the other hand, may participate in the equity market up to 100% of total assets and includes stocks of companies offering a low current yield and representing firms which may have significant long-term potential from the standpoint of earnings growth. These stocks tend to fluctuate in price to a far greater extent than those in the income share account. The fixed return account, invested entirely in bonds, is not subject to changes in market fluctuations. The amounts contributed each year into this account, however, will earn varying interest rates depending upon the existing yield structure.

The growth share and income share accounts were established on a unit basis on October 1, 1967, with each unit worth \$10.00 on that date; due to a two-for-one split on June 30, 1973, the current units had a net worth of \$5.00 on inception date. A summary of the market valuations experienced by the two accounts since the beginning of the program in 1967 is as follows (as adjusted for the two-for-one split):

	Income Share Account		Growth Share Account	
	High	Low	High	Low
Oct. '67 - Dec. '68	\$5.52 (Nov. '68)	\$4.98 (Oct. '67)	\$5.44 (Nov. '68)	\$4.52 (Feb. '68)
1969	5.40 (Jan.)	4.99 (Dec.)	5.32 (Oct.)	4.71 (July)
1970	5.69 (Dec.)	4.81 (Jan.)	4.94 (Feb.)	3.73 (June)
1971	6.30 (Dec.)	5.86 (Jan.)	6.21 (Dec.)	5.09 (Jan.)
1972	7.11 (Dec.)	6.36 (Jan.)	7.92 (Dec.)	6.47 (Jan.)
1973	7.15 (Sept.)	6.69 (Nov.)	7.53 (Jan.)	5.29 (Dec.)
1974	6.80 (Feb.)	5.31 (Sept.)	5.35 (Jan.)	3.21 (Sept.)
1975	7.12 (Dec.)	6.26 (Jan.)	5.17 (June)	3.95 (Jan.)
Jan. - June '76	8.00 (June)	6.94 (Jan.)	5.52 (June)	5.28 (May)

Schedule IX lists the assets in the income share account on June 30, 1976. Because of the increase in both equity and bond valuations during the past 18 months, this account has shown particularly favorable market results. The comparative "safety" of this portfolio, due to the type of stock used and the diversification between fixed-income and equity securities, has resulted in its use by most retirement organizations eligible to participate in the Supplemental Retirement Fund. It is anticipated that the results, over a period of years, will never be spectacular, but will tend to be satisfactory from the standpoints of safety, yield and long-term growth.

Schedule X consists of a listing of the securities in the growth share account on June 30, 1976. Under the terms of the Prospectus for the growth share account, it is a policy of the Department to maintain a steady investment in stocks of companies which evidence growth potential. It has also been an established policy to avoid extreme "buy" or "sell" programs which could result in a high cash position for a brief period of time. Such a program can be disastrous if the market makes unanticipated moves. This means that the account is in a reasonably fully invested position at all times and will continue to be subject to significant changes in market values, particularly during periods of stock market increases, as in 1972, and during times of market uncertainty and decline, such as during 1973 and 1974. The upward movement of stock prices in 1975 and 1976 resulted in sizeable increases in market valuations of the growth share account. It is apparent, however, that those stocks which led the market increases during the 1971-73 period may not provide such leadership in future market recoveries. We are now revising the investment policies applicable to this fund to achieve a greater degree of diversification by industry and to include equities representing broad segments of our economy.

The assets in the fixed return account, established on July 1, 1974, are listed in Schedule XI. Unit valuations do not change; they are arbitrarily set at \$5.00 per unit. The return from this fund is based entirely upon the rate of interest received from the bonds purchased in the account.

Under the provisions of the applicable statutes, the Investment Department establishes an "indicated rate" of return for the coming fiscal year on July 1. On July 1, 1974, this rate was set at 8.50%. The bonds purchased during the fiscal period provided a yield somewhat higher than that anticipated. The participants - then consisting only of individual retirement funds - received 9.10% on all contributions made during the 1975 fiscal year. During fiscal 1976, the plan was broadened in scope to include individuals who wish to participate in a fixed-return investment under various retirement or deferred income plans. In early July 1976, the return for individual participants was set at 8.9% for those contributions received during the 1976 fiscal year. This rate will be subject to change annually.

The contributions received from the various retirement organizations will provide earnings of 8.8% during the past fiscal year, with an indication that the rate set on these contributions will continue for another nine years, or

through June 30, 1985. The slightly lower rate attributed to the institutional participants is due to the fact that a portion of the income will be set aside in the form of reserves to provide for any possible future diminution of income. Most bonds purchased during the year may not be refunded at a lower interest rate for a ten-year period.

Because of the uncertainties in the economy, an assumed rate for the 1977 fiscal year has been established at 7.50%. Participants will be paid a higher rate of return if the securities purchased during the coming year warrant such payments.

There is a substantial amount of interest in the fixed-return account because of the investment uncertainties made evident by the 1973-74 decline in both the stock and bond markets. The idea of a definite interest earnings - with no dependence upon stock or bond market fluctuations - apparently has great appeal to many fund participants. Because of the response to this new account, the assets increased from \$1.0 to \$4.2 million during the 1976 fiscal year. The significant influx of incoming contributions to this account has resulted in considerable reserves being held in short-term investments. These moneys will be placed in securities of longer maturity for which commitments are being made. It is the intent of the Investment Department that approximately 30 to 40 issues of fixed-income securities be selected within a comparatively short time so that the fund may be assured of adequate industry diversification. It is emphasized that the bonds purchased are concentrated in the AAA and AA quality levels. This will add to the safety applicable to the fund contributions and should minimize the chance of losses.

#### MINNESOTA VARIABLE ANNUITY FUND

The Minnesota Variable Annuity Fund was advocated prior to the adoption of the "five high year" plan by the Teachers Retirement Association. The participants received a net return of 5.4500% in fiscal 1971, 9.1670% for fiscal 1972, and 6.2393% for fiscal 1973. During fiscal 1974, the participants suffered a decline of 4.1478%, followed by another decrease of 17.9638% during fiscal 1975, and a decline of 0.0161% for the fiscal year ended June 30, 1976. The laws applicable to valuations and computation of net return dictate that a two-year period be used in calculating increases or decreases to the fund. As has previously been indicated in this report, the stock and bond market "lows" of 1974 will be used in these calculations until mid-1977. Therefore, the Minnesota Variable Annuity Fund will not show a positive net return until the end of the 1977 fiscal year. Market-value-to-cost ratios already applicable to the June, 1977 computations indicate a significant positive net return for the next fiscal year.

Although most variable plans are based entirely on participation in equity investments, the widespread use of this fund and the fluctuations in the stock market since the account's inception have caused the investment department to adopt a policy which includes approximately 25% to 35% in fixed-income investments.

The option for the Variable Annuity was terminated during fiscal 1974. Therefore, the fund will continue only as an investment medium for those teachers who have already chosen to have a portion of their retirement moneys invested in accordance with the Variable Annuity concept. The securities in this fund on June 30, 1976, are listed on Schedule XII.

#### THE PERMANENT TRUST FUNDS

The State's permanent trust funds showed their greatest rate of growth during the 1940's and 1950's. Until a constitutional amendment was passed in 1956, half of the receipts from the iron ore occupation tax accrued to the principal of the permanent trust funds, which were invested for the benefit of the schools, the University of Minnesota and other state institutions. In recent years, the entire receipts from this tax have been applied directly toward meeting the State's current educational needs.

During the years immediately following the adoption of the constitutional amendment, long-term low-coupon U.S. Treasury bonds were sold from the Permanent School Fund, with the proceeds being invested in higher yielding corporate securities. In accordance with this amendment, corporate bonds were purchased to the approximate maximum of 40% of the fund. During the past several years, however, mortgage backed securities guaranteed by the U.S. government and issued through private organizations in cooperation with the Government National Mortgage Association have offered a yield comparable to or greater than that received from corporate bonds of similar quality. These Government National Mortgage Association mortgage backed securities were purchased during the summer months of 1974 at yields as high as 10.14%. Because of the lack of inflow of new cash into this fund, the gradual return of principal offered by this type of investment has been very attractive; we have thus been able to maintain a cash flow for current investment needs. During fiscal 1976, additional types of United States Government guaranteed securities were used; they have added both quality and yield to the fund. Arrangements between the State Board of Investment and the Minnesota Banker's Association have resulted in a program through which the Permanent School Fund has purchased those portions of Small Business Administration loans which are guaranteed by the United States Government. These loans are arranged through various banks in Minnesota and are "pooled" through the facilities of the Summit National Bank of Richfield. This program, initiated through the cooperation of

the Governor, the State Treasurer and the Minnesota Banker's Association, appears to offer a unique opportunity to achieve a comparatively high yield and an adequate cash flow to this permanent trust fund. It also marks a unique opportunity for following prudent investment principles in achieving an appropriate yield, while aiding the development of businesses in Minnesota.

Within the past few months, we have negotiated for other United States Government guaranteed securities based on hospital mortgages throughout the United States. These securities also offer a comparatively high yield, a continued repayment of principal and the highest possible quality.

Because of the comparative attractiveness of United States Government backed securities, the corporate bond portfolio has been reduced to 29.8% of the book value of the Permanent School Fund; it is anticipated that the holdings of high quality debt securities will be increased as more appropriate yield spreads become prevalent. United States Government and government guaranteed obligations constitute 47.7% of the book value of this account; common stock investments are maintained very near to the 20% limit.

Schedule XIII indicates that the investment changes have resulted in an increase in net yield from 2.68% during the late 1950's to 5.54% during the 1976 fiscal year. A very marked increase in return during the past five years was possible because of the use of United States Government guaranteed obligations. A portion of the income will be transferred on an annual basis to the principal of the account to replenish the book losses taken through the sale of long-term United States Treasury and corporate fixed-income obligations during the past 15 years.

Schedule XIV lists the securities in the Permanent School Fund on June 30, 1976.

\* \* \* \* \*

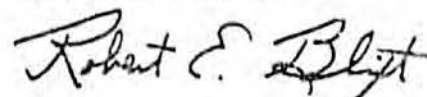
A review of policies concerning the placement of business, together with a summary of transactions completed during the fiscal year from July 1, 1975, through June 30, 1976, follows the schedules described above.

\* \* \* \* \*

The investment results achieved in fiscal 1975 and 1976 have been particularly pleasing to the Departmental staff. The cooperation and advice received from the members of the State Board of Investment and the Advisory Committee on State Trust Funds played a most important part in achieving these results. It is now evident that the funds benefited considerably through the significant purchase program completed during late 1974 and 1975. Likewise, the income from the Invested Treasurer's Cash Fund has been increased both through the accumulated surplus during the period of high interest rates and the degree of attention accorded this account by the various State finance offices.

The Investment Department is also appreciative of the cooperation by the staff of the Legislative Commission on Pensions and Retirement and by the interest shown in the State funds by the securities dealers, brokers and research personnel throughout the securities industry. Although the many Minnesota investment accounts must be managed under widely different investment policies and procedures - in order to achieve individual objectives - it is hoped that all of these funds can be invested so as to be of lasting benefit to the beneficiaries and to all citizens of Minnesota.

Respectfully submitted,



Robert E. Blixt, C.F.A.  
Executive Secretary

REB:be

## SCHEDULE XIII

### STATE OF MINNESOTA STATE BOARD OF INVESTMENT

#### PERMANENT SCHOOL FUND

#### RATE OF RETURN ON AVERAGE AMOUNT INVESTED DURING FISCAL PERIODS June 30, 1976

	Book Value (1)	Average Book Value for Year Ending (2)	Total Investment Income for Year Ending (3,4)	Yield (5)		Less Transfer to Principal (6)	Net Investment Income for Year Ending (7)	Net Yield (8)
June 30, 1957	\$244,700,475.47	\$242,386,448.84	\$ 6,486,999.70	2.68%				
December 31, 1957	\$248,558,062.99	-	-	-				
June 30, 1958	\$249,513,233.84	\$247,590,592.43	\$ 6,512,261.41	2.63%				
December 31, 1958	\$252,324,357.47	-	-	-				
June 30, 1959	\$253,243,898.53	\$251,693,830.95	\$ 7,005,142.92	2.78%				
December 31, 1959	\$275,520,490.05	-	-	-				
June 30, 1960	\$256,276,151.72	\$255,013,512.77	\$ 7,116,641.31	2.79%				
December 31, 1960	\$259,324,537.57	-	-	-				
June 30, 1961	\$260,019,901.33	\$258,540,156.87	\$ 7,578,635.92	3.09%				
December 31, 1961	\$261,981,702.84	-	-	-				
June 30, 1962	\$262,388,564.04	\$261,463,389.40	\$ 8,610,672.52*	3.29%*				
December 31, 1962	\$264,203,940.11	-	-	-				
June 30, 1963	\$264,631,949.26	\$263,741,484.50	\$ 8,048,170.78*	3.05%*				
December 31, 1963	\$263,710,744.23	-	-	-				
June 30, 1964	\$263,552,120.96	\$263,964,938.18	\$ 8,579,156.81	3.25%				
December 31, 1964	\$264,704,185.42	-	-	-				
June 30, 1965	\$262,170,084.20	\$263,475,463.53	\$ 9,186,790.66	3.49%		\$ 76,936.86	\$ 9,109,853.80	3.46%
December 31, 1965	\$262,324,844.32	-	-	-				
June 30, 1966	\$261,686,991.05	\$262,060,609.86	\$ 9,647,417.30	3.68%		\$ 329,472.90	\$ 9,317,944.40	3.56%
December 31, 1966	\$262,423,814.16	-	-	-				
June 30, 1967	\$263,316,276.40	\$262,970,307.20	\$10,215,172.70	3.88%		\$ 856,275.53	\$ 9,358,896.77	3.56%
December 31, 1967	\$264,303,404.43	-	-	-				
June 30, 1968	\$264,578,182.47	\$264,232,621.10	\$10,511,771.10	3.98%		\$1,016,014.48	\$ 9,495,756.62	3.59%
December 31, 1968	\$266,225,867.42	-	-	-				
June 30, 1969	\$264,122,329.06	\$264,975,459.65	\$10,512,970.80	3.97%		\$1,100,277.41	\$ 9,412,693.39	3.55%
December 31, 1969	\$264,797,800.95	-	-	-				
June 30, 1970	\$259,550,404.67	\$262,823,538.23	\$11,324,151.11	4.31%		\$1,034,987.16	\$10,289,163.95	3.91%
December 31, 1970	\$248,210,564.03	-	-	-				
June 30, 1971	\$248,077,642.59	\$251,946,230.43	\$12,380,084.13	4.91%		\$1,435,834.16	\$10,944,250.01	4.34%
December 31, 1971	\$250,918,742.94	-	-	-				
June 30, 1972	\$251,249,760.37	\$250,082,048.63	\$13,691,318.17	5.47%		\$1,937,452.41	\$11,753,865.46	4.70%
December 31, 1972	\$251,129,535.01	-	-	-				
June 30, 1973	\$249,010,860.05	\$250,461,438.48	\$14,348,252.97	5.72%		\$2,361,011.68	\$11,987,241.29	4.79%
December 31, 1973	\$252,105,340.61	-	-	-				
June 30, 1974	\$256,282,207.38	\$252,466,169.35	\$14,947,257.78	5.92%		\$2,445,336.93	\$12,501,920.85	4.95%
December 31, 1974	\$254,000,064.12	-	-	-				
June 30, 1975	\$254,252,308.35	\$254,845,059.85	\$15,993,845.27	6.28%		\$2,784,257.93	\$13,209,587.34	5.18%
December 31, 1975	\$258,709,589.62	-	-	-				
June 30, 1976	\$259,305,894.51	\$257,422,797.49	\$17,048,127.94	6.62%		\$2,793,175.78	\$14,254,951.76	5.54%

(1) Book value figures based on those shown on Treasurer's General Report on State Finances on date listed, with adjustments for calls, maturities and investments committed for but not yet received. Beginning December 31, 1974, book value was taken from State Board of Investment ledgers.

(2) Computed by averaging book value of fund on last three report dates, ending with date listed.

(3) Income figures obtained from the State Department of Finance. Beginning June 30, 1975, income figures are from State Board of Investment ledgers.

(4) Includes investment income from the Swamp Land Fund which was combined into the Permanent School Fund after passage of a Constitutional Amendment in 1967.

(5) Computed by dividing total investment income of fund for fiscal period by average book value of fund. Yield figures beginning on June 30, 1975, reflect the fact that income was taken from the State Board of Investment ledgers, which are computed on an accrual basis, whereas the figures formerly obtained from the State Department of Finance were on a cost basis.

(6) The transfer of a portion of the income to the principal of the account is called for under the Minnesota Constitution, Article VIII, Section 4, as amended in 1962, and implemented by Minnesota Statutes 1974, Section 11.015, Subdivision 7, in order that the difference between the sales price and original cost of securities be returned to the principal of the account. Sales of low coupon U.S. Treasury securities at less than cost resulted in the transfers during recent years.

(7) Computed by dividing net investment income of fund for fiscal period by average book value of fund.

\*The income received during fiscal 1962 and 1963 was subjected to accounting adjustments which tended to overstate the 1962 figures, due to the accumulation of discounts on bonds purchased (Minnesota Statutes 1974, Section 11.05, Subdivision 2) and understate the 1963 results, due to the combining of the Swamp Land Fund into the Permanent School Fund during that fiscal year.

## SCHEDULE XIV

### PERMANENT SCHOOL FUND June 30, 1976

#### RESUME OF ASSETS IN ACCOUNT

CASH CERTIFIED FOR INVESTMENT*	\$ 256,059.23
<b>MONEY MARKET SECURITIES</b>	
Repurchase Agreements Maturities up to 6 days	\$ 8,106,000.00
<b>STATE AND LOCAL OBLIGATIONS</b>	\$ 398,600.00
<b>UNITED STATES GOVERNMENT-GUARANTEED OBLIGATIONS</b> (See Listing Below)	\$126,744,833.23
<b>CORPORATE BOND OBLIGATIONS</b> (See Listing Below)	\$ 78,519,662.85
<b>COMMON STOCKS</b> (See Listing Below)	\$ 53,116,507.88
<b>TOTAL ASSETS IN ACCOUNT</b> (for accounting purposes; not indicative of true market value)	<b>\$287,141,663.19</b>

\*Cash balance signifies amount due from sales of securities several days before fiscal year end.

Note: Bond investments are listed at face value; common stocks are listed at market value.

#### COMMON STOCK HOLDINGS

Common Stock	Shares	Market Price 6-30-76	Market Value	Total % Market
<b>UTILITIES</b>				
<b>ELECTRIC</b>				
Central and South West Corporation	23,000	\$ 14.50	\$ 333,500.00	
Cincinnati Gas & Electric Company (The)	24,000	17.83	429,000.00	
Commonwealth Edison Company	21,499	28.00	601,972.00	
Florida Power & Light Company	25,400	23.88	606,425.00	
Houston Lighting & Power Company	16,500	23.50	387,750.00	
Middle South Utilities, Incorporated	34,000	14.63	497,250.00	
Minnesota Power & Light Company	15,100	19.53	294,887.50	
Northern States Power Company (Miss.)	21,500	24.38	524,062.50	
Pacific Gas & Electric Company	21,500	20.38	438,062.50	
Public Service Company of Indiana, Inc.	18,150	25.50	462,825.00	
Southern California Edison Company	20,000	19.63	392,500.00	
Southern Company (The)	24,000	14.38	345,000.00	
Texas Utilities Company	23,000	19.00	437,000.00	
Virginia Electric and Power Company	10,000	13.75	137,500.00	
<b>Total Electric</b>			<b>\$ 6,102,034.50</b>	<b>11.00%</b>
<b>NATURAL GAS</b>				
Panhandle Eastern Pipe Line Company	20,000	\$ 35.13	\$ 702,500.00	1.27%
<b>COMMUNICATIONS</b>				
American Telephone & Telegraph Company	27,000	\$ 56.50	\$ 1,522,500.00	
General Telephone & Electronics Corp.	40,800	25.68	1,055,700.00	
<b>Total Communications</b>			<b>\$ 2,578,200.00</b>	<b>4.65%</b>
<b>TOTAL UTILITIES</b>			<b>\$ 8,380,234.50</b>	<b>16.32%</b>
<b>FINANCIAL SERVICES</b>				
<b>BANKS</b>				
Bank America Corporation	18,000	\$ 56.25	\$ 1,012,500.00	
Citicorp	29,112	36.13	1,051,621.00	
First Bank System, Incorporated	21,500	45.88	986,312.50	
J. P. Morgan & Co., Incorporated	16,920	62.75	1,061,730.00	
Northwest Bancorporation	27,000	53.25	1,437,750.00	
<b>Total Banks</b>			<b>\$ 5,549,953.50</b>	<b>10.00%</b>
<b>FINANCE</b>				
Beneficial Corporation	17,925	\$ 24.13	\$ 432,440.63	
Household Finance Corporation	26,000	19.50	507,000.00	
<b>Total Finance</b>			<b>\$ 939,440.63</b>	<b>1.65%</b>
<b>INSURANCE</b>				
INA Corporation	15,300	\$ 37.88	\$ 579,467.50	
Northwestern National Life Insurance Co.	25,300	14.00	354,200.00	
SAFECO Corporation	15,800	38.75	612,250.00	
The St. Paul Companies, Inc.	32,000	27.50	880,000.00	
United States Fidelity & Guaranty Company	17,000	38.88	660,975.00	
<b>Total Insurance</b>			<b>\$ 3,086,812.50</b>	<b>5.54%</b>
<b>TOTAL FINANCIAL SERVICES</b>			<b>\$ 9,550,218.63</b>	<b>17.21%</b>
<b>CONSUMER ORIENTED</b>				
<b>AUTOMOBILES &amp; AUTOMOTIVE PARTS</b>				
Ford Motor Company	18,800	\$ 58.50	\$ 1,099,100.00	
General Motors Corporation	21,200	68.50	1,452,200.00	
Goodyear Tire & Rubber Company (The)	23,000	27.00	621,000.00	
<b>Total Automobiles &amp; Automobile Parts</b>			<b>\$ 3,299,300.00</b>	<b>5.94%</b>
<b>CONSUMER DURABLES</b>				
Sunbeam Corporation	14,000	\$ 23.63	\$ 330,750.00	
Whirlpool Corporation	22,200	27.13	602,175.00	
<b>Total Consumer Durables</b>			<b>\$ 932,925.00</b>	<b>1.68%</b>

Common Stock	Shares	Market Price 6-30-76	Market Value	Total % Market
<b>CONSUMER NONDURABLES</b>				
Eastman Kodak Company	7,250	\$100.13	\$ 735,918.75	
Minnesota Mining and Manufacturing Co.	18,000	55.63	1,001,250.00	
Proctor & Gamble Company (The)	7,700	94.88	730,537.50	
Revlon, Incorporated	8,000	84.00	672,000.00	
<b>Total Consumer Nondurables</b>			<b>\$ 3,139,706.25</b>	<b>5.68%</b>
<b>DRUGS</b>				
American Home Products Corporation	22,800	\$ 34.25	\$ 780,900.00	
Merck & Co., Inc.	10,000	72.00	720,000.00	
Pfizer, Inc.	30,000	29.25	877,500.00	
<b>Total Drugs</b>			<b>\$ 2,378,400.00</b>	<b>4.29%</b>
<b>FOOD-BEVERAGE</b>				
CPC International, Inc.	8,000	\$ 46.00	\$ 368,000.00	
Coca-Cola Company (The)	8,000	84.13	673,000.00	
General Foods Corporation	35,000	29.13	1,019,375.00	
General Mills, Incorporated	30,000	31.50	945,000.00	
<b>Total Food-Beverage</b>			<b>\$ 3,005,375.00</b>	<b>5.42%</b>
<b>RETAIL SALES</b>				
Federated Department Stores, Incorporated	18,000	\$ 47.63	\$ 857,250.00	
Penney (J.C.) Company, Incorporated	10,800	52.25	564,300.00	
Sears, Roebuck and Company	12,000	64.75	777,000.00	
<b>Total Retail Sales</b>			<b>\$ 2,198,550.00</b>	<b>3.90%</b>
<b>TOTAL CONSUMER-ORIENTED</b>			<b>\$14,954,256.25</b>	<b>26.55%</b>
<b>TECHNOLOGY</b>				
<b>OFFICE EQUIPMENT</b>				
Burroughs Corporation	9,500	\$104.00	\$ 988,000.00	
Honeywell, Inc.	10,000	49.63	496,250.00	
International Business Machines Corporation	12,525	276.75	3,463,061.25	
Xerox Corporation	6,440	61.63	396,865.00	
<b>Total Office Equipment</b>			<b>\$ 5,350,176.25</b>	<b>9.64%</b>
<b>TOTAL TECHNOLOGY</b>			<b>\$ 5,350,176.25</b>	<b>9.64%</b>
<b>BASIC INDUSTRY</b>				
<b>BUILDING &amp; FOREST PRODUCTS</b>				
Weyerhaeuser Company	17,000	\$ 44.38	\$ 754,450.00	1.42%
<b>CHEMICALS</b>				
Dow International Company (The)	12,000	\$ 48.25	\$ 579,000.00	
du Pont (E. I.) de Nemours and Company	7,500	130.50	978,750.00	
Monsanto Company	4,000	93.25	373,000.00	
Union Carbide Corporation	11,700	67.63	791,312.50	
<b>Total Chemicals</b>			<b>\$ 2,719,112.50</b>	<b>4.60%</b>
<b>ELECTRICAL EQUIPMENT</b>				
General Electric Company	16,200	\$ 57.13	\$ 925,425.00	1.62%
<b>MACHINERY</b>				
Caterpillar Tractor Co.	10,100	\$ 37.13	\$ 374,923.50	
Trans Union Corporation	10,400	34.25	356,200.00	
<b>Total Machinery</b>			<b>\$ 1,278,562.50</b>	<b>2.30%</b>
<b>METALS</b>				
Aluminum Company of America	14,000	\$ 56.50	\$ 791,000.00	1.42%
<b>PAPER</b>				
International Paper Company	7,000	\$ 73.00	\$ 511,000.00	0.92%
<b>TOTAL BASIC INDUSTRY</b>			<b>\$ 7,013,678.00</b>	<b>12.64%</b>
<b>ENERGY</b>				
<b>OIL DOMESTIC</b>				
Atlantic Richfield Company	8,000	\$104.50	\$ 836,000.00	
Continental Oil Company (Del.)	20,000	38.38	767,500.00	
Standard Oil Company (Indiana)	24,000	53.50	1,284,000.00	
<b>Total Oil Domestic</b>			<b>\$ 2,887,500.00</b>	<b>5.07%</b>
<b>OIL INTERNATIONAL</b>				
Exxon Corporation	21,408	\$104.63	\$ 2,239,812.00	
Mobil Corporation	21,300	59.88	1,275,327.50	
Texas Inc.	34,000	25.13	854,250.00	
<b>Total Oil International</b>			<b>\$ 4,471,399.50</b>	<b>8.05%</b>
<b>TOTAL ENERGY</b>			<b>\$ 7,286,899.50</b>	<b>13.12%</b>
<b>TRANSPORTATION</b>				
<b>AIRLINES</b>				
Northwest Airlines, Incorporated	16,884	\$ 32.50	\$ 548,730.00	0.98%
<b>RAILROADS</b>				
Burlington Northern Incorporated	13,800	\$ 46.00	\$ 634,800.00	
Union Pacific Corporation	8,400	97.38	818,250.00	
<b>Total Railroads</b>			<b>\$ 1,453,050.00</b>	<b>2.52%</b>
<b>TOTAL TRANSPORTATION</b>			<b>\$ 1,453,050.00</b>	<b>2.51%</b>
<b>TOTAL COMMON STOCKS</b>			<b>\$53,116,507.88*</b>	<b>100.00%</b>

\*Original cost of equities on June 30, 1976, was \$49,314,237.03

Schedule XIV continued

UNITED STATES GOVERNMENT-GUARANTEED BONDS  
AND CORPORATE BOND HOLDINGS  
June 30, 1976

Company	Type of Security	Maturity Date (a)	Coupon Rate %	Average Yield %	Total Amount
<b>UNITED STATES GOVERNMENT-GUARANTEED OBLIGATIONS</b>					
<b>FARMERS HOME ADMINISTRATION NOTES</b>					
U.S. Department of Agriculture, Farmers Home Administration	Insured Notes	1-31-80	8.90	8.90	\$ 2,997,834.82
U.S. Department of Agriculture, Farmers Home Administration	Insured Notes	7-31-85	8 5/8	8.625	2,995,877.33
<b>Total Farmers Home Administration Notes</b>				<b>8.76%</b>	<b>\$ 5,993,712.15</b>
<b>GOVERNMENT NATIONAL MORTGAGE ASSOCIATION GUARANTEED MORTGAGE-BACKED SECURITIES</b>					
California Mortgage Service	Mtg. Backed Cert.	7-15-2004	8 1/4	9.61	\$ 936,874.24
Citizens Mortgage Corp.	Mtg. Backed Cert.	12-15-2000	8.00	8.72	1,523,953.50
First National Bank of Minneapolis	Mtg. Backed Cert.	12-15-2000	8.00	8.65	1,171,367.24
First National Bank of Minneapolis	Mtg. Backed Cert.	2-15-2001	8.00	8.50	1,241,769.13
Guild Mortgage Company	Mtg. Backed Cert.	2-15-2004	8.00	8.52	1,752,438.75
Heritage Mortgage	Mtg. Backed Cert.	7-15-2004	8 1/4	9.48	1,889,554.91
International Mortgage	Mtg. Backed Cert.	4-15-2004	8.00	8.52	1,831,598.19
IOS Mortgage Corp.	Mtg. Backed Cert.	12-15-2001	6 1/2	7.13	2,502,606.28
IOS Mortgage Corp.	Mtg. Backed Cert.	11-15-2001	5 1/2	7.13	2,502,409.75
IOS Mortgage Corp.	Mtg. Backed Cert.	2-15-2002	7.00	8.92	2,020,673.47
IOS Mortgage Corp.	Mtg. Backed Cert.	6-15-2000	8.00	8.94	1,448,089.65
IOS Mortgage Corp.	Mtg. Backed Cert.	7-15-2000	8.00	8.73	1,565,703.11
IOS Mortgage Corp.	Mtg. Backed Cert.	10-15-2000	8.00	8.73	1,511,034.63
IOS Mortgage Corp.	Mtg. Backed Cert.	11-15-2000	8.00	8.65	1,514,143.08
IOS Mortgage Corp.	Mtg. Backed Cert.	1-15-2001	8.00	8.57	1,536,118.23
IOS Mortgage Corp.	Mtg. Backed Cert.	2-15-2001	8.00	8.50	680,712.37
IOS Mortgage Corp.	Mtg. Backed Cert.	3-15-2001	7 1/2	7.40	840,081.56
IOS Mortgage Corp.	Mtg. Backed Cert.	3-15-2003	6 1/2	7.34	1,004,651.12
IOS Mortgage Corp.	Mtg. Backed Cert.	4-15-2003	6 1/2	7.34	1,007,627.01
IOS Mortgage Corp.	Mtg. Backed Cert.	4-15-2003	6 1/2	7.54	3,003,586.84
IOS Mortgage Corp.	Mtg. Backed Cert.	6-15-2003	6 1/2	7.60	2,860,949.14
IOS Mortgage Corp.	Mtg. Backed Cert.	7-15-2003	6 1/2	7.89	4,602,016.53
IOS Mortgage Corp.	Mtg. Backed Cert.	11-15-2003	8.00	8.55	1,835,022.70
IOS Mortgage Corp.	Mtg. Backed Cert.	11-15-2003	8.00	8.55	2,790,085.08
IOS Mortgage Corp.	Mtg. Backed Cert.	4-15-2004	8.00	8.47	2,638,865.97
Iowa Securities Co.	Mtg. Backed Cert.	12-15-2000	8.00	8.94	1,302,318.43
Iowa Securities Co.	Mtg. Backed Cert.	1-15-2001	8.00	8.10	1,291,314.48
Lumbermans Investment	Mtg. Backed Cert.	7-15-2004	8 1/4	9.61	1,735,169.90
Mallon, Allen & Wms.	Mtg. Backed Cert.	2-15-2004	8.00	8.52	942,326.94
National Home Acceptance Corp.	Mtg. Backed Cert.	5-15-2010	7.00	8.92	1,412,537.00
National Home Acceptance Corp.	Mtg. Backed Cert.	9-15-2007	8.00	8.80	1,520,963.50
National Home Acceptance Corp.	Mtg. Backed Cert.	7-15-2000	8.00	8.89	1,573,280.78
Peoples Mortgage Co.	Mtg. Backed Cert.	11-15-2004	9.00	9.92	1,858,229.13
Steed (W.S.)	Mtg. Backed Cert.	7-15-2004	9.00	8.86	1,904,051.33
Virginia Mtg. & Investment Co.	Mtg. Backed Cert.	9-15-2004	9.00	9.23	994,859.38
Percy Wilson Mortgage & Finance Corp.	Mtg. Backed Cert.	8-1-2000	8 1/2	8.94	1,591,811.78
<b>Total Government National Mortgage Association, Guaranteed Mortgage Backed Securities</b>				<b>8.38%</b>	<b>\$ 68,458,044.75</b>
<b>MERCHANT MARINE BONDS</b>					
American Mail Line	Govt. Guar. Bond	3-1-93	6.00	6.20	\$ 1,470,000.00
American President Lines, Ltd.	Govt. Guar. Bond	11-1-91	4.00	4.8	1,470,000.00
American President Lines, Ltd.	Govt. Guar. Bond	11-1-92	5.00	5.60	1,000,000.00
Construction Aggregate, Corp.	Govt. Guar. Bond	6-1-91	7 1/2	7.50	1,875,000.00
Delta Steamship Lines, Inc.	Govt. Guar. Bond	3-1-86	5 1/2	5.50	306,000.00
Eagle Terminal Tankers, Inc.	Govt. Guar. Bond	6-1-89	6.00	6.00	3,296,000.00
El Paso Columbia Tankers	Govt. Guar. Bond	12-15-01	9 1/4	9.25	3,000,000.00
Farrell Lines, Inc.	Govt. Guar. Bond	4-1-88	8.05	8.05	678,000.00
Farrell Lines, Inc.	Govt. Guar. Bond	8-29-97			
		through			
		9-2-98	9.00	9.00	876,000.00
Grace Line, Inc.	Govt. Guar. Bond	2-1-92	5.10	5.10	1,476,570.00
Ingram Ocean Systems, Inc.	Govt. Guar. Bond	2-1-89	8 3/4	8.75	1,263,000.00
Intercontinental Bulk Tank Corp.	Govt. Guar. Bond	9-1-90	7.80	7.80	1,168,000.00
Martin Drilling Co.	Govt. Guar. Bond	1-1-91	8.90	8.90	3,000,000.00
Melton Navigation Co.	Govt. Guar. Bond	11-10-94	7 1/2	7.50	384,000.00
Moore McCormick Leasing	Govt. Guar. Bond	7-15-2001	8 3/8	8.875	3,000,000.00
Moore McCormick Lines, Inc.	Govt. Guar. Bond	4-1-87	5 3/4	5.86	1,308,000.00
Overseas Bulk Tank Corp.	Govt. Guar. Bond	12-1-90	7.80	7.80	1,182,000.00
Pacific Far East Line, Inc.	Govt. Guar. Bond	12-1-97	8 3/4	8.75	2,101,000.00
Penn Tanker	Govt. Guar. Bond	10-1-89	6.00	6.00	1,309,000.00
Prudential Lines, Inc.	Govt. Guar. Bond	11-1-89	6.00	6.00	2,168,000.00
Puget Sound Tug & Barge	Govt. Guar. Bond	2-15-2001	9 1/8	9.125	2,984,000.00
States Steamship Co.	Govt. Guar. Bond	3-31-93	5.10	5.10	1,500,000.00
United States Lines, Inc.	Govt. Guar. Bond	10-1-87	5.00	5.00	1,299,000.00
United States Lines, Inc.	Govt. Guar. Bond	1-1-91	8 5/8	8.625	1,350,000.00
Western Co. of North America	Govt. Guar. Bond	8-1-90	8 1/4	9.25	3,000,000.00
Zapata Off Shore Co.	Govt. Guar. Bond	6-15-96	8 5/8	8.625	3,000,000.00
<b>Total Merchant Marine Bonds</b>				<b>7.58%</b>	<b>\$ 48,279,000.00</b>
<b>NEW COMMUNITIES ACT DEBENTURES</b>					
Cedar Riverside Land Company	Govt. Guar. Deb.	12-15-91	7.20	7.20	\$ 2,500,000.00
Jonathan Development Corp.	Govt. Guar. Deb.	10-1-90	8 1/2	8.50	2,500,000.00
<b>Total New Communities Act Debentures</b>				<b>7.85%</b>	<b>\$ 5,000,000.00</b>
<b>SMALL BUSINESS ADMINISTRATION LOANS</b>					
SBA Loans	Govt. Guar. Bond	8-22-85	9 1/2	9.35	\$ 503,983.67
SBA Loans	Govt. Guar. Bond	4-27-84	9 1/4	9.31	513,092.88
<b>Total Small Business Administration Loans</b>				<b>9.11%</b>	<b>\$ 1,017,076.55</b>
<b>TOTAL UNITED STATES GOVERNMENT GUARANTEED OBLIGATIONS</b>				<b>7.08%</b>	<b>\$126,744,833.23</b>

Company	Type of Security	Maturity Date (a)	Coupon Rate %	Average Yield %	Total Amount
<b>CORPORATE BOND OBLIGATIONS</b>					
<b>PUBLIC UTILITY OBLIGATIONS</b>					
<b>ELECTRIC</b>					
Duke Power Co.	First & Refunding Mortgage	2-1-95	4 1/2	4.47	\$ 1,500,000.00
Florida Power & Light Co.	First Mortgage	4-1-94	4 5/8	4.50	1,200,000.00
Hawaiian Electric Co., Ltd.	First Mortgage	7-1-93	4.45	4.45	1,000,000.00
Interstate Power Co.	First Mortgage	5-1-93	4 3/8	5.45	2,000,000.00
Iowa Power & Light Co.	S/F Debenture	4-1-89	4 5/8	4.57	1,200,000.00
Jersey Central Power & Light Co.	Debenture	10-1-88	4 5/8	4.56	950,000.00
Long Island Lighting Co.	First Mortgage	6-1-85	4.55	5.20	1,700,000.00
Massachusetts Electric Co.	First Mortgage	12-1-93	4 5/8	4.55	1,100,000.00
Northern States Power Co.	First Mortgage	9-1-93	4 3/8	4.38	1,000,000.00
Otter Tail Power Co.	First Mortgage	11-1-93	4 5/8	4.65	1,017,000.00
Potomac Edison Co.	First Mortgage & Coll. Trust	3-1-94	4 5/8	4.55	1,200,000.00
Southwestern Public Service Co.	First Mortgage	2-1-94	4 1/2	4.50	1,200,000.00
<b>Total Electric</b>				<b>4.72%</b>	<b>\$ 15,077,000.00</b>
<b>GAS</b>					
Columbia Gas System, Inc.	Debenture	5-1-89	4 5/8	4.64	\$ 1,200,000.00
The Gas Service Co.	First Mortgage	6-1-85	4.65	4.65	926,000.00
Michigan Consolidated Gas Co.	First Mortgage	6-1-89	4 3/4	5.52	2,375,000.00
Peoples Gas Light & Coke Co.	First & Refunding Mortgage	7-15-91	5 3/8	5.38	1,317,000.00
<b>Total Gas</b>				<b>5.17%</b>	<b>\$ 5,823,000.00</b>
<b>TELEPHONE</b>					
American Telephone & Telegraph Co.	Debenture	5-1-99	4 3/8	4.365	\$ 1,500,000.00
The Bell Telephone Co. of Canada	First Mortgage	5-1-95	4.85	5.53	2,500,000.00
The Bell Telephone Co. of Canada	First Mortgage	6-1-2004	9 1/2	9.50	3,000,000.00
General Telephone Co. of Florida	First Mortgage	6-1-91	4 5/8	4.687	1,000,000.00
General Telephone Co. of Illinois	First Mortgage	9-1-95	4 7/8	4.875	1,200,000.00
General Telephone Co. of Indiana	First Mortgage	8-1-95	4.70	4.70	1,200,000.00
New York Telephone Co.	Refunding Mortgage	1-1-2004	4 5/8	4.53	1,500,000.00
Pacific Northwest Bell Telephone Co.	Debenture	12-1-2000	1 1/2	4.49	1,500,000.00
Southern Bell Telephone & Telegraph Co.	Debenture	3-15-2013	7 5/8	8.42	4,600,000.00
<b>Total Telephone</b>				<b>6.43%</b>	<b>\$ 17,400,000.00</b>
<b>TOTAL PUBLIC UTILITY OBLIGATIONS</b>				<b>5.54%</b>	<b>\$ 38,300,000.00</b>
<b>FINANCE OBLIGATIONS</b>					
Gulf Life Insurance Co.	Capital Note	6-1-89	4 3/4	4.75	\$ 780,000.00
Northwest Bancorporation	Debenture	10-15-90	4 3/4	4.73	1,500,000.00
Northwest Bancorporation	S/F Debenture	3-15-2003	7 3/4	7.75	1,500,000.00
<b>TOTAL FINANCE OBLIGATIONS</b>				<b>5.95%</b>	<b>\$ 3,780,000.00</b>
<b>INDUSTRIAL OBLIGATIONS</b>					
Aluminum Co. of America	Promissory Note	3-31-88	8 3/8	4.50	\$ 995,000.00
Aluminum Co. of Canada, Ltd.	S/F Debenture	3-1-95	9 1/2	9.37	1,000,000.00
Armour Dial, Inc. (Ardison Properties, Inc.)	Note	1-15-2003	7.90	7.90	3,811,650.00
Atlantic Richfield Co.	Guaranteed Note	7-15-96	9 1/4	9.25	3,000,000.00
Cummins Engine Co., Inc.	Note	7-15-90	4.60	4.60	900,000.00
Diamond Shamrock Corp.	Note	5-1-89	4.65	5.26	975,000.00
Dow Chemical Co.	Debenture	9-15-88	4.35	4.35	1,000,000.00
FMC Corporation	S/F Debenture	1-15-2000	9 1/2	9.50	3,000,000.00
General Cable Corp.	Note	1-1-89	4 7/8	4.875	720,000.00
Honeywell, Inc.	Note	4-1-90	4.55	5.22	1,839,062.50
Ingersoll Rand Co.	Note	1-1-91	4 3/4	4.75	866,000.00
Shell Oil Co.	Note	4-15-90	4 1/2	4.50	1,150,000.00
Sprague Electric Co.	S/F Debenture	9-1-88	4 3/8	4.16	1,000,000.00
Standard Oil of California (Union Bank)	First Preferred Ship Mtg. Bond	9-7-97 through 11-6-97	7.70	7.70	3,000,000.00
Standard Oil Co. (Indiana) (Midcontinent Properties, Inc.)	Note	10-1-2000	7.30	7.30	4,000,000.00
Standard Oil Co. (Ohio)	Note	7-15-90	4.55	4.55	1,064,000.00
Swift & Co.	S/F Debenture	8-1-92	6.30	6.20	1,275,000.00
Texasco, Inc.	Note	12-15-83	4 1/2	4.50	1,238,000.00
Union Carbide Corp.	Note	12-31-96	4 1/2	4.47	982,835.57
Youngstown Sheet & Tube Co.	First Mortgage S/F Bond	7-1-95	4.60	4.60	1,260,000.00
<b>TOTAL INDUSTRIAL OBLIGATIONS</b>				<b>6.69%</b>	<b>\$ 33,241,548.57</b>
<b>TRANSPORTATION DEBT OBLIGATIONS</b>					
Atchafalaya, Topeka & Santa Fe Railway Co.	Gen. Bond	10-1-95	4.00	4.40	\$ 1,500,000.00
<b>RAILROAD EQUIPMENT OBLIGATIONS</b>					
Flying Tiger Corp. (Formerly North American Car Corp.)	Equipment Trust	9-176/78	4.65	4.65	\$ 800,000.00
Illinois Central Railroad Co.	Conditional Sale	2-15-77/83	6 7/8	6.875	948,999.99
Kansas City Southern Railway Co.	Conditional Sale	1-15-77			
		7-15-78	4.45	4.45	248,114.79
<b>TOTAL RAILROAD EQUIPMENT OBLIGATIONS</b>				<b>6.14%</b>	<b>\$ 1,996,114.78</b>
<b>TOTAL CORPORATE BOND OBLIGATIONS</b>				<b>6.05%</b>	<b>\$ 78,519,842.85</b>
<b>TOTAL UNITED STATES GOVERNMENT GUARANTEED AND CORPORATE OBLIGATIONS</b>				<b>7.30%</b>	<b>\$205,264,436.08</b>

(a) Most corporate issues have substantial sinking funds and an average life far shorter than the stated maturity date.

**Exhibit III**

Institution: (Montana) Resource Indemnity Fund  
created in 1974

Location: Helena, Montana

Size:

Capital Funds: \$4.5 million

Purpose: The Resource Indemnity Fund was created to accumulate income from a Severance Tax on Coal and other minerals for the purpose of providing moneys to enhance the State ecological environment and rectify damage thereto. Accumulations in the Fund shall continue until the Fund reaches \$100 million.

Source of Funds: Moneys are deposited in the Fund from a severance tax on various minerals and  $2\frac{1}{2}\%$  of the Severance Tax on Coal.

Management Structure: Moneys are collected and deposited in the Fund by the Department of Revenue. Investments in the Fund are made in accordance with guidelines established by the State Board of Investments which is composed of five private citizens appointed by the Governor for 5 year terms.

Management of Funds: Moneys are invested in debt instruments authorized by State Statutes.

Portfolio: Moneys are currently invested in corporate bonds that have been rated A or better by Moody's Investors Service and Standard & Poor's Corporation.

Income: Income from investments remain in the Fund until \$10 million has been accumulated. After the accumulation of \$10 million, income may be used for enhancement or repair of the environment.

Institution: (New Mexico) State Permanent Fund  
created in 1898

Location: Santa Fe, New Mexico

Size:

Assets: 10 million acres  
Capital Funds: \$675 million

Purpose: The State Permanent Fund was established to collect royalties and other income from the lease of State-owned land. Income from the Fund is applied to the New Mexico public school systems and educational and eleemosynary institutions.

Source of Funds: Moneys in the Fund were initially provided from the sale of State land. Currently, revenues to the Fund are provided from royalties and income from State-owned lands under lease. Such revenues include oil and gas royalties and grazing and timber leases. In addition, any capital gains on investments remain in the Fund.

Management Structure: The State Permanent Fund is managed by the State Investment Council. Members of the Council include the Governor, the State Treasurer, the Commissioner of Public Lands, the Finance Officer and four public members who are appointed by the Governor for terms of five years.

Management of Funds: The State Investment Officer is responsible for investing moneys in the State Permanent Fund. Fifty per cent of the Fund must be invested in Federal Securities. The remainder may be invested according to State Statutes.

Portfolio: The Fund is currently invested as follows: 18% equity, 32% corporate obligations and 50% U.S. Government and Federal Agency Obligations.

Income: Income from the Fund is distributed to the public school system (80%) and the remainder to educational and eleemosynary institutions.

Institution: (New Mexico) Severance Tax Bonding Fund, created in 1941

Location: Santa Fe, New Mexico

Size:

Capital Funds: \$9,040,756.02

Purpose: The Severance Tax Bonding Fund was created to secure tax-exempt bonds issued for public capital projects.

Source of Funds: Moneys derived from the levy of the New Mexico Severance Tax on severed natural resources are paid in their entirety to this Fund. Additional sources of income include revenues from projects financed with Severance Tax Bonds and receipts from ground rentals of Public Buildings. Moneys in excess of the next two semi-annual payments on all outstanding Severance Tax Bonds are transferred to the Severance Tax Permanent Fund.

Management Structure: The Fund is managed by the State Treasurer under the supervision of the State Board of Finance. The State Board of Finance consists of the Governor, Lieutenant Governor and three private citizens appointed by the Governor for two year terms. The State Treasurer is responsible for repayment of principal and interest on Severance Tax Bonds.

Management of Funds: Moneys in the Fund are invested in debt instruments authorized by State Statutes.

Portfolio: N.A.

Income: All moneys in the Severance Tax Bonding Fund except an amount sufficient to repay principal and interest on the Severance Tax Bonds on the next ensuing semi-annual payment date is transferred to the Severance Tax Permanent Fund.

Indebtedness Limitation: The State Board of Finance may issue additional Severance Tax Bonds payable from the Severance Tax Bonding Fund provided that aggregate annual debt service on Bonds outstanding including the proposed issue be equal to no more than 50% of previous fiscal year's deposits into the Severance Tax Bonding Fund.

Institution: (New Mexico) Severance Tax Permanent Fund created in 1971

Location: Santa Fe, New Mexico

Size:

Capital Funds: \$103 million, currently accruing at rate of \$4 million per month.

Purpose: The Severance Tax Permanent Fund was created to encourage economic development in the State of New Mexico.

Source of Funds: Moneys in the Severance Tax Permanent Fund are provided from the New Mexico Severance Tax levied for the privilege of severing natural resources including oil and gas, potash, copper, uranium, timber, coal and certain other minerals. Proceeds from the Severance Tax are deposited in the Severance Tax Permanent Fund after the required payments to the Severance Tax Bonding Fund.

Management Structure: The Fund is managed by the State Treasurer under the supervision of the State Board of Finance. The State Board of Finance consists of the Governor, Lieutenant Governor and three private citizens appointed by the Governor for terms of two years.

Management of Funds: Moneys in the Fund may be invested at the discretion of the State Board of Finance. Moneys currently are invested by the State Treasurer in Certificates of Deposit of State banks who in turn make loans for capital projects to the private sector. Loan feasibility and appropriateness of the capital project is left entirely up to the bank. Participation by the Fund in sizeable loans by State banks requires the approval of the State Board of Finance. The principal of the Fund may be used for economic development purposes upon the approval of the State Board of Finance. An amendment to require 3/4's approval of the legislature prior to invasion of the principal of the Severance Tax Permanent Fund is on the November ballot.

Portfolio: Approximately \$94 million of the Fund is invested in Certificates of Deposits of State banks maturing one to five years at a floating rate of short term treasury obligations plus 50 basis points. The remainder is invested under Repurchase Agreements.

Income: Income from the Severance Tax Permanent Fund is transferred to the Severance Tax Income Fund.

Institution: (New Mexico) Severance Tax Income Fund created in 1971

Location: Santa Fe, New Mexico

Size:

Capital Funds: \$2.2 million as of 9/27/76

Purpose: The Severance Tax Income Fund was created to finance public capital improvement projects.

Source of Funds: Income from the investments of the Severance Tax Permanent Fund is deposited in this Fund.

Management Structure: Moneys are invested and disbursed by the State Treasurer under the supervision of the State Legislature.

Management of Fund: Pending appropriation for capital projects, moneys are invested under Repurchase Agreements.

Portfolio: N.A.

Income: Income from the Fund is transferred to the State General Fund.

Institution: Texas Permanent University Fund created in 1881

Location: Austin, Texas

Size:

Assets: 2,100,000 acres of land in nineteen West Texas counties  
Book value 8/31/75 \$781,771,634.49

Purpose: Fund created by provisions of the Texas Constitution in order to enable the State Legislature to carry out the purpose, as declared by the Republic of Texas and later in early State Constitutions, of creating a State University. The Constitutional provisions set aside all lands previously appropriated for the creation of a State University, together with the proceeds of any sale thereof, to create a Permanent University Fund. All moneys available in the Fund are to be invested in securities, the income from which will be appropriated by the Legislature, in order to accomplish the purpose of creating, maintaining, supporting and directing a university for the promotion of literature, and the arts and sciences, including an agricultural and mechanical department.

Source of Funds: Funds are accumulated annually in the Fund from oil, gas and water royalties, gains on investments, mineral lease rentals, lease bonuses, and any proceeds of land sold. The Permanent Fund shall be forever kept intact and all annual income shall become part of the Fund.

Management Structure: The Fund is held by the Treasurer of the State of Texas and invested by direction of the Board of Regents of the University of Texas. The Board of Regents consists of nine members who serve without compensation. They are appointed by the Governor for six year terms subject to approval by the Senate.

Management of Funds: The Fund is invested in permitted securities which are bonds of the United States, the State of Texas, or counties of the State, or in school bonds of municipalities in the State, or bonds of any city in the State, or in bonds issued under the Federal Farm Loan Act. In addition, the Fund may be invested in securities, bonds or other obligations issued, insured or guaranteed in any manner by the U.S. Government, or any of its agencies, and in bonds, debentures, or obligations, and preferred and common stocks issued by corporations, associations, or other institutions as the Board of Regents deem to be proper, provided that not more than 1% of the Fund will

Management of Funds:  
continued

be invested in the securities of any one corporation nor more than 5% of the voting stock of any one corporation be owned. In addition, stocks purchased will be only in companies incorporated in the U.S. and who have paid dividends for at least five consecutive years and, except for bank or insurance company stocks, are listed on a registered stock exchange.

Portfolio:

Capital Funds (August 31, 1975)	
Securities, cash and equivalent at cost	\$781,771,634.49
U.S. Governments	
Direct Obligations	106,828,987.45
Guaranteed	103,089,999.03
Corporate Bonds	279,571,990.53
Convertible Debentures & Preferreds	16,440,190.64
Common Stocks	254,425,102.52
Short Term Securities & Cash	<u>21,415,364.32</u>
Total	\$781,771,634.49

Income:

The income from Fund investments is appropriated annually by the State Legislature; two-thirds to the University of Texas and one-third to Texas A & M. The income of the Fund may be used only for permanent improvement and not for current expenses. Prior to the distribution of the income of the Fund, provision is made for the expenses of administering the Fund.

Institution: (Wyoming) University Permanent Land Fund created in 1881

Location: Cheyenne, Wyoming

Size:

Assets: 34,492 acres  
Capital Funds: \$8,565,000

Purpose: The University Permanent Land Fund was created to receive income from lands granted to Wyoming to be used for the financial benefit of the University of Wyoming. Income from the Fund is used to support capital projects of the University.

Source of Funds: Moneys in the Fund are provided from income received on specific State-owned lands.

Management Structure: The State Treasurer is responsible for investing the Fund. Income from the Fund is transferred to the Treasurer of the University of Wyoming.

Management of Funds: The State Treasurer invests the Fund in debt instruments authorized by State Statutes.

Portfolio: N.A.

Income: Income from the Fund is transferred to the University of Wyoming.

Institution: (Wyoming) Permanent Mineral Trust Fund created in 1974

Location: Cheyenne, Wyoming

Size:

Capital Funds: \$51,250,000

Purpose: The Permanent Mineral Trust Fund was created to retain moneys collected from a Severance Tax on all minerals. Moneys in the Fund may be used for loans to political subdivisions upon legislative approval.

Source of Funds: Collections of a Severance Tax on all minerals are placed in the Fund.

Management Structure: The State Treasurer is responsible for managing and investing this Fund.

Management of Funds: Moneys are invested in debt instruments authorized by State Statutes.

Portfolio: N.A.

Income: Income from the Permanent Mineral Trust Fund is transferred to the State's General Fund.

Institution: (Wyoming) Government Royalties Fund created in 1973

Location: Cheyenne, Wyoming

Size:

Assets: 3.1 million acres

Capital Funds: N.A.

Purposes: Moneys collected in the Fund are applied as follows:

- 50% to Public School System
- 35% to State General Fund
- 9% to University of Wyoming for capital projects
- 6% to counties

Source of Funds: Mineral royalties and lease payments from operators on U.S. Government-owned lands in Wyoming are divided between the U.S. Government and Wyoming. Prior to 1976 the State of Wyoming received 37 1/2% and the U.S. Government 62 1/2%. As of 1976 the U.S. Government and Wyoming divide the mineral royalties and lease payments equally.

Management Structure: Mineral royalties and lease payments are collected by the U.S. Government and disbursed to the State semi-annually.

Management of Funds: Moneys remitted to the State are deposited with the State Treasurer. The Wyoming legislature intends to address the management and application of additional income received pursuant to the State's increased share of mineral royalties and lease payments.

Portfolio: N.A.

Income: N.A.

The following is a summary of States that have not created permanent trust funds to receive income derived from taxation on or royalties from finite natural resources.

STATE

APPLICATION OF SEVERANCE TAX AND ROYALTY INCOME

Alabama

Proceeds of the Timber Severance Tax support State Conservation Department timber restoration activities.

The Coal Severance Tax is used to pay debt service on Alabama State Docks Department, Seaport Facility Revenue and Special Tax Bonds. \$15,000,000 originally issued. \$13,075,000 presently outstanding. No additional bonds may be issued with the Coal Severance Tax as security.

Arkansas

Revenue from severance taxes are returned to the county level after the State deducts all claims against the county, plus a 1 1/2% charge. The 1 1/2% charge is deposited in State General Fund.

California

Fifty-six percent for capital outlay programs in California's Higher Education System.

Twenty-two percent for special projects including irrigation aqueducts and improvement in navigable waterways.

Eight percent to State Conservation Department to support various activities.

Fourteen percent deposited in State General Fund.

Colorado

Severance tax deposited in State General Fund

Idaho

Severance tax deposited in State General Fund.

Kansas

All revenue from Oil, Gas and Minerals Severance Tax is deposited in State General Fund.

All revenue from Sand and Gravel Royalty Tax is returned to counties.

Kentucky

Proceeds from severance tax are placed in short term investments. Semi-annually counties receive money for special projects. All remaining money is deposited in State General Fund.

STATE

APPLICATION OF SEVERANCE TAX REVENUE

Louisiana

Ninety percent of severance tax revenue is retained by the State for general purposes. The remaining 10% is allocated to parishes (counties)

Minnesota

Minnesota deposits 10% of the Taconite Production Tax in their general fund. Ninety percent is returned to districts where taconite is produced.

All proceeds from the Ore Royalty Tax are deposited in State General Fund.

Mississippi

Of the Timber Severance Tax, 50% is allocated to the Forest Redevelopment Fund, 25% is returned to counties and 25% is deposited in State General Fund.

The State levies taxes on gas production with 30% going to participating counties and 70% to State General Fund.

Mississippi also imposes a tax on oil production. Counties receive 30% of the first \$600,000, 10% of the next \$600,000 and 5% thereafter. The balance is deposited in State General Fund.

North Dakota

Thirty-five percent of the taxes which North Dakota levies on coal extraction goes to the Coal Impact Office. The Office then allocates money on the basis of application for public projects in the areas where coal is mined.

Thirty percent is allocated to the Land Board Trust Fund. Two-thirds of this is used to finance environmental studies. One-third is invested with interest proceeds deposited in State General Fund.

Thirty percent is deposited in State General Fund.

Remaining 5% allocated to counties.

Ohio

Seventy-five percent of severance taxes are used for the restoration of orphaned strip mining land.

Twenty-five percent is allocated to replug abandoned oil and gas wells which are deemed as hazards.

Oklahoma

State General Fund receives 85% of severance tax revenue. Fifteen percent is allocated to counties.

Utah

All revenue from severance taxes is deposited in State General Fund. Expenditures are then allocated by State legislature.

**Exhibit IV**

## ORGANIZATION AND MANAGEMENT

### Tentative Organizational Structure

#### Governor

- . Appoints Public Members of Policy Board of Directors

#### Legislative

- . Confirms Public Policy Board of Directors Appointments
- . Determines Use of Fund Income
- . Determines Percentage Allocation of Natural Resource Revenues to Fund if over 25%

#### Policy Board of Directors

- . 12 Members
- . 4 Permanent/Government Members
  - 2 Legislators
  - 2 Commissioners
- . 7 Public (Appointed Members) - Staggered Terms
- . Fund President (Non-voting)

#### Duties and Responsibilities

- . Determines Fund Policies
- . Reports to the Legislature and to the Public on Fund Operations
- . Selects Fund President
- . Approves Fund Budgets
- . Performs Audit, Operational and Performance Analysis of Fund
- . Responsible for Sectoral Analysis of Alaskan Economy
- . Approves Loans and Investments in Excess of Specified Amounts
- . Appoints Public Members of Investment Committee

#### Investment Committee

- . 5 Members
  - Fund President (Chairman)
  - 4 Public/Appointed Members

#### Duties and Responsibilities

- . Approval of Loans and Investments
- . Determination and Review of Funds' Organization and Operating Policies

### Fund Personnel/Advisors

- . Fund President
  - Chief Operating Officer
- . Fund Staff
  - Invest or Re-invest Moneys not subject to Investment Committee or Policy Board Approval
  - Evaluate Loan and Investment Proposals; Prepare and Package Loan and Investment Proposals for Presentation to Investment Committee for Approval
  - Supervision and Monitoring of Investments
- . Employ External/Internal Advisor (s) to assist in above functions
- . Operating Management
  - Accounting and Control

**Exhibit V**

INVESTMENTS

Corporate Securities

The purpose of the following discussion is to summarize briefly the principal characteristics of the various types of debt and equity securities most frequently issued by publicly owned corporations in the U. S. Although the discussion confines itself to the characteristics of publicly issued securities, these characteristics also apply generally to privately sold securities. The last section discusses the primary difference between publicly issued and privately sold corporate securities.

Debt Securities

Debt obligations are incurred by corporate entities for various reasons, the most important of which are to provide funds for the acquisition of fixed assets or to add additional cash resources to the borrower's supply of general working funds on a semi-permanent basis. The issuance of debt generally permits the borrower to accelerate its rate of growth beyond that which it would be capable of achieving were it solely dependent upon its own internally generated capital funds. Although debt securities can be of various types, all rely on the borrower's future revenues as the principal means of repayment.

Corporate Debt Holders

The holders of corporate debt instruments are creditors of the borrower; they generally cannot exercise control over its affairs and do not have a voice in its management unless it has violated certain of the provisions of the contract governing the borrowing. In addition, debt holders are not entitled to participate in the residual earnings of the borrower; instead, their return is limited to the fixed coupon rate of the security. Further, a debt security has a specified maturity date whereas a share of common or preferred stock has no fixed maturity. Importantly, the claims of creditors rank prior to those of common and preferred stockholders, although there may be differences in priority of claim among the various creditors themselves.

Principal Features of Debt Securities

The five principal aspects of a debt instrument are its fixed return (or "coupon"), its maturity, its repayment provisions, its redemption provisions and its restrictive covenants.

The coupon of debt instrument is determined by many factors, principally the credit standing of the issuer, the term of the borrowing and the market rates for similar issues of comparable companies at the time of the borrowing. Generally, the lower the credit standing of the issuer and the longer the term of the borrowing, the higher will be the interest coupon. An additional important influence

on the level of the interest coupon is the form of the security, and senior or secured obligations commonly carry lower interest coupons than unsecured or subordinated obligations. Certain subordinated obligations convertible into the common stock of an issuer may, however, carry a lower coupon than the same borrower's senior obligations in recognition of the conversion feature. Other factors also impact the level of the interest coupon on certain types of debt securities, with the repayment schedule over the term of the borrowing and the length of the period during which the issue cannot be optionally prepaid by the issuer bearing importantly on the interest coupons of long term borrowings. A more rapid repayment schedule and a longer prohibition on prepayment will usually contribute to a lower interest coupon. Finally, borrowings with extremely liberal contractual provisions commonly require higher rates of interest.

The maturity of a debt security denotes the date on or by which the entire principal amount of the borrowing must be repaid. In the U. S., the most common maturities for publicly issued debt securities are 5, 10, 20, 25 and 30 years. Intermediate term securities (securities with maturities up to ten years) frequently are repayable only at maturity via a single lump sum payment. Longer term issues (securities with maturities of 20 to 30 years) generally require periodic repayment, beginning after a certain number of years, through the means of a sinking fund. If a debt security has a sinking fund, the issuer must make periodic payments to a trustee, who uses these funds to purchase the securities in the market and retire them. A sinking fund is valuable to securities holders as it provides support for the market price of the issue and provides for the orderly repayment of the borrowing. The amount of a required sinking fund payment may be fixed or variable, depending on the terms of the borrowing. Most issues either require fixed payments during the repayment period (referred to as a level sinking fund), increasing payments over the repayment period, or fixed payments in each year except the last when a larger (or "balloon") payment is required. In certain cases borrowers are permitted to anticipate future sinking fund payments by "doubling up" or to surrender securities purchased in the open market in lieu of making a cash payment. Types of sinking fund schedules other than the above, including schedules which only require repayments to be made when earned, are used infrequently.

Some debt issues are serial issues. Instead of being a single issue subject to a sinking fund, a serial issue consists of separate securities which mature periodically until the final redemption date. Because of the differences in the maturities of the securities comprising a serial issue, it is common for a serial issue to be split into two or more tranches each bearing a different interest coupon.

In most debt issues, the borrower is given the right to buy back (or "call") all or a portion of its issue prior to maturity at a specified price. Commonly, the borrower is only allowed to exercise this right after a certain number of years. In some circumstances, the borrower is allowed to call its issue immediately. A call provision favors the borrower over the investor as, if an issue is called to permit the borrower to refinance at a lower interest cost, an investor may not be able to reinvest at an equally high yield. As a result, a borrower usually has to pay a premium over par value when it calls its securities, which normally amounts to one year's interest and declines to zero one year prior to maturity. Many intermediate term issues are callable only one or two years prior to maturity, however, at no premium.

For most debt issues, the contract between the borrower and the lender contains restrictive provisions designed to provide a measure of protection for the lenders' investment over the term of the borrowing. Usually these covenants limit such items as the amount of the borrower's additional debt, dividend payments, leases and mergers. Two of the most important restrictive provisions are the negative pledge provision - which prohibits a borrower from pledging its assets to secure future debts - and the cross default provision - which accelerates the repayment of the issue if the borrower defaults on certain of its other debts. Frequently, these covenants are contained in an indenture between a corporate trustee (generally a bank) and the issuer. If no indenture is used, these covenants are usually contained in the terms of the security itself. The extent of the restrictions placed on a borrower depends on his credit standing and the term of the issue.

### Types of Debt Instruments

The two principal types of corporate debt securities are generally referred to as "notes" and "bonds" or "debentures". Notes are typically short to intermediate term obligations which are either payable in full at maturity or subject to a limit 1 sinking fund, are callable at par one to two years prior to maturity and are not governed by a formal indenture. The restrictive covenants of a note issue are generally contained in the security itself and the provisions governing the operational aspects of repayment are found in an accompanying fiscal agency agreement between the borrower and a bank. Notes of the form described above are generally unsecured obligations. Notes, however, may be secured obligations and subject to a formal borrowing agreement with a corporate trustee.

The terms "bonds" and "debentures" are used interchangeably to refer to unsecured long term obligations governed by a formal indenture between a corporate issuer and a trustee. Bonds and debentures usually require a sinking fund and permit a call by the borrower only after a certain number of years.

A mortgage bond is a bond issue secured by a lien on specific assets (usually fixed assets) of the borrower. The mortgage providing the lien to the bondholders may be closed-end or open end. Under a closed-end mortgage, no further bonds can be issued against the specific property. Under an open-end mortgage, the borrower can issue additional bonds under the same lien. To prevent an unlimited amount of indebtedness from being issued against specific property, most open-end mortgage bonds contain restrictions limiting the total debt under the mortgage to a certain percentage of the value of the pledged assets. Many mortgage bonds also contain an after-acquired clause which extends the lien to properties acquired after the date of the initial issue. Although mortgage bonds are secured by specific assets, a bondholder is nevertheless required to look to the earning power of the issuer as his primary source of repayment.

The most common type of mortgage bond is a first mortgage bond and is so called because its security is a first lien on the pledged assets. A second mortgage bond is exactly the same as a first mortgage bond except that it is secured by a second lien on the pledged property. Second mortgage bonds are used less frequently than first mortgage bonds.

Collateral trust bonds are bonds secured by stocks or bonds or other securities pledged by the issuer to a trustee. In the event of default, the trustee sells the collateral and repays the bondholders. This type of bond, popular in the 1920's and 1930's, is now used infrequently.

Income bonds are securities whose interest is required to be paid only when earned by the issuer. This type of issue offers an investor little hope of a fixed return and its use has generally been restricted to corporate reorganizations.

A subordinated debenture is a security which is subordinated in right of payment to other indebtedness of the issuer. Such securities, however, are senior to both common and preferred stock in liquidation. Because of their status, subordinated debentures are commonly regarded by senior lenders as near-equity and consequently can support further senior borrowings. It is possible for an issuer to have several issues of subordinated debt outstanding and for one issue to be subordinate to another; such issues are called junior subordinated debentures.

Convertible debentures are debentures which may be converted into the common stock of the issuer at a specified price. Such debentures are usually subordinated and from the standpoint of a senior creditor are viewed as equity when the market price of the related stock is reasonably close to or above the specified conversion price. When the market price of the related stock is well below the conversion price, convertible debentures are viewed as non-convertible subordinated issues.

## INVESTMENTS

### Equity Securities

#### Common Stock

The most important type of equity security is common stock. Collectively, holders of a company's common stock are its owners and are entitled to share in its residual earnings if dividends are paid. They are also required to bear the risks of ownership, but their liability is generally limited to the amount of their original investment. In liquidation, common stockholders have a claim on the assets of the company only after the claims of all creditors and preferred stockholders have been settled in full. Unlike a debt security, common stock has no fixed maturity date; the only way in which a shareholder can realize his investment is to sell his shares in the secondary market.

Authorized common stock is the number of shares which a company can issue without amending its charter. Issued shares are shares which have been sold to the public. Outstanding shares are shares which are in the hands of the public. Treasury shares are shares which have been repurchased but not cancelled by the company.

The par value of a common stock is a stated figure in the corporate charter. Although it is used in the preparation of accounting material, the par value of common stock has little economic significance. Stocks may be authorized without par value and there is no difference in value between a par value and a no par value stock.

The book value of a common stock is derived by dividing the net worth of the issuing company, less the par value of any preferred shares outstanding, by the number of common shares. In theory, the book value of a common stock is its liquidating value, but in reality the actual liquidating value may be higher or lower than the book value. Like par value, the book value of a common stock is of little economic significance.

The market price of a common stock is the price at which the shares are being traded in one of the stock exchanges or in the over-the-counter market. The market value of a common stock usually will differ considerably from its par value, book value or liquidating value as it is a function of the company's current and anticipated future earnings and dividends and the perceived risk of the stock on the part of investors. The market capitalization of a company is equal to the number of outstanding shares times the market price per share.

As owners, common shareholders are entitled to elect the company's board of directors which, in turn, selects management and runs the business. The only recourse a shareholder has against management is via the board of directors. If a director acts in a manner which results in personal gain, he is liable to suit. In electing directors, a shareholder is entitled either to vote all of his shares for each director (majority voting) or to vote all of his shares, multiplied by the number of directors to be elected, for less than the total number of directors being elected (cumulative voting).

Certain companies may have one or more classes of common stock differing in their claims on income and as to voting power. One class of stock may have no voting privilege but be entitled to a prior claim on dividends while another may have voting power but a junior claim on dividends. The use of various classes of common stock is generally adopted when it is desired to concentrate the voting control of the company in a single group.

Occasionally, a common stock has preemptive rights. A preemptive right entitles a shareholder to maintain his proportional ownership interest in the company by giving him the first opportunity to purchase, on a pro-rata basis, any new common stock or convertible securities being sold to the public.

### Preferred Stock

Preferred stock is a hybrid type of security, combining certain features of both debt and common stock. Like debt holders, holders of preferred stock do not participate in the residual earnings of the issuer and their rate of return is limited to the specified dividend of the preferred stock. Unlike interest payments on debt issues, however, preferred dividends can be omitted without resulting in the insolvency of the company. When preferred dividends are omitted, holders of preferred shares are usually entitled to elect a certain number of directors; otherwise, preferred shareholders do not participate in the management of the issuing company. Most preferred dividends are cumulative and if they are omitted, all arrearages must be made up before common dividends can be resumed. Preferred dividends are a contractual obligation, and are senior in right of payment to common dividends.

Preferred stock, like common stock, has no specified maturity. However, preferred stock is rarely viewed as a permanent means of financing and provisions are usually made for an issue's orderly retirement via a sinking or purchase fund. A preferred stock sinking fund operates in the same manner as a bond sinking fund. A purchase fund requires the issuer to expend a certain sum each year to acquire and retire the outstanding shares, but this requirement is usually limited by restricting the price which can be paid for the shares to par value. If the market price is above par, no purchases will be made for the purchase fund.

Practically all preferred stocks have call provisions similar to those of corporate bonds. Certain preferred stocks are convertible into the common shares of the issuer. Other preferred stock issues are participating and share in the residual earnings of the issuer according to certain formulae, usually based on common dividends.

### Differences Between a Public and a Private Securities Issues

A securities issue which has been registered with the Securities and Exchange Commission and sold in an underwritten offering by a syndicate of investment banking firms is referred to as a public issue. Such issues, whether listed on a major stock exchange or traded between dealers, are freely transferable between holders and consequently offer an investor a high degree of liquidity.

A securities issue which has been sold directly by an issuer to an institutional investor (such as an insurance company) without registration with the Securities and Exchange Commission is referred to as a private issue. Because they are not registered, private issues are not freely transferable and their marketability is consequently very limited. To compensate an investor for this lack of liquidity, private debt issues usually carry higher interest coupons and more restrictive covenants than similar public debt issues. Similarly, private equity issues generally cannot be sold at as advantageous prices as public equity issues.

## INVESTMENTS

### Long Term Government Securities

The direct obligations of the U. S. government and its agencies, together with securities bearing the full faith and credit guarantee of the government, constitute the highest quality debt securities in the U. S. Although certain of such securities, principally Treasury bills, are issued for very short maturities, a substantial amount is issued for maturities ranging from three to thirty years. Short term government securities are considered in the following section on Money Market Instruments.

The principal long term direct obligations of the U. S. government are Treasury notes and bonds which are usually issued for maturities of up to ten and thirty years, respectively. Such bonds and notes are sold periodically directly by the Treasury and a substantial amount is outstanding at all times; secondary market trading is very active.

Along with the direct obligations of the Treasury, the government also raises funds through its agencies which issue both short and long term securities either guaranteed by the government directly or backed by the agencies, which are themselves instrumentalities of the government. Many government agencies issue such securities, but principal among these are the Federal Home Loan Banks, the Federal National Mortgage Association, the Federal Land Bank and the Bank for Cooperatives. Issues of these borrowers are generally sold through public offerings underwritten by banks and investment firms.

Through Acts of Congress, the government has also authorized certain quasi-government entities to issue securities bearing its full faith and credit guarantee including the Export Import Bank of the U. S. and Private Export Funding Corporation. Congress has also authorized the application of its guarantee to securities of private corporate issuers for specific purposes, including bonds issued to finance the construction of U. S. flag ships under the provisions of Title XI of the Maritime Act. Such bonds have recently begun to be issued in significant amounts and are generally referred to as Title XI bonds.

**Exhibit VI**

INVESTMENTS

Money Market Instruments

Money market instruments are short-term, high grade debt instruments that carry a minimum amount of risk and which can readily be turned into cash without material loss. Because of their relatively short maturity, generally no more than twelve to twenty-four months, money market instruments have a readily stable market value at all times. The principal types of money market securities are Treasury bills, notes and bonds, securities guaranteed by the government or issued by its agencies, municipal securities, bank certificates of deposit, bankers acceptances and corporate commercial paper. These securities are frequently purchased by investors seeking a temporary investment for surplus cash resources.

Treasury Securities

The Treasury securities which are most often referred to as money market instruments are Treasury bills and Treasury notes and bonds maturing within two years. Treasury bills, issued at auction each week and maturing in periods from three months to one year, are the backbone of the money market. Because of the large volume of Treasury bills outstanding and their continual issuance, a short term investor can normally find an issue with a maturity on or close to the date when his surplus funds will be required for their intended purpose.

Treasury bills are issued in bearer form and on a discount basis. The holder receives the full face value of the security at maturity in lieu of interim interest payments.

Treasury notes and bonds are government securities which have original maturities of over one year. Both are issued in bearer form and interest is payable upon presentation of a coupon. Treasury notes by law may not have a maturity in excess of ten years while Treasury bonds generally mature in more than ten years. As either Treasury bonds or notes move into the under two-year money market maturity range, they become attractive investments for investors who wish to invest for longer maturities than offered by Treasury bills.

Other Government Securities

A large number of government agencies also issue securities which are either guaranteed directly by the government or fully backed by the agencies themselves which are conservatively run entities chartered by Congress and supervised and/or owned by the government. Among such issuers are the Federal National Mortgage Association, the Federal Home Loan Banks, the Federal Land Banks, the Government National Mortgage Association, the Federal Intermediate Credit Banks and the Banks for Cooperatives. Securities of these issuers are sold on both a coupon and a discount basis and for various maturities from three months to twenty years. Most issues are relatively short-term, however, and fall either directly into the money market or are drawn in as their maturity date approaches.

The attraction of these securities to money market investors is that their yields are somewhat higher than those of Treasury securities in light of the fact that they are indirect rather than direct obligations of the government.

### Municipal Securities

Municipal securities possess two characteristics that are important prerequisites for a money market instrument: a large outstanding supply of obligations of various types and maturities and an active secondary market. The principal types of municipal securities traded in the money market are short term notes and long term bonds, drawn into the money market as their maturity approaches. Municipal securities are attractive to investors because of their tax-exempt yields.

### Certificates of Deposit

A Certificate of Deposit is a negotiable instrument representing an interest bearing time deposit in a commercial bank. Certificates of deposit (CD's) began to be issued by commercial banks in 1961 and are ideal instruments for the investment of short term idle cash because a purchaser (lender) can negotiate with the bank seller (borrower) to tailor a CD to his exact maturity needs. Moreover, there is a very substantial amount of CD's outstanding and the secondary market is extremely active; if unforeseen circumstances arise an investor can sell his CD's in the marketplace. The interest rate on CD's is higher than that for either Treasury or agency securities of the same maturity.

### Banker's Acceptances

A banker's acceptance is created when a commercial bank "accepts" (endorses) a draft drawn on it for the account of one of its customers for payment on a specified future date. Time drafts are usually associated with the payment for goods shipped in international trade. By accepting a time draft, a bank substitutes its credit for that of its customer and an accepted draft thus becomes similar to a security of the bank itself. Because of the very short maturity of most banker's acceptances, usually not more than ninety days, they are readily sold in the money market.

### Commercial Paper

Commercial Paper is an unsecured promissory note of relatively short maturity issued by a well known corporation with good credit ratings to finance short term borrowing needs. Commercial Paper, because of Securities and Exchange Commission requirements, may not be issued for maturities longer than 270 days. All commercial paper is sold in bearer form at a discount with rates running slightly higher than Treasury bills. Because of their short maturity and high liquidity, commercial paper is an ideal money market instrument.

**Exhibit VII**

## INVESTMENT COUNSEL ASSOCIATION OF AMERICA

### STANDARDS OF MEASUREMENT AND USE FOR INVESTMENT PERFORMANCE DATA

#### INTRODUCTION

In recent years, the measurement of investment performance has become a topic of widespread interest. The techniques employed and the uses of the results have been varied and remain in a considerable state of change. Consequently, it is often impossible to gain perspective through comparisons of different investment records measured with different calculation methods. The principal problem is that there are no minimum, uniform standards for measurement and use guiding all organizations providing investment management services.

This report will formulate standards to provide the Investment Counsel Association of America membership with some guidelines and background information for compiling and using portfolio performance data. The problems associated with measuring investment results are complex and make it extremely difficult to arrive at a satisfactory and still simple solution to them. The central problem is that rarely, if ever, do two distinct portfolios have identical characteristics and investment objectives. Therefore, an attempt to compare the success of different investment programs solely on the basis of quantitative, statistical results without regard to the qualitative, individual, subjective circumstances must have limited value. However, despite the imperfect character of purely numerical measurements, the Investment Counsel Association of America does endorse certain standards of measurement and use. The recommendations are not intended to deal with

every facet of performance measurement. Some areas are intentionally treated in a general way in order to provide scope for adapting the subject to varying circumstances and also because being too specific on some subjects would result in having to establish more "rules" to deal with exceptions than seems practical. Therefore, this report is confined primarily to recommendations of minimum standard on how to calculate performance data and how best to use this information. Moreover, while performance measurement of specific portfolios for manager or client use has unquestioned individual value, this report is written with the objective of facilitating performance comparisons between portfolios and the recommendations are stated accordingly.

No firm is required to adopt these recommendations unless it wishes to make the statement regarding the presentation of investment performance figures that: "All Representations are in Accordance with Standards Approved by the Investment Counsel Association of America."

There are many purposes served through comparisons of different portfolio performance records. Perhaps the purpose which is the most controversial is the presentation of a performance record in an effort to demonstrate to prospective clients the abilities of an investment manager. It is very difficult to construct a sample of data which is an accurate picture or is representative of a manager's work. The difficulties of data construction and interpretation exist whether the data sample is one account, ten accounts, or all of a manager's accounts, either of a certain class (by account type, size, performance rank, etc.) or in total. A major goal of the recommendations in this report is to provide a systematic approach to this problem. The solution, and the concept of this report, is that the following recommendations are not

isolated from each other but stand together as flexible parts of a unified filtering process. In most instances, the recommendations act as guides and are not narrowly restrictive. They encompass many filtering alternatives and the only general restrictions are disclosure and willingness to substantiate representations if requested.

Performance figures might be selected for presentation including (1) total portfolios of (2) all (3) corporate pension funds (4) managed continuously (5) during a five-year period and (6) with assets at the end of the period in excess of \$1 million. The rates of return would be (a) calculated and displayed along the lines of the techniques described in this report, (b) captioned and/or footnoted to disclose that they include accounts filtered or selected with the six above criteria and (c) substantiated, upon request, as being representative, for example, if a median statistic, one account or ten accounts were used to represent all accounts. Within these same conditions, one account with a very favorable rate of return could be held out as an example of a firm's work so long as (a) the return calculations are appropriate, (b) it is disclosed that the account was selected and has one of the best rates of return of all accounts managed and (c) it is substantiated that it is only representative of itself and no other account managed by the firm.

RECOMMENDATIONS:

I Standards of Measurement

1. Total Return: Investment results should be computed on a total return basis.
2. Rates of Return: Investment results should be computed as "time weighted" rates of return for use in making comparisons with market indices and results of other portfolios.
3. Total Portfolio and Various Portfolio Segments: Investment results should be computed on the total portfolio and, where useful to demonstrate the ingredients of the total results or specific areas of investing, on the portfolio's various segments.
4. Definitions within Portfolio Segments: Investment results for portfolio segments should be based on comparable characteristics such as types, marketability and size of holdings.
5. Total Time Period Shown: Investment results quoted to third parties should include at least five years' experience where possible.
6. Time Intervals Used: Investment results should indicate the total rate of return on an annual basis and on a compound annual basis for multiple time periods.
7. Variability of Return: Investment results should be characterized not only by the magnitude attained but also by the degree of variability experienced in reaching the return.

II Standards of Use

1. Management Discretion: Investment results should be used to reflect the manager's performance only if he operated with effective discretion.
2. Number of Results Shown: Investment results should be shown for all portfolios within the designated category. Adequate disclosure should be made regarding the description of the sample shown. If requested, substantiation should be provided of representations made.

3. Tax-Exempt Portfolios: Because of the differences in impact on investment results of various tax brackets, some common base should be used when comparing rates of return. Tax-exempt portfolios automatically solve this problem and are preferred for use.
4. Similarity of Investment Objectives: Comparisons of investment results should be made only for portfolios with similar objectives.
5. Size: Comparisons of investment results should be made only for portfolios within reasonable categories of size.
6. Relevance to Third Parties: The selection of investment results shown should relate in some logical way to the circumstances of those receiving the information.
7. Comparative Format: Investment results should be shown in a way to facilitate comparisons.
8. Distribution of Information: The distribution of investment results is regulated under the Investment Advisers Act of 1940 and care should be taken to comply with these regulations.

## DISCUSSION

### I Standards of Measurement

#### Total Return

The investment results of a portfolio should be measured in terms of all the results produced. This includes the income generated as well as capital gains and losses both realized and unrealized. These are the three ingredients of performance and, even though a portfolio might not be managed on a "total return" concept, the only proper approach is to measure all of the portfolio's output. There is a considerable body of disagreement on this, particularly regarding the accounting for unrealized capital gains. We recommend that investment results be measured on an accrual accounting basis from period to period and not on a cash accounting basis that might require that the capital gains be realized or income (e.g., bond interest income paid out semi-annually) be received before being credited to portfolio performance. An acceptable procedure to account for income accruals is to estimate income by using the indicated annual rate of income at the beginning of the period. In each quarterly performance computation, this amount would be dividend by four.

#### Rates of Return

Rates of return are of two general types: dollar weighted (or internal) and time weighted. The dollar weighted rate of return has specific value in measuring a given portfolio's results and this is the most appropriate figure for comparison with actuarial assumptions for corporate pension funds. However, when comparing investment results between portfolios, the differences

in size and timing of cash flows can create considerable distortions. It can be argued that a dollar weighted rate of return is appropriate for use when measuring only the common stock portion of a portfolio because the investment manager has control over the timing and amounts of cash flows into and out of equities within the portfolio. However, whereas this is true to some extent, these judgments are often influenced by cash flows into and out of the total portfolio. We have concluded that the time weighted rate of return is appropriate for use in making comparisons between total portfolios as well as various segments of portfolios and, also, with market indices which are by default time weighted because there are no cash flows.

It is difficult for many organizations to provide an exact time weighted rate of return measurement because of the necessity to revalue the entire portfolio whenever significant cash contributions or distributions are made. Therefore, we believe that an approximate time weighted rate of return is satisfactory in most cases and recommend the following principles be observed:

1. The portfolio be valued at least quarterly.
2. A formula should be used to minimize the impact of cash flows on performance results within a measurement period. One such formula is:

$$R = \frac{V^2 - V^1 - C + I}{V^1 + 1/2C}$$

Where  $V^1$  = beginning market value = \$1,000,000.  
 $V^2$  = ending market value = \$1,200,000.  
 (including reinvested income)  
 $C$  = net cash flow = \$ 100,000.  
 (from any source including reinvested income)  
 $I$  = total measurement = \$ 10,000.  
 period income  
 $R$  = rate of return

$$R = \frac{\$1,200,000. - \$1,000,000. - \$100,000. + \$10,000.}{\$1,000,000. + 1/2(\$100,000.)}$$

$$R = \frac{\$ 110,000.}{\$1,050,000.} = 10.5\%$$

The formula states that the total rate of return for the time period is equal to what was earned in both price change and income (the numerator) as a percentage of the capital at work (the denominator). The amount earned is the difference between the beginning and the ending market values, adjusted for the net of all capital additions and withdrawals because they are not part of the return, and adjusted again for income because it is part of the total return. The capital at work is the beginning market value plus one-half of the net of all capital additions and withdrawals. The one-half is used because no effort is being made to identify the dates of cash flows. They are being netted together and the assumption is being made that they all took place at the mid-point of the time period. So, rather than saying the entire cash flow was at work for half the time, the formula says one-half the cash flow was at work the entire time. When the contribution  $C$  is very large relative to the beginning market value  $V^1$  (e.g., over 10%) it may be necessary to modify the use of the above formula or value the portfolio as of the date of the cash flow to remove possible distortions by eliminating any sub-period containing an overly large cash flow.

3. A linked index should be used in keeping a record of this performance data over time and provides a means of developing annual figures from separate quarterly calculations. Such an index would be as follows:

	<u>% Change</u>	<u>Index</u>
Beginning Value	-----	100.0
Period 1	+5.0	105.0
Period 2	-3.6	101.2
Period 3	+1.8	103.0
Period 4	+6.2	109.4
Overall Return	+9.4%	

### Total Portfolio and Various Portfolio Segments

The most appropriate comparison between portfolios is to show the results of the total portfolio investments. An extra dimension is given when the total portfolio returns are supplemented by percentage figures showing the proportions held in various portfolio segments. It is often useful to demonstrate bond management or stock management using the bond and stock segments of a total portfolio balanced between bonds and stocks. Therefore, it is also recommended that segments of different portfolios be used for comparisons to measure selection and also the impacts of timing of shifts between portfolio segments. The procedure described above for calculating rates of return on total portfolios is the same used for portfolio segments such as common stocks. When computing the performance of an equities only segment, however, it is necessary to compute the net cash flow as equal to the difference between the total of all common stock purchases and the total of all common stock sales during the period.

### Definitions within Portfolio Segments

When comparing segments of portfolios such as the common stock segment of one portfolio with the common stock segment of another portfolio, it is important that the segments have comparable characteristics. It would not, for example, be appropriate to compare the common stock portfolio of a corporate pension fund which was 25% invested in the company's own stock with the common stock portfolio of another pension fund which had no such distortion. Managers inherit portfolios from a variety of sources which might hold concentrations in poorly marketable securities which would take time to

work out of successfully. The manager should not be charged with the distortions produced, good or bad, during a prolonged period of liquidation. There are also differences in treatment of types of holdings. In the case of convertible securities, some treat them as part of the portfolio's bond holdings, some treat them as common stocks and some divide them between those convertible issues selling near their base investment value as a straight bond and those convertible issues selling more on a common stock equivalent basis. Finally, it is not appropriate to compare results for diversified and undiversified portfolios. For example, "bond performance" should not be compared on the basis of one portfolio which has 30% invested in bonds including a diversified list of issues and another portfolio which might be of equal total dollar size but have a much smaller percentage of the total portfolio devoted to bonds and, perhaps, use only one or two issues.

Total Time Period Shown

The five-year time period for investment results is designed to be long enough to cover most business and market cycles. The minimum objective should be a length of time encompassing at least one market cycle containing rising market and declining market periods in order to permit an assessment of investment performance during both types of markets. Depending on the timing of market cycles and the fact that they do not usually open and close in consonance with the calendar, there will inevitably be occasions when a total time period of less than five years will be more appropriate.

Time Intervals Used

Within the total time period shown, the time interval recommended is one year with some indication of results for multiple time periods on a compound annual basis. An example of this type of presentation is illustrated below:

	<u>Annual Rates of Return</u>					<u>Compound Annual Rates of Return</u>			
	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>2 years '72-'73</u>	<u>3 years '71-'73</u>	<u>4 years '70-'73</u>	<u>5 years '69-'73</u>
Fund 1	-5.2	8.3	12.8	19.0	-15.5	0.3	4.3	5.3	3.1

(All figures are hypothetical)

Variability of Return

It is not sufficient to know that a certain magnitude of return was attained. It is also valuable to know the degree of variability experienced in reaching the return. An appropriate way to express this variability is through the use of some statistical measure of dispersion of the sub-period rates of return around their average rate of return. The standard deviation is recommended as a means of quantifying dispersion. It is a widely used measure and, although there are a number of other techniques to measure dispersion, it is appropriate as a minimum supplement to rate of return figures.

The standard deviation indicates the limits within which the sub-period returns vary in producing an average return for a total time period. In normal distributions of a series of returns, plus or minus one standard deviation from the average would encompass approximately 68% of the returns. Plus or minus two standard deviations from the average would encompass 95% and plus or minus three standard deviations would encompass 99%. The task, then, is to calculate one standard deviation as the basic unit.

It is suggested that the sub-period returns be quarterly figures. The standard deviation of the quarterly rates is found by:

- (1) obtaining the arithmetic average
- (2) calculating the deviations of each rate from the average
- (3) squaring each individual deviation
- (4) taking the average of these squares
- (5) extracting the square root of this average

Since these calculations produce the standard deviation of the quarterly rates, it is necessary to make a conversion so the standard deviation can be used as a supplement to rate of return figures expressed as compound annual rates. This is accomplished by multiplying the standard deviation of the quarterly rates by 2, the square root of the number of quarters in one year.

NOTE: See calculations at end of report.

## II Standards of Use

### Management Discretion

A primary purpose for generating performance figures is to provide a quantitative basis for evaluating the job done by the portfolio manager. It is only fair, then, for the results to reflect truly the manager's performance without an undue overlay imposed by others. This overlay may take the form of policy constraints (e.g., a current income requirement, ceilings on percentage to be invested in common stocks, restrictions as to the types of securities to be purchased, etc.) or approval mechanisms involving rejection of proposed investments. The investment results should reflect the portfolio manager's decision process. Although we recognize that the effective discretion of a portfolio manager might not be within the legal

definition of "discretionary," we believe a portfolio should be presumed to be discretionary if the portfolio manager can arrange purchases and sales of securities of his selection (within reasonable limits) and vary the portfolio mix between stocks, bonds, or cash equivalents without undue restrictions on his own best professional judgment.

Number of Results Shown

Selection criteria for a statistical sample of any size must be accurately disclosed to identify what the sample includes. The criteria might be complex (e.g., common stocks only of accounts which are fully discretionary, tax-exempt, managed by a firm's New York office for five years, etc.) or simple (e.g., "our best account" or "our three largest accounts") but they must be disclosed. Whatever the basis for selection of investment results to be shown, all accounts described by the selection criteria must be included. Although the quantity of accounts shown can be controlled by the specifics of categorization filters, the account sample must be complete as described.

A broad sample is desirable because the record of one portfolio or several portfolios is not statistically significant as the record of a portfolio manager or an entire firm of portfolio managers managing many portfolios. One account cannot be presumed to be representative of an individual's or firm's work unless the individual or firm so states and is prepared to substantiate. Therefore, it would not usually be appropriate to compare two firms of portfolio managers by comparing one account

of one firm with one account of another firm. This is true for any type of portfolio, including mutual funds or any other commingled funds. The use of one account may be appropriate in representing itself when it is desirable to show the results of specific types of investing such as with a high risk mutual fund, a mutual fund of international securities or a mutual fund whose policy it is to keep pace with general market averages. Furthermore, a single portfolio, pension fund, mutual fund or otherwise, should not be used by any firm as representative of another firm unless that firm has so stated and substantiated. It is not one firm's realm to present another firm's record. A firm's responsibility is to represent itself and not others.

In presenting investment performance results, it is appropriate to use summary statistical techniques such as averages, medians, etc., as long as they are representative of a broad sample of similar portfolios. Statistical and graphic representations should be specifically footnoted to disclose what they represent and a firm using them should be prepared to substantiate the representations by standing ready to describe the details of the underlying calculations. This substantiation should at a minimum contain the data presented in the attached worksheets.

#### Tax-Exempt Portfolios

The purpose of showing investment results of existing clients to third parties is to provide an illustration of what has been achieved under varying conditions. Due to differences in impact on investment results of various tax brackets, it is difficult to compare the results of different taxable portfolios. In order to demonstrate the investment process, the

common base of tax-exempt portfolios can be used with both tax-exempt and taxable third parties.

#### Similarity of Investment Objectives

No two portfolios are exactly the same. Inevitably, there is some variation between different portfolios and their objectives. However, comparisons of investment results should be made only for portfolios with generally similar objectives and involving acceptance of the total return approach.

#### Size

Size is an important consideration and effort should be made to compare portfolios only within reasonable categories of size. It is inappropriate to compare the investment results of very small portfolios with very large portfolios due to the great differences in operational flexibility. The use of a size threshold is suggested such as including only portfolios over \$1 million

#### Relevance to Third Parties

The selection of investment results to be shown should have some relationship to the circumstances of those receiving the information. For example, it is logical to show investment results which include a number of employee benefit funds in response to an inquiry from an employee benefit fund.

Mutual fund performance data are often used because they are a "public record." We conclude that this general use relates more to the integrity of an audited public statement rather than to the relevance of this record

and recommend that specifically selected investment results be used which have as close as possible a relationship to the third party viewing them.

Comparative Format

There are three general comparisons which might be drawn by those receiving a statement of investment results and the statement format should facilitate such comparisons.

1. The investor should be interested in the absolute level of accomplishment compared to his own goals. This does not speak to the realism of these goals whether they be achieving an actuarial assumption or some other pre-stated quantitative objective. He wants to assess the accomplishment relative to his own special standard.
2. The investor should be interested in the relative level of accomplishment within various market environments.
3. The investor should be interested in the relative level of accomplishment compared to some general representation of how others fared during the same time.

The first comparison uses the investor's own calculations and standards.

The second comparison requires some representation of the market environment. The widely used market averages involve a variety of calculation methods so that the results vary depending on market circumstances. This means a given index is not necessarily consistent in its reflection of the environment. The most appropriate answer (although not entirely satisfactory) is to review records of several market indices on a total return basis and assess the flow of experience over a sufficient period of time.

The third comparison requires the selection of representative universes of other managed money. This type of information has not been available for

many years but there are available universes of pension funds, mutual funds, bank commingled funds, insurance company separate accounts, etc. The integrity of the information has been high to date and provides a valuable means of comparison.

#### Distribution of Information

Care should be taken that any information provided third parties regarding portfolio investment results is in compliance with the Investment Advisers Act of 1940 and other guideposts, statutes, rules and court cases. In certain states, for example, any registered investment adviser must file new business materials. The judicial definitions of so-called federal "anti-fraud rules" are continually expanding to include prospect and client communications.

Outlined below are guidelines of what is deemed permissible and not permissible within the context of this report in distributing portfolio investment results.

#### Permissible:

Investment performance data may generally be shown which are:

1. clear disclosures of all relevant facts,
2. accurate,
3. for objectively justifiable time periods, and
4. for generally recognized categories within portfolios (e.g., total portfolio, total bonds, total common stocks) and for overall categories of portfolios (e.g., large pension funds, all tax-exempt institutional accounts).

Not Permissible:

Investment performance data may not be shown which are:

1. unclear, untrue or otherwise false or misleading and/or,
2. in the case of advertisements as defined under the Investment Advisers Act of 1940, in violation of the rules relating to advertisements.

In the Investment Advisers Act of 1940, a specific guideline is found in Rule 206(4)-1. This rule concerns "advertisements" by investment advisers and, in relation to the subject matter of this report, the most important provisions of the rule define the conditions under which distribution of an "advertisement" may constitute fraud or deception. For these purposes, "advertisement" is defined broadly as any written communication sent to more than one person (The term "person" is defined to include any organized group or persons, so that, for example, a corporate pension fund would be one person, even though it may have four people on its Finance Committee.) or any other notice or announcement in any publication or on radio or television which offers any investment advisory service with regard to securities.

One noteworthy example of circumstances under which an "advertisement" may not be distributed involves any situation where reference is made to past specific recommendations of the investment adviser which were or would have been profitable to anyone, unless the advertisement sets out or offers to furnish a list of all recommendations made by the investment adviser for the immediately preceding period of not less than one year -- a list which must contain specified, detailed information. The list must also contain

language in large type stating "IT SHOULD NOT BE ASSUMED THAT RECOMMENDATIONS MADE IN THE FUTURE WILL BE PROFITABLE OR WILL EQUAL THE PERFORMANCE OF THE SECURITIES ON THIS LIST."

#### Calculation Worksheet

The attached calculation worksheet utilizes quarterly rates of return derived from the formula described on Pages 7 and 8. The quarterly rates are used to develop:

1. Annual Rates - calculated by linking the quarterly rates geometrically through multiplication (not the same as the arithmetic average).
2. Compound Annual Rates - calculated by linking the annual rates for the specified time period and, then, reference to compound interest tables.
3. Standard Deviation of the Five-Year Quarterly Rates - calculated as indicated (also refer to Page 11 of report).

NOTE: The calculations described are basic to the production of investment performance figures. Of course, in large volume applications, appropriately programmed computers perform these tasks and the calculation worksheet is unnecessary.

#### Sample Report Format

The attached sample report format embodies the recommendations contained in this report. It is an example of how the recommendations can be used. There are a variety of alternatives and display methods which involve the use of the return figures or graphic representations of the rates of return. This example provides a basic standard for presentation or is appropriate substantiation of statistical or graphic representations. The two pages are companion pieces and the recommendations on Pages 4-5 of this report should be used as a checklist for completeness.

CALCULATION WORKSHEET

FUND 1

<u>Quarterly Periods</u>	<u>Quarterly Rates</u>	<u>Annual Index</u>	<u>Annual Rates</u>	<u>Compound Annual Rates</u>	<u>Deviation** from Average</u>	<u>Deviations Squared</u>
		100.0				
1.	- 3.3	96.7			6.3	39.69
2.	14.0	110.2			11.0	121.00
3.	2.2	112.7			0.8	0.64
4.	1.5	114.4	14.4	11.4 (5 years)	1.5	2.25
		100.0				
5.	- 2.5	97.5			5.5	30.25
6.	- 2.3	95.3			5.3	28.09
7.	- 0.4	94.9			3.4	11.56
8.	4.5	99.1	- 0.9	10.7 (4 years)	1.5	2.25
		100.0				
9.	- 2.1	97.9			5.1	26.01
10.	-18.0	80.3			21.0	441.00
11.	14.6	92.0			11.6	134.56
12.	9.8	101.0	1.0	14.9 (3 years)	6.8	46.24
		100.0				
13.	8.4	108.4			5.4	29.16
14.	- 1.5	106.8			4.5	20.25
15.	0.9	107.7			2.1	4.41
16.	9.2	117.6	17.6	22.5 (2 years)	6.2	38.44
		100.0				
17.	8.4	108.4			5.4	29.16
18.	4.6	113.4			1.6	2.56
19.	5.6	119.7			2.6	6.76
20.	6.6	127.6	27.6	27.6 (1 year)	3.6	12.90
Total	60.2					1,027.18
Average	3.0					51.36
					Standard Deviation	7.2
					(Conversion Factor to annualize)	x 2
					5 Year Variability	14.4

\*squares, square roots and compound rates are readily available in standard statistical tables  
 \*\*squaring deviations makes them all positive so minus signs can be ignored

SAMPLE REPORT FORMAT  
(Hypothetical Figures Used Below)

COMPARATIVE PERFORMANCE  
(All figures are total return including price change plus income)

	<u>Annual Rates of Return</u>					<u>Compound Annual Rates of Return</u>				<u>5 Year Variability</u>
	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>2 years '72-'73</u>	<u>3 years '71-'73</u>	<u>4 years '70-'73</u>	<u>5 years '69-'73</u>	
ABC INVESTMENT COUNSEL, INC.										
<u>Equity Performance of Selected Tax-Exempt Portfolios</u>										
Fund 1	- 7.6	7.2	12.4	14.2	- 6.8	4.6	8.2	7.1	4.8	8.5
Fund 2	- 5.2	2.8	12.4	22.2	-11.0	3.3	4.1	3.7	2.2	7.9
Fund 3	1.2	- 1.5	19.0	25.6	-10.0	6.7	6.6	5.1	4.5	9.4
Fund 4	3.5	- 2.6	13.9	19.5	-14.4	2.4	8.7	3.6	4.6	8.1
Fund 5	2.0	2.6	15.0	22.6	-17.4	2.1	8.6	5.0	3.0	8.8
Fund 6										
Fund 7										
Fund 8	----- ETC. -----									
Fund 9										
Fund 10										
Fund 11										
Fund 12										
Fund 13	----- ETC. -----									
Fund 14										
Fund 15										
<u>Equity Market Averages</u>										
Dow Jones	-11.8	9.3	9.9	18.5	-13.3	1.4	4.1	5.4	1.7	8.6
S & P 500	- 8.5	3.9	14.3	19.0	-14.9	0.7	5.0	4.7	2.0	7.5
<u>Mutual Fund Averages*</u>										
Growth Funds	-15.6	-16.0	19.8	8.5	-27.8	-11.5	- 2.1	- 5.8	- 7.8	15.2

\*Lipper Analytical Services

ALL REPRESENTATIONS IN ACCORDANCE WITH STANDARDS APPROVED BY THE INVESTMENT COUNSEL ASSOCIATION OF AMERICA

2  
SAMPLE REPORT FORMAT

KEY TO EQUITY PERFORMANCE\*

	<u>TYPE</u>	<u>SIZE</u> <u>12/31/73</u>
Fund 1	Corporate Pension Fund	\$10.5 million
Fund 2	Corporate Profit Sharing Fund	\$ 6.8 million
Fund 3	College Endowment	\$12.6 million
Fund 4	Charitable Foundation	\$18.4 million
Fund 5	Religious Institution	\$ 5.4 million
Fund 6		
Fund 7		
Fund 8	----- ETC. -----	
Fund 9		
Fund 10		
Fund 11		
Fund 12		
Fund 13	----- ETC. -----	
Fund 14		
Fund 15		

\*Discretionary Management

**Exhibit VIII**

## Selection of Discretionary Fund Managers

Studies: We have found no single investment manager or investment method with exceptional performance in all market environments.

It is, therefore, necessary to set forth the philosophy of the investment organizations, their approaches to the investment of discretionary funds and the resources they bring to bear on this part of their business.

The first priority should be to identify those characteristics felt to be most important to the fund. The more information one has about managers, the better the chances are of selecting a manager that has the characteristics the fund feels are important.

The following items are important areas of inquiry by the fund in discussions with prospective investment managers.

Organization: An understanding of the business base of the organization and its parent (if any), its current status and any conflicts with the parent's business, and the nature of ownership and capital give an indication of whether the investment management organization is likely to remain structured as it presently is or whether change is likely. The important points to review with the manager may be the importance of the investment entity's profits to the whole, the nature of its client base, how potential conflicts of interest within the management organization are resolved, and what motivation for the staff the form of ownership may provide.

Staff: Staff must be sufficient to support the investment philosophy, system, research capabilities and assets under management. In conjunction with biographies, interviews may provide the basis to assess the experience, maturity and capability of key staff members and portfolio managers, make certain the fund would receive the level of attention it deserves, and determine whether the investment philosophy is accepted throughout the organization.

Assets Under Management: The relative emphasis is on the types of accounts under management at one point in time. It may be important to know whether this reflects the organization's direction for the future. The fund should compare the mix of stock, bond and cash reserve assets to the philosophy, consider the number of stock and bond accounts, and find out how these may differ from the past.

Philosophy: The fund must discern the investment organization's central philosophy and method of implementation to determine whether such organization suits the fund's requirements, especially with respect to asset mix, flexibility in

the use of cash reserves, and diversification of securities and issues within a portfolio. The fund must be certain that there is sufficient staff and a defined system in order to implement the philosophy. The fund should also know whether the philosophy is new or relatively long-standing and how it may be affected by extreme market conditions.

System: For a fund to be able to have confidence in a manager, the system must be understandable. It must fit the manager's organization, philosophy and personnel. From biographies or interviews the fund should discern whether key people are performing the most important functions in the system. Along with an understanding of how the system functions should come a sense of how ideas are generated, the main sources of input and the importance of the individual portfolio manager to the process. The account load per manager should also be considered at this point.

Research: This function may not be equally important for all investment philosophies and systems, but its importance and depth should be understood.

Fees: These are very often negotiable and flexible; so the fund should inquire specifically as to fees in relation to the size of the fund and special services required.

Performance: Performance reflects the results of the past and is not a prediction for the future. The performance of most investment organizations is dependent in great measure on general market conditions and must be viewed in relation to market conditions during the specific time period covered. It is important to understand the reason for the organization's performance results in the past (staff, philosophy, style, issue selection or industry weightings, among others).

#### Types of Money Management Organizations -

- Banks
- Insurance Companies
- Investment Management Firms
- Internal Staff

The great bulk of monies are still managed by banks. A major portion of this money is managed in individual accounts, and the treatment of those funds is very much like that provided by independent investment management companies. The banks have also established pooled investment trusts for funds. These are vehicles that serve a variety of purposes. For small funds they provide a way of getting intensive management in a way that is not practical if they were to be individually handled. For larger funds they offer a way of providing specialized investment opportunities, either in risky securities or in specialized holdings such as short-term investments where it is desirable to get a spread of holdings rather than concentrating in a limited number of issues.

Over the years, banks have emphasized their fiduciary responsibility for the monies under their supervision, and that has been a major selling point with them.

Insurance companies have become increasingly competitive in recent years in offering investment services. The great bulk of the monies which they handle for such funds are held in their general accounts. These are portfolios largely invested in bonds and mortgages but which also include stocks, real estate and various miscellaneous investments. These are massive pools of capital, and the insurance companies are able to offer guarantees with respect to contracts they offer based on their general accounts. Some of those contracts involve one-shot guarantees on a lump-sum deposit made at a specific time, and others provide a guarantee over some period of years.

In addition, insurance companies offer a broad range of separate account investments which are very similar to the pooled trust vehicles offered by banks. They include equity investment, separate accounts, bond investment, short-term investment accounts and, in the case of a few companies, real estate accounts.






The third major category of organizations offering services to funds are investment management firms. These include independent ones and those that are affiliated with brokerage houses or other financial institutions. These organizations typically offer services in the form of managing an individual account and tying the investment management of those funds to the particular needs and circumstances of their fund clients. Some of these organizations are specialists focusing on particular types of securities.

Finally, there are some funds, generally the very largest ones, who use internal staff for management of their assets. That is a possibility that is worth consideration if you are confident that you can hire and retain competent professionals who will be able to work with the trustees of the fund in establishing policies and procedures that will meet their particular needs.

Conclusion: It is clear that there is a very broad menu to choose from in the investment advisory field. A systematic procedure for considering the various characteristics of the different organizations in light of your particular fund's requirements, can substantially increase the likelihood that you are going to be able to satisfy your long-term investment needs.

**Exhibit IX**

EXHIBIT 3  
 BASIC SERIES  
 INVESTMENT TOTAL ANNUAL RETURNS  
 1926 - 1976

Series	Geometric Mean	Arithmetic Mean	Standard Deviation	Distribution
Common Stocks	9.2%	11.6%	22.4%	
Long Term Corporate Bonds	4.1%	4.2%	5.6%	
Long Term Government Bonds	3.4%	3.5%	5.8%	
U.S. Treasury Bills	2.4%	2.4%	2.1%	
Inflation	2.3%	2.4%	4.8%	

-50%      0%      +50%

EXHIBIT 31

COMMON STOCKS  
Simulated Total Return Distributions  
For the Period 1977-2000  
Geometric Average Annual Rates

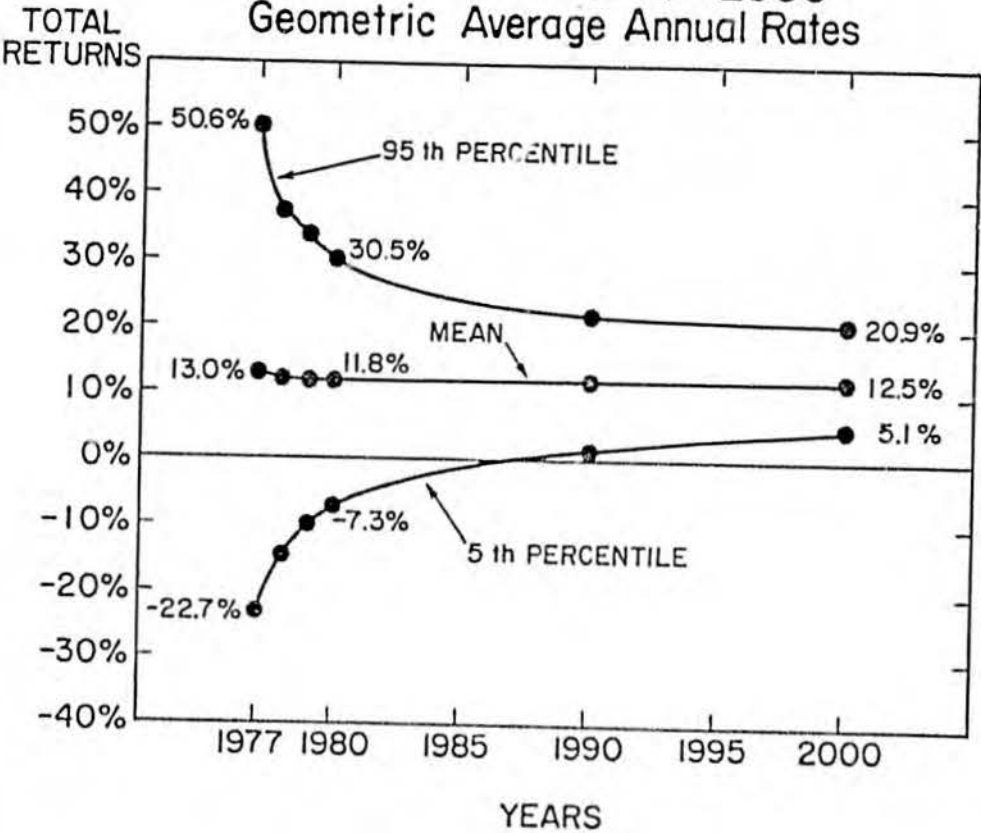


EXHIBIT 33

LONG TERM CORPORATE BONDS  
Simulated Total Return Distributions  
For the Period 1977-2000  
Geometric Average Annual Rates

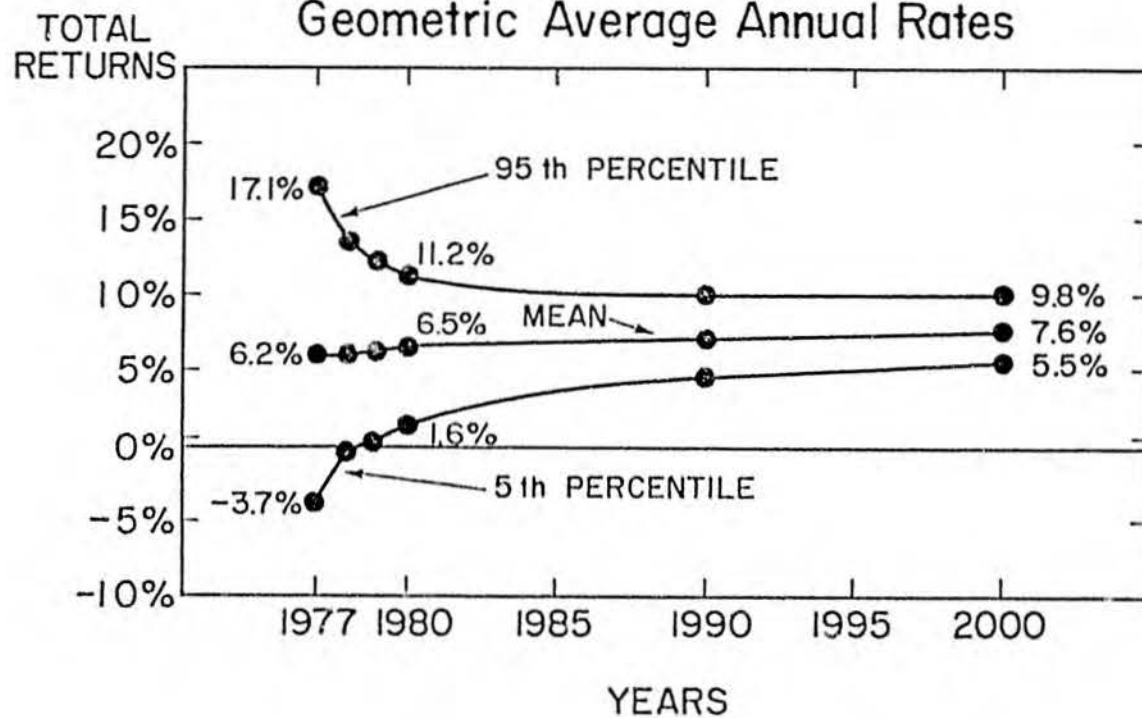


EXHIBIT 35  
INFLATION

Simulated Rate Distributions  
For the Period 1977-2000  
Geometric Average Annual Rates

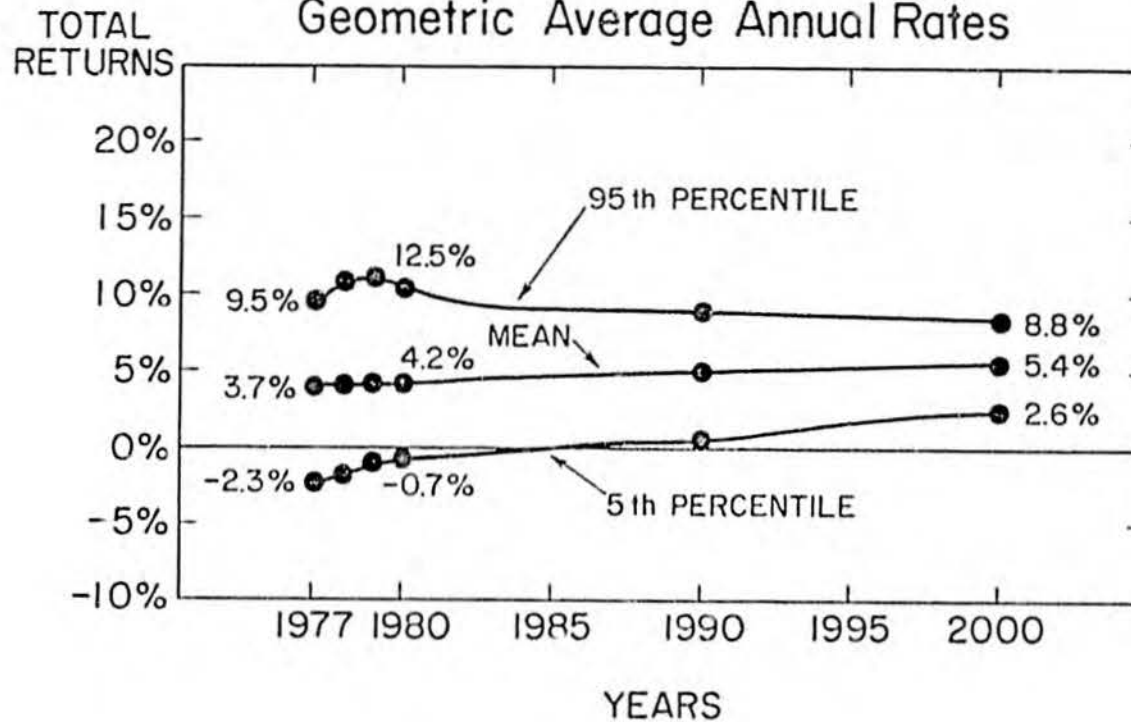


EXHIBIT 37

COMMON STOCKS, INFLATION ADJUSTED  
Simulated Total Return Distributions  
For the Period 1977-2000  
Geometric Average Annual Rates

