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Pooled Pension Investments: (1979) An Option For City Pension Systems

(Research Report No. 153)

Kentucky.

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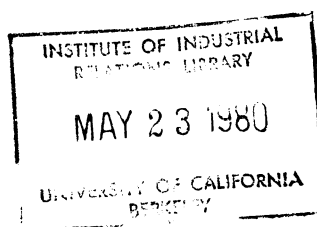
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Pooled Pension Investments: An Option For City Pension Systems

Prepared by
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②

FOREWORD

Pension plans as a matter of public policy are drawing more attention today than ever before. The interest and concern aroused are justified by the important but costly role pensions play in maintaining individual retirement income security, and thereby the social welfare of our society. Improvements are urgently needed because sufficient care has not always been taken in the past to design public pension systems rationally, or to fund them adequately. This concern is manifested by legislative and executive efforts at the national, state and local levels to improve planning and management of public pension affairs.

In Kentucky, study of state and city pension systems has recently become an important activity of the Legislative Research Commission, as evidenced by Research Report No. 128, *An Analysis of Retirement and Benefit Plans for Kentucky State Employes* (1975), and Research Report No. 143, *Locally Administered City Pension Systems* (1977). The latter report was a comprehensive study of the law regulating locally-administered city pension systems in Kentucky, and of the management and administration of those systems. One result of this study was the realization that many of Kentucky's city pension systems are too small to establish or manage effective investment programs for their accumulated pension funds. In order to overcome problems of inadequate size and to realize the investment power which can be gained through aggregation of resources, many states have adopted or are adopting centralized investment programs for their cities. A current response to the problem in Kentucky is House Resolution 72 (1978 General Assembly), calling for a study of alternative methods for pooling the assets of city-administered pension systems for the purpose of earning a greater return on these assets. This study was to be conducted with the assistance of the parties most affected by Kentucky's city pension systems—the cities which create and administer the systems, and the employees who derive the benefits as an important part of their employment package. An Advisory Committee on City Pension Fund Investment, comprised of representative city employer and employee groups, was created by the Legislative Research Commission to gain their participation and assistance.

While this report represents the cooperative efforts of William Wiley of the Legislative Research Commission staff and the members of the Advisory Committee, Mr. Wiley is its sole author. Professional advice was rendered by Meidinger and Associates, Actuaries and Employee Benefit Consultants. The manuscript was edited by Charles Bush. Allen Salyer designed the cover.

VIC HELLARD, JR.
Director

Frankfort, Kentucky
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SUMMARY

House Resolution No. 72 of the 1978 General Assembly called for a study of alternative methods of pooling city pension funds for the purpose of gaining greater power in investment markets, and consequently, higher yields on investments. The study was to be conducted by the Legislative Research Commission staff with the assistance of a consultant qualified to advise on investment practices, and with the cooperation of representative administrators and employees concerned with the various city pension systems. An Advisory Committee on City Pension Fund Investment, comprised of representatives from the Kentucky Municipal League, the Fraternal Order of Police, and the Associated Professional Firefighters, and including representative city administrators and representatives of non-uniformed city employees, was created by the Legislative Research Commission. This advisory Committee met three times with LRC staff and a private consultant, Meidinger and Associates, Inc., to develop an acceptable proposal, and finally with the Interim Joint Committee on Cities to present that proposal.

Prior to the first meeting of the Advisory Committee, three alternative proposals for investment pooling were considered by the LRC staff. These included: 1) investment of city pension funds by the staff officer of the state investment commission; 2) investment of city pension funds by the board of trustees of Kentucky Retirement Systems; 3) creation of a new entity in the public sector, or creation of the legal capacity for city pension systems to work cooperatively with the private sector, to develop a pooled investment mechanism.

Certain technical problems would complicate the adoption of alternative number one. It was, moreover, the initial feeling of the LRC staff that city employer and employee groups would be sensitive about any amalgamation of their pension systems with a state entity, as suggested by either alternative number one or number two. Therefore, the most probable course of action would be the adoption of some form of alternative number three. These feelings were confirmed when the Advisory Committee met and established that independence from state government and adequate representation of interested parties should be base line criteria for the creation of an investment mechanism which would exist as an investment option for still-independent city pension systems.

The Performance Planning Service Division of Meidinger and Associates, Inc., responded to these criteria by proposing the creation of a Pension Investment Fund, comprised of participating city pension systems, governed by a representative board, and employing qualified investment managers and a single custodian. The Fund would be comprised of several investment pools, characterized by varying sorts of investments with differing levels of risk and return. These pools would exist as investment options for the city pension systems, but within the pools, investment decisions would be made by the investment managers working with the board. Participation in the Fund would be completely voluntary, there would be no sharing of pension fund liabilities within the Fund, accounts would be kept on each pool and for each participating pension system, earnings would be distributed or reinvested monthly, and investment charges would be uniform, based upon degree of investment. Custodial charges would include a fixed fee for all participants, a variable charge for various degrees of participation, and

special charges for such optional services as check writing and preparation of reports to governmental agencies or beneficiaries.

The Meidinger proposal was distilled to a concept bill draft by the LRC staff and refined and approved by the Advisory Committee. The Co-chairmen of the Advisory Committee presented their proposal and concept draft to the November, 1978, meeting of the Interim Joint Committee on Cities. The members of the Cities Committee reacted favorably to the proposal and requested that it be put in the form of a bill draft. The result is 1980 BR 84, which is reproduced as Appendix No. 5 of this report. Further action on the proposal of the Advisory Committee on City Pension Fund Investment must wait until the probable introduction of BR 84, or similar legislation, in the 1980 session of the General Assembly.

Chapter I

INTRODUCTION

Although Kentucky is not a large state in terms of population or number of cities, it does have a surprisingly large number of locally-administered city employee pension systems. An earlier LRC study, *Locally Administered City Pension Systems* (Research Report No. 143), revealed that there were at least fifty-two separate pension systems operating throughout the state. These range in size from the Louisville police and firemen systems, with 789 and 680 members respectively, to Carrollton's insurance funded plan, with just 12 members. There are no state laws requiring most of these pension systems to exist. Only second-class city and urban-county government police and fire fighter pension systems (eight in number) are mandatory. The remaining local pension systems could be closed to new members at any time by local action, and new employees could be granted membership instead in the state-administered County Employees' Retirement System. Employees with service credit in the local system could also be transferred, if the city purchased prior service credit for them in the CERS. Although there has been significant movement in this direction among pension systems for nonuniformed employees,¹ there is strong resistance toward such a move among the police and fire fighters of the state, because of differences in retirement ages and benefit levels. For this reason, Kentucky can expect the continuation of many city pension systems in the foreseeable future. Therefore, it is important to ensure that they will be well administered and able to meet their pension obligations toward their participants. The ability to meet these obligations depends on many important factors, but the most important is adequate and timely funding through the contributions of employers and employees. After these contributions are made it is extremely important that investment of the principal of the pension funds achieve the highest yield compatible with the safety of the principal. While calculating the return on improvements in investment yield is a complex undertaking, and the results depend upon the assumptions made, concrete examples can be instructive. One example of savings resulting from improved yields is that improving investment yields by one percent can reduce required annual contributions by eight and one-half percent for an employee who works for 20 years and lives for 20 years after retirement.²

Data resulting from the survey taken for Research Report No. 143 revealed several vital facts about the status of city pension system funding throughout the Commonwealth. First, most of the city systems are not very well funded. This shortcoming is tempered by the fact that most are at least holding their own or slowly improving their levels of funding, although a few are falling further behind. Second, many of the systems have few members, have relatively small pension funds, and are not professionally managed. Third, as the size of the city decreases, the tendency to invest very conservatively in relatively low-yield savings accounts and certificates of deposit characteristic of individual savings plans increases. Finally, the aggregate amount which the cities feel they cannot invest at all because of liquidity needs may frequently exceed \$600,000. These facts lead to the conclusion that, because of their small size

many of the city pension systems in Kentucky are losing significant investment opportunities. It is evident that if these systems could somehow aggregate their pension funds for investment purposes, they could employ professional investment counsel, increase the return on their investments, and increase the amount invested, since pooling their resources would reduce their liquidity problems. If the cities were to join such a system these benefits of pooling pension fund investments would be immediately available. Benefits would be even greater in the future as each system grew individually and the investment power of their pooled resources grew accordingly. It was this reasoning which led to the introduction and passage in 1978 of HR 72, calling for a study of alternative methods of pooling city pension funds for investment purposes, and for interested employer and employee groups to lend their advice during the course of the study.

The issue of public employee pensions is one of special significance to both public employers and their employees, because pensions are at the same time vital economic security to employees and a significant factor in municipal budgets. In order to procure the advice of these interested employer and employee groups in a systematic manner and to facilitate the exchange of ideas, an Advisory Committee on City Pension Fund Investment was created by the Legislative Research Commission. The Advisory Committee was given a primary role in the development of an acceptable program, and an attempt was made to achieve consensus in the group's decision making. The goal was achieved, and as a result, the proposal developed was acceptable to all interests represented. The proceedings of this Advisory Committee had a vital role in the development of this report and a dominant role in formulating the proposals growing out of it.

CHAPTER II

INVESTMENT POOLS—CHARACTERISTICS AND EXAMPLES

The concept of pooling local government funds for investment is finding increasing acceptance among the states. An Advisory Commission on Inter-governmental Relations study, *Understanding State and Local Cash Management* (1977), reports that state sponsored local government investment pools have been created or authorized in eight states. The basic principle behind each of these pools is that the collective return on the investments of many small entities can be increased through the aggregation of their funds into a central fund. This result will occur for several reasons.

- (1) Larger investment funds are attractive to skilled money managers, whose services would otherwise be unavailable to smaller local governments. Sufficient concentration of funds permits the employment of managers with specialized skills applicable to specified investment pools within the investment fund.
- (2) Skilled money managers, in addition to otherwise making wise investments, can take advantage of ebbs and flows in various markets by aggressive and timely purchases and sales of various assets. Such operations might be too risky for the less experienced local pension fund investor, or the local investor, because of other responsibilities, simply might not have the time to watch market fluctuations on a daily basis.
- (3) Managing assets in larger amounts creates economies of scale; investment charges are proportionately less on larger investments than on small investments.
- (4) Certain investments, such as certificates of deposit, may pay a higher return if purchased in larger denominations.
- (5) Aggregation of funds allows certain investments which would otherwise be unavailable to the small local government investor. For example, large amounts of money available on a temporary basis can profitably be invested overnight or on the weekend, while the return on these investments for small accounts would be less than the administrative costs. In other cases, profitable investments might be available only in denominations too large for the smaller pension systems.
- (6) More local government money can be invested because liquidity problems are overcome. Frequently local governments have on hand considerable sums of money in demand deposits, which cannot be invested because disbursements would occur prior to the maturity of any investment vehicle. If many local governments have sums on hand but the dispersal times are not the same, an investment pool can invest this money based on

the knowledge that at any given time a certain amount will be available. The local government can treat the investment pool like an interest-bearing checking account,³ and make deposits or withdrawals on a one-day basis. In this manner, investment strategy can be separated from cash flow patterns.

An additional advantage of a pooled investment fund not directly related to investment earnings is the possible centralization of investment records and custody of securities. This concentration permits computerization of record keeping and can lead to such specialized services as check writing and preparation of reports to participants or government entities.

A pattern that has developed in states which have created local government investment pools is the adaptation of already existing state government investment programs for local government purposes. (See Table I.) Examples from six states are presented below.

TABLE I
CHARACTERISTICS OF LOCAL GOVERNMENT INVESTMENT POOLS

	Connecticut	Wisconsin	Massachusetts	Oregon	Illinois	Montana
ADMINISTRATION						
State Agency	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer
State Investment Board	Yes	No	No	Yes	No	Yes
Local Government						
Advisory Council	Yes	No	No	Yes	No	No
Voluntary Participation	Yes	Yes	Yes	Yes	Yes	Yes
With State Funds	Yes	Yes	No	No	No	Yes
PROCEDURES						
Daily Transactions	Yes	Yes	Yes	Yes	Yes	Yes
Wire Transfers	Yes	Yes	Yes	Yes	Yes	Yes
Minimum Transaction	None	None	None	\$5,000	None	\$1,000
Advance Notice of						
Large Withdrawal	One Day	None	One Day	One Day	None	One Day
Interest Earned	Daily	Quarterly	Daily	Daily	Daily	Daily
Interest Paid	Quarterly	Quarterly	Monthly	Quarterly	Monthly	Semi-Annually or Upon Sale of Units
Direct Deposit of						
State Aid & Taxes	No	Yes	No	Yes	No	No

Source: Adapted from Table I, ACIR Information Bulletin No. 78-1, Montana Data Added by Legislative Research Commission

Oregon

In Oregon the state treasurer can invest moneys of participating local governments on either a short-term basis in an investment pool, or a long-term basis in an investment fund. He is advised by a five-member local government investment board, three members of which are local government finance officers. The state treasurer's investment operation is computerized, and transfer of funds to or from the pool can be accomplished on a one-day basis by correspon-

dent bank transfer. The accounting system is twofold, dealing with transactions within the pool, and local government transactions to and from the pool. Earnings are calculated by a daily accrual method and credited monthly to local government principal accounts. Administrative expenses are limited to one percent of the pool's earnings. While the treasurer's office plans suitable long-term investments for local governments,⁴ it is prohibited by law from purchasing stocks. Thus, it does not have all the investment powers commonly associated with pension investment programs.

Wisconsin

The State of Wisconsin also has a centralized investment process for state funds that has been adapted for the investment of local government funds. Local governments can either leave their portion of shared taxes with the state treasurer for investment in the short-term pooled investment fund, or they can deposit idle reserves or other local funds available for investment. Local money earns interest based upon the average yield of all short-term investments, determined quarterly by the investment board. Funds are transferred efficiently; the local government gives the state treasurer written instructions as to the amount of local shared taxes which should be retained for investment, or the local treasurer may ask the local government's commercial bank to transfer idle funds to the state treasurer for deposit in the investment pool. Computer programs are used to determine the balance, deposits and withdrawals on a daily basis for each local government. Administrative expenses are limited to one-fourth of one percent of the earnings from the pooled investments.⁵

A local government trust-investment fund for longer-term fixed investments by local governments is also permitted by law in Wisconsin. While this fund, also to be managed by the state treasurer, would involve investments similar to what many local pension systems in Kentucky would desire, it has the unfortunate requirement that individual accounts are required for each municipality, including separate records on interest earned, penalty charges for early withdrawal and individual notice when investments have matured. This system allows the local finance officer to use the trust investment fund in much the same manner as an individual uses the services of his stockbroker. The accounting services which would be necessitated by implementation of this system would mean the employment of additional personnel if state management were involved, or additional management charges if the fund were managed by the private sector. Maintaining only one set of accounts for a pooled fund, on the other hand, with local government assets measured in terms of units of participation, would eliminate these extra costs. As a result of these present administrative limitations, the local government trust investment fund has not been implemented, and the authorization for this fund may be deleted from the statutes.⁶

Illinois

Illinois is a third state which has adapted its state investment program for participation by local governments. The Illinois Public Treasurer's Investment Pool operates under the supervision of the state treasurer, who also acts as custodian. Accounting services and execution

of investment orders are accomplished by contract with a bank trust department. The pool provides a mechanism for the investment of short-term funds (as short as one day). Deposits in or withdrawals from the pool may be made by wire. Assets are valued daily, and income is computed and reinvested on a daily basis. Monthly statements of all transactions are provided to participants, and fees are limited to four-tenths of one percent of value per annum, accrued daily and charged monthly.⁷ Apparently there has been no attempt to establish a central pool for longer term investments by local governments in Illinois.

Massachusetts

In Massachusetts, the state treasurer's office has established the Massachusetts Municipal Depository Trust. The trust serves primarily as a means for cities to invest idle cash. Custodianship, account servicing and investment services are all provided through the private sector. Deposits or withdrawals of any size may be made at any time by bank wire or by check. The trust invests in high quality instruments with a maturity of one year or less, and may engage in portfolio trading. Services are provided to local governments for fees based on a sliding scale related to the volume of investments. For example, if \$50 million is invested, the fee is one-third of one percent of principal; if \$250 million is invested, the fee drops to one-fourth of one percent of principal. While the treasurer is advised by the Investment Advisory Council, the investment manager has the authority to make independent investment decisions within the framework of the trust objectives.⁸ The trust is a legal investment medium for state and local retirement boards in Massachusetts. Because of the short-term nature of its investments, however, it serves only as a temporary medium while retirement boards wait to invest their funds in longer term and higher yield securities. There is no centralized investment pool for independently administered city pension systems that concentrates on the long-term investments characteristic of pension funds.⁹

Connecticut

Connecticut also has a Short-Term Investment Fund, administered by the state treasurer and open to participation by local governments. It invests in certificates of deposit and in other fixed income securities offered either by the federal government or highly rated commercial concerns. Investments may be made in any amount, and deposits or withdrawals may be made at any time by wire. The fund includes moneys invested by the Municipal Employees' Retirement Fund, a system similar to Kentucky's County Employees' Retirement System, and the Teachers' Pension Fund.¹⁰ As is the case with other state investment pools, these pension moneys appear to be invested for the short term until suitable long-term investments can be made. The Short-Term Investment Fund does not serve as a viable investment option for the bulk of funds of any retirement system.¹¹

Montana

Finally, Montana has created a Short-Term Investment Pool (STIP) which local governments are eligible to join, and fifty-six local governments have done so. Transactions may

be made by wire on a one-day basis in amounts of \$1,000 or more. Monthly summaries of STIP investment activity and the individual participant's account are provided. Income is distributed twice a year. Operating expenses are appropriated by the legislature.¹²

TABLE II
COMPARISON OF RETURNS:
OREGON INVESTMENT POOL VERSUS SELECTED MONEY-MARKET INSTRUMENTS

		Money Market Instruments: Six-Month Maturities			
	Oregon Investment Pool: Average Daily Earnings	Prime Commercial Paper	Treasury Bills Rate on New Issue	Federal Agencies	CDs
December 1974	9.58%	8.98%	7.09%	8.00%	9.30%
January 1975	9.00	7.30	6.53	6.88	9.35
February	7.91	6.33	5.67		
March	7.88	6.06	5.64	5.79	6.20
April	7.17	6.15	6.01	6.36	6.80
May	6.60	5.82	5.65	5.74	6.15
June	7.02	5.79	5.46	5.66	6.55
July	7.00	6.44	6.49	6.92	7.20
August	6.76	6.70	6.94	7.28	7.70
September	6.91	6.86	6.87	7.32	7.90
October	7.87	6.48	6.39	6.05	7.00
November	6.52	5.91	5.75	6.20	6.90
December	6.67	5.97	5.93	5.80	6.05
January 1976	6.71	5.27	5.24	5.10	5.40
February	6.19	5.23	5.14	5.70	5.90
March	5.93	5.37	5.49	5.45	5.60
April	6.45	5.23	5.20	5.40	5.70

Source: *Understanding State and Local Cash Management*, Advisory Commission on Intergovernmental Relations (Washington, D.C., May 1977), p. 44.

Possibilities for Kentucky

It is obvious from this brief survey that the creation of central investment pools open to local governments is a workable program option. The potential of this type of operation may be demonstrated by the figures in Table II, which detail the performance of the Oregon Local Government Investment Pool from late 1974 through early 1976.¹³ Equally obvious, however, is that these pools are generally designed for the short-term investment of idle money, not for the longer term investments characteristic of pension funds. While no state has yet created a combined investment pool for independently administered city pension systems, the similarities between the existing state pools and what Kentucky might establish for its city-administered pension systems far outweigh the differences. These pools all depend upon the aggregation of funds to: (1) achieve economies of scale and more options in investment transactions; (2) achieve operational efficiencies; (3) provide expert money management and; (4) break

the linkage between liquidity needs and investment strategy. Kentucky's city pension systems also need to cooperate in order to achieve economies of scale and a greater array of investment options, to achieve operational efficiencies, and to attract expert money management. Pension systems, on the other hand, do not ordinarily have the high liquidity needs characteristic of the investment of idle funds. This is an advantage, however, rather than a disadvantage. Investments can be made for the longer term, and higher yields can ordinarily be attained. It is also probable that some of Kentucky's city pension systems would have greater liquidity needs than others, and these liquidity problems would be more easily overcome in an investment pool than on an individual basis.

Each of the successful investment pools of other states takes advantage of existing capabilities which are absolutely essential to their operation—the states' capability to accurately and efficiently account for the separate investment charges and earnings of many entities in a single operation. This capability requires the implementation of sophisticated computer technology. If such computer technology does not exist or, for some reason, is unavailable at the state government level, then it must be found in the private sector, or else the pooled investment concept must be rejected as premature.¹⁴

CHAPTER III

ARRIVING AT A PROPOSAL—THE ADVISORY COMMITTEE PROCESS

The Advisory Committee

Formulating a workable proposal for a local government pension investment fund involved applying professional advice to the needs and preferences of the employees and city administrators who hold a vital interest in the outcome. That advice was provided by Meidinger and Associates, Performance Planning Services Division. Opinions and preferences of city employees and city administrators were voiced by the aforementioned Advisory Committee on City Pension Fund Investment. This committee was comprised of three representatives of the Kentucky State Lodge, Fraternal Order of Police, three representatives of the Associated Professional Firefighters, three representative city administrators selected by the Kentucky Municipal League, the Executive Director of the Kentucky Municipal League, two representatives of city pension systems for nonuniformed employees, and three representatives of the Lexington-Fayette Urban-County Government. (See Appendix 2 for the membership of this advisory committee.) Representatives of the Louisville Police and Firefighter Pension Systems were also contacted and were sent materials relating to the work of the committee as work progressed. The Advisory Committee held three meetings with the Meidinger Company and the LRC staff during June, August, and September, and arrived at an acceptable working proposal at their third meeting.

Consideration of Alternative Proposals

Prior to the first meeting of the Advisory Committee, several alternative proposals for a pooled pension fund were considered by the author of this report. Briefly described, these alternatives included:

- (1) Turning local pension fund assets over to the staff of the state investment commission and permitting investments for local governments as funds are now invested for the state, pursuant to KRS 41.380.
- (2) Turning local pension fund assets over to the board of the Kentucky Retirement Systems for co-mingling and investment of funds with those of the Kentucky Employees, County Employees, and State Police Retirement Systems, pursuant to KRS 61.650, 78.790, and 16.642.
- (3) Creating a new entity within state government to invest local government pension funds, or enabling local governments to associate for pension investment purposes, including the purchase of professional assistance in the private sector.

The first two alternatives have flaws which could handicap a pooled investment fund. There are several disadvantages of investment of state funds by the state investment officer.

While investment of state funds in Kentucky is for the most part a centralized process, governed by an investment commission comprised of the governor, the commissioner of finance and the state treasurer, the investment officer for the commission does not have the freedom of action characteristic of investment managers in the private sector or his counterpart in several of the other states. The investment officer must recommend purchase or sale of securities, in writing, to the commission, usually represented by the treasurer, and receive commission approval, prior to executing a sale or purchase. While this approval may be gained on a same-day basis, market fluctuations may require even more rapid decision making for maximizing investment returns. If for some reason, such as absence or the call of other state business, the investment commission is unable to respond on a given day to the investment officer's recommendations, investment opportunities are simply lost. This process prevents the kind of aggressive management characteristic of successful investment officers in the private sector and in other states.

Another limitation is the statutory restriction of state investments to direct obligations of the Commonwealth of Kentucky or the United States Government (KRS 41.380). Pension funds are commonly invested in a wide variety of securities, including securities issued by federal agencies and private sector stocks and bonds. While investments in private markets involve an element of risk and should be approached cautiously, investments in federal agencies, which usually pay higher rates of return than direct obligations, are virtually risk free and should be an option for any pension fund investor.

A third concern is record keeping. While the state investment commission currently invests for several state funds and makes overnight and weekend investments with unobligated funds, accounting capability is limited. In the case of the overnight investments, earnings are not presently allocated to the various state funds because of the accounting difficulties involved. If a number of small local government pension systems were to transfer assets to the state investment commission for investment, the accounting necessary for proper allocation of fees, principal and earnings would require computer management similar to that used by other states surveyed in this report. Unless Kentucky develops this computer capability, investment of local funds by state government is impractical. If this capability is developed, it will provide an opportunity for overnight or weekend investment of idle local funds by the state as a supplement to any longer term investment pool created for the bulk of pension funds.

While the second alternative, investment by the board of the Kentucky Retirement Systems, might seem a logical investment strategy, it too has disadvantages. The first is a political problem which was alluded to in the introduction to this report. There is strong resistance among Kentucky's municipal police and fire fighters to adoption of the County Employees' Retirement System (CERS) as an alternative to their own locally administered systems. The normal retirement age in the CERS is fifty-five, while in the cities it may be fifty, fifty-one, or twenty years' service with no age requirement, depending upon the class of city and applicable statute. In addition, the locally administered systems offer 2.5 percent of salary in retirement for each year of service, while the CERS offers only 2.25 percent. While allowing Kentucky Retirement Systems to invest local pension funds would not affect retirement ages or benefit levels, it could be interpreted as the first step in the amalgamation of state and local pension systems. Awareness of the obstacle created by these kinds of fears would dissuade one from recommending Kentucky Retirement Systems' investment of local funds.

Creation of a second board of trustees within Kentucky Retirement Systems to establish policy for local government investments, and thus alleviate the fears mentioned above, would be an unworkable alternative, simply because it would be incompatible with procedures of the three existing pension systems. The investments of the Kentucky Employees' Retirement System, County Employees' Retirement System and the State Police Retirement System are all governed by the same board. It would be possible, and in fact probable, that a separate fund would be created for local governments. Performance of the fund would be measured from the day of its creation, and assets would be separately accounted for. But money available for investment from this fund would be combined with the assets of the other retirement systems, and invested according to the current policies of the board of trustees of Kentucky Retirement Systems. There would be no opportunity for local government pension systems to determine investment policy. Therefore, while it is technically feasible to give local governments the benefit of a large, well-managed pension fund through cooperation with Kentucky Retirement Systems, the required mode of participation would have significant drawbacks and would probably encourage fears of eventual consolidation. The third alternative, then, appears the most desirable.

Criteria Established by the Advisory Committee on City Pension Fund Investment

During their several meetings with the LRC staff and Meidinger and Associates, the members of the Advisory Committee on City Pension Fund Investment established several criteria which they felt a pooled investment fund would have to meet if it were to gain acceptance from potential municipal pension system participants. The first among these was that it had to be a strictly voluntary enterprise, which each system would choose or reject as it saw fit. If local pension boards felt that they would lose their discretion on investments, their support would quickly fade. A corollary to this criterion was that the fund must be governed by a board controlled by the participants, and not by state government. While not every participating pension system would be represented on the board, it would be necessary to select board members who represented characteristic pension systems of different sizes. At the same time it was felt that the largest cities, which might invest the largest amounts of money, would each require individual representation if they were to participate. It was also agreed that each type of pension system—police, fire fighter or nonuniformed employee—should have equal representation on the board.

A need for expertise on the board was clearly recognized, while the method for obtaining this expertise was not specified. It was a matter of consensus, however, that all investment decisions should be influenced only by prudent attention to earnings. Political considerations were not relevant. Consideration was given to investing funds locally to stimulate the local economy. A counter argument was made that depositing money locally would not guarantee that it would be locally invested. Banks tend to seek the highest return on their investments, whether those investments are local or otherwise.¹⁵ Pension boards should also.

Finally, the members of the Special Advisory Committee felt that local pension systems would not want initially to commit large sums to the pooled investment fund. They

would want instead to invest small sums and measure the success of the fund before proceeding further.

The Response of Meidinger and Associates

The firm of Meidinger and Associates responded to these criteria and conditions with a proposal consistent with the third alternative presented at the beginning of this chapter and generally acceptable to the Committee members. This proposal was subsequently distilled into a concept bill draft by the Legislative Research Commission staff for later presentation to the Interim Joint Committee on Cities.

The Meidinger proposal would create a pooled investment entity, called the "fund," with three basic objectives: to increase yields on investments, to reduce investment costs, and to make available a wider variety of investment alternatives. The fund would be governed by a representative board drawn from the participants. This board would employ a private sector investment manager or managers, and a single custodian.

Two basic types of service would be offered. First would be the investment of assets by professional money managers. Second would be the administrative services offered by the custodian. These services would include such necessary functions as record keeping and performance measurement, or optional services, such as check writing and preparation of reports to individuals or agencies of government. The custodian would be responsible for establishing a system whereby contributions could be received and disbursements made to the participating pension systems on an efficient and timely basis. He would distribute investment income among the various participants, or channel it to the investment manager for reinvestment, according to the desires of the participants.

The board, which would establish basic investment policies, would create investment pools as options within the fund as they became practical and acceptable to the participants. These pools could be specific and limited to certain types of investments, such as stocks or mortgages; or assets could be mixed within a "balanced" pool with predetermined objectives. Balanced pools could be conservative, or aggressive, to a limit consistent with pension fund objectives. The participants would select the pools and the amount they wished to invest in each pool. The custodian would maintain records on each pool as a unit, and on each pension system's participation in the pool.

Meidinger further recommended, consistent with the advice of the Committee, that initially the number of pools be small, rather conservative, offer investments not otherwise available, and be subject to short-term performance measurement. The board could then expand the number and variety of pools as initial success attracted more money to the fund, and as local pension systems were able to free moneys from previous local investments to add to the fund. Initially, Meidinger advised the creation of a balanced pool with relatively conservative objectives, a certificate of deposit fund large enough to negotiate rates of return, and a government-backed mortgage pool. A marketable bond pool, a common stock pool and a real estate pool would come later.

An examination of Table III, comprised of data gathered for the preparation of LRC Research Report No. 143, reveals that the pools Meidinger proposes are generally supported by

the types of investments the city pension systems are already making on an individual basis. For example, in 1976, pension systems in cities of the second, third and fourth class collectively invested \$4.72 million in passbook savings and certificates of deposit. This amount in a single certificate of deposit pool would provide the strength to negotiate for high rates of return, and the pooling process would satisfy the liquidity needs that may have motivated individual investments in low-yield passbook savings.

TABLE III
INVESTMENT PREFERENCES OF CITY PENSION SYSTEMS IN KENTUCKY IN 1976
 (Figures in Millions of Dollars)

Class of City	Investment Medium							
	Stocks	Corp. Bonds	Mutual Funds	Federal Securities	Local Government Bonds	Savings Accounts	Certificates of Deposit	Mortgages
First	19	11		7.5				
Urban-County	3.7	2.5		3.3				
Second	2.02	1.56	.95	7.04	1.15	.79	2.1	3.25
Third and Fourth	.1	.33	.21	.51		.18	1.65	

Cities of the second class have invested \$7.04 million in federal securities and \$3.25 million in mortgages. Much of the \$7.04 million in federal securities might already be invested in federally insured mortgage instruments traded on the open market. The \$3.25 million, however, is invested in mortgages originated and held locally. While insured mortgages are secure investments, and at times offer a high return, they do not appreciate over time. Furthermore, the fixed rate of return that may be attractive in one year may be inadequate in terms of market opportunities five years later. The inflexibility of local mortgage investments can be overcome through purchase instead of mortgage-backed federal securities traded on the open market. The \$10.29 million that Kentucky cities of the second class have in federal securities and local mortgages would provide ample funds to initiate the government-backed mortgage pool Meidinger suggests.

Also noteworthy are the \$11.37 million which second through fourth-class cities and urban-county governments have invested in stocks, corporate bonds and mutual funds. This amount of money would provide the financial strength to initiate the balanced pool with conservative objectives that Meidinger suggests. A problem which must be recognized with respect to creating both the mortgage pool and the balanced pool, however, is that sale of existing holdings, especially during a period of high interest rates, might involve substantial losses because market prices would be below original purchase prices. Proper timing of sales would be essential.

In terms of fund operations, Meidinger would require (1) accounting that would give an exact determination of the proportion of assets of each pool attributable to each plan, (2) a single custodian to achieve economies of scale and insure uniform and complete record keeping, and (3) a single investment manager for each pool. In order to ensure that each participant

received its fair value for securities, a strict market value basis would be applied for both entry and withdrawal from each pool. Book value could be used for actuarial purposes and understanding performance. The accounting period for entry and withdrawal from a pool, as well as for reporting, would be monthly, in order to accommodate the various year ends for the participants. Income would be available on a monthly basis.

Charges related to investment and custody of securities would be billed separately to each plan. Investment charges would be allocated proportionately to those utilizing those investment services. Custodial services could be on two levels: a fixed charge for any degree of participation, chargeable to all, and a variable charge dependent on the degree of assets owned.

The Meidinger Firm enumerated several advantages which would be available to city pension systems. These advantages fall into two basic categories: improvement of the investment function, and improvement in administrative capabilities and ability to comply with applicable law and regulations.

Improvement of the Investment Function

(1) Availability of Alternatives

There are a number of investment vehicles which require a large investment pool. It is virtually impossible to manage fixed income securities actively unless the portfolio includes at least \$1 million in assets. An investment pool makes this sort of opportunity available to the small pension system.

(2) Added Liquidity

Pooling of resources can add liquidity to the investments of each plan. The maturity of the investment structure can be lengthened and higher yields can be generated.

(3) Lower Investment Expenses

Typical investment fees are quoted on a sliding scale, and rates decrease as volume increases. Pooling of assets makes lower rates available to each participating pension system.

(4) Professional Management

By creating sufficient pools of money for various types of securities, professional management can be secured for each pool.

Improvement of Administrative Capabilities

(1) Reporting

The record keeping and reporting function can be made identical for all participating pension systems, enabling the financial reporting among the various cities to be more consistent, and allowing the development of a reporting system by the master custodian that fits the needs of each participant.

(2) Fiduciary Aspects

A federal pension law, the Employee Retirement Income Security Act, was

passed in 1974 for the regulation of all pension plans in the private sector. While a similar pension law regulating the public sector has not passed, one has been introduced in the Congress (95th Congress, 2d Session, H.R. 14138). Establishment of practices which would be in keeping with anticipated federal regulations might help Kentucky city pension systems begin to prepare for this eventuality.

House Resolution 72 was intended to stimulate the creation of investment alternatives for city pension systems. The Meidinger report indicates that there are viable alternatives. An important fallout of this effort may be the creation of a method for centralizing record keeping and reporting for pension systems, thus achieving uniformity and efficiency.

Given the probable imposition of federal controls upon local government pension systems in the near term future, this secondary benefit of a pooled investment fund could become as valuable as the investment benefits themselves. This perspective was offered by Mr. Mim Clark, General Manager of the Kentucky Retirement Systems and a volunteer participant in the deliberations of the Advisory Committee. In Mr. Clark's opinion, federal regulation is inevitable and the reports and record keeping such regulation requires could become onerous and expensive burdens for local pension managers. Assistance from the master custodian of the pooled investment fund could be an inexpensive method of meeting anticipated regulatory requirements in the areas of fiduciary responsibility, disclosure on investments, and reporting to the membership of the various pension systems.

CHAPTER IV

THE POOLED INVESTMENT FUND— DYNAMICS OF SUCCESS OR FAILURE

The principles upon which a pooled investment fund is based are sound. The advantages which may be gained through proper implementation of this concept have been demonstrated by the several short-term investment pools in other states. Whether such a fund for city pension systems can be successfully implemented in Kentucky depends upon several factors. Among critical factors now foreseeable are the rapidity with which the fund can be brought to a viable magnitude of investments, the degree of success the proposed advisory board has in choosing skilled investment managers, and whether the structure and procedures of the proposed board will promote a smooth and productive working relationship with the investment advisor.

Attaining Viable Size

Small pension systems can gain through the aggregation of funds because they sever the bond between liquidity needs and investment strategy, derive economies of scale in the investment market, and attract more experienced and successful investment managers (see Chapter II). In order to accomplish these goals there must be initially a substantial commitment of funds—the more the better. A pension system which might be interested in the pooled investment concept cannot wait for all the other systems to prove its worth. Either many systems make an initial commitment of resources in a spirit of cooperation for mutual benefit, or the pooled investment concept cannot be set in motion.

The cities most in need of a pooled investment fund are those with the least resources. Because of their limited size, they have the least power to implement the concept by their own efforts. Their power grows with the percentage of their resources they are willing to commit. But if we include in this category all of the twenty-seven pension systems in cities of the third and fourth class which do not have contracts with insurance companies, their aggregate resources (using 1976 figures) total only \$3,215,000. Even in the perfect situation, where each city could commit all of its resources, this amount of money would be sufficient to begin an investment pool with but a limited scope of objectives and rather high investment fees on a percentage basis. Realistically, however, not all of this money is immediately available. Some of it is already invested in securities with varying lengths of maturity, and most cities would be unwilling to entrust all of their pension funds to the pooled fund immediately, even if they could. It would be extremely difficult for cities of the third and fourth class to implement the pooled investment concept on their own.

The fund, then, must depend upon the participation of larger cities, which have greater resources but somewhat less need. There are twelve city pension systems in seven cities of the second class. In 1976, these cities had aggregate resources of \$20,288,000. While the size of pension funds in these cities obviously tends to be greater than those in the smaller cities, it is

not evident that all are managing their resources optimally. In fact, only four of these systems, with thirty-six percent (or \$7,303,000) of this money, chose professional investment in 1976. While it is easier for these cities because of their size to employ investment counsel, it is interesting to note that this percentage is not much higher than that for cities of the third and fourth class. In 1976, seven of twenty-seven cities of the third or fourth class entrusted thirty percent, or \$965,000, of their money to professional investment counsel. These figures exclude the eight cities which have chosen insurance companies as their investment medium. If cities of the second class have funds of sufficient size to employ professional investment managers, their pension boards, as a class, have not shown a strong tendency to do so. If, in the future, they would begin to make greater use of professional advice, they could do so most profitably by combining their resources in a single investment program, as should be evident from the principles discussed elsewhere in this report. This same principle holds, of course, for cities of the third and fourth class.

Cities of the second, third and fourth class, on the basis of their combined assets, should be able to create a viable pooled investment fund. A concrete example of a successful fund of a size these cities could easily create is a pooled investment fund for local governments in Utah. This fund maintains an average balance of \$4.5 million. Its purpose is to allow local governments to buy negotiable certificates of deposit in a minimum amount of \$100,000. These negotiable certificates offer higher interest rates than non-negotiable certificates in smaller amounts.¹⁶

Cities of the second, third and fourth class which do not presently use professional investment services do not pay a charge for investment management. While these pension systems and the representatives who handle their investments would find their investment task simplified by participation in a pooled investment fund, they would have to adjust to management charges. Gaining their participation would require demonstrating that a pooled investment fund could gain them a greater return, even after investment charges were paid.

The remaining categories of city, cities of the first class and urban-county governments, have vastly greater resources in their pension funds. In 1976, the Louisville police and fire fighter pension funds had \$38 million in resources between them, while the Lexington police and fire fighter system and the civil service system shared nearly \$11 million in assets. Each of these four pension systems employs professional investment counsel, and each, with the possible exception of the Lexington civil service fund, which was approximately \$3 million in size, has less incentive to join a pooled investment fund, but more of the financial power which could make it work. To say, however, that they have less incentive is not to say that they could not benefit from a pooled investment fund and the various services it could offer. Each city should make its own determination in this respect. Since these cities are already experienced in working with professional investment counsel, they would have little adjustment to make if they were to allocate a percentage of their investments to the pooled fund.

In summary then, success of the investment fund depends in part upon the initial participation of many systems; the need for the fund is greatest among those systems with the least financial resources to ensure success; those systems which most need the fund tend to have less working experience with professional investment managers; but in the aggregate the various cities have sufficient financial resources to make the concept work. Initiating the fund requires

convincing enough cities that they have something to gain through participation. Each city must then move with others to initiate the fund cooperatively, rather than withholding participation until others have demonstrated success.

Choosing Skilled Investment Managers

Once sufficient resources are allocated to create a pooled investment fund, the continued existence and growth of that fund depend upon the performance of the investment manager, who works according to investment policies established by the board. Selection of qualified investment counsel is critical. It will be a board responsibility and therefore subject to the wisdom of the board. Safeguards and guidelines can be built into enabling legislation, however, by including qualifications which any investment manager must satisfy. These qualifications are included in the bill draft (80 BR 84) for the pooled investment fund, wherein a qualified investment manager is defined as a bank or trust company as regulated by KRS Chapter 287, or an investment advisor registered either under KRS Chapter 292, or the federal Investment Advisors Act of 1940, or an insurance company certified pursuant to KRS 304.3-160.

Working With the Investment Manager

Provisions governing the composition of the board and its authority with respect to the investment manager are also of utmost importance to the eventual success of the fund. The General Assembly must consider two aspects of board composition and operation: gaining support for and participation in the fund from local governments, and creating a board-investment manager relationship which will promise optimal investment results.

The bill draft for the pooled investment fund (80 BR 84) presently provides for a board with a maximum of fifteen members. This board would include two each chosen by the Fraternal Order of Police, Associated Professional Firefighters, the Kentucky Municipal League, and nonuniformed employees. It would also include a professional chosen by the other board members, and six members selected by each city that contributed at least fifteen percent of the total assets of the fund and was not otherwise represented. The smallest board under the current concept would be eight in number; there would be only one representative of nonuniformed employees, and no representative positions based on contribution of fifteen percent of total assets. The actual composition of the typical board would be somewhere between eight and fifteen members.

Under the present concept the composition of the board is obviously designed to maximize representation and thereby participation. This it would no doubt accomplish. The question which arises is whether by maximizing participation the present board composition would create a less than optimal working situation between board and investment manager. This result would tend to reduce investment earnings and hinder the fund in proving its worth. That the size of an investment board would affect the performance of an investment manager might not be immediately apparent. Yet consultation with investment managers indicates that this can be the case. Investment managers must gain the confidence of their boards in order for their

recommendations to be generally accepted. This confidence is established by working with the board to define an acceptable investment strategy, and then by successfully implementing that strategy. The more board members there are, the more opinions are offered. Working out an acceptable program takes more time and becomes more difficult. When an investment manager has more people to please and more shades of opinion to cope with, he is likely to offer his recommendations in terms of what will be acceptable to a majority of the board. Thus compromises may supplant the strategy which the manager himself feels is the best. He may become more of a diplomat than an expert advisor.

As mentioned earlier in this report, optimal investment fund performance depends upon aggressive money management, and the execution of investment decisions within a framework of hours. In order to manage money in this way, a manager must be given authority by his board to execute specific transactions within a general policy framework, but without having to have their consent on each decision. In the concept draft, the board may grant this authority, but it is not required to do so. Gaining this kind of authority could be more difficult with a large board than a small one. If this authority is not granted, then investment decisions must be made at regular meetings or by obtaining approval by telephone. Obviously obtaining approval by calling each board member becomes more difficult as the size of the board increases, and an investment manager could be easily discouraged from such an undertaking.

Board Size and Fund Success

In addition to the possibility that a large board can hinder the performance of an investment manager, another obvious consideration is the cost of maintaining a large board. Since board members may receive compensation for their necessary expenses when attending to board business, compensation which comes out of the earnings of the fund, the expense of the board increases with each additional member. On the other hand, the board increases in size as cities contribute large amounts of money for investment. The expenses of a fifteen-member board might not be proportionately any larger than the expenses of an eight-member board. But is an eight-member board too large? The basic question is what is the ideal size board for the purposes of the fund. The smallest board possible for accomplishing these purposes would be the logical choice, as long as the participants felt their interests were properly represented.

There are several questions which should be asked of those who would advocate a large board. First is the question of objectives. Will the investment objectives of the participants in a pooled investment fund be dissimilar, or will they be essentially the same? If objectives are similar, it should be possible to achieve adequate representation through a small board. It is also true that when investment objectives vary somewhat, each participant may satisfy its investment objectives by choosing to invest in pools within the fund which differ somewhat in their mix of risk and return. This option is written into 80 BR 84.

Another important aspect is the degree of control each participant exercises simply by the decision to invest or withdraw funds. The boards of individual pension systems can express satisfaction or dissatisfaction through investment decisions. The fund is entirely voluntary and it will live or die depending upon its performance.

Finally, we have the example of other states. In no state is a board as large as that proposed for Kentucky required. Oregon has a local government investment board of five, Wisconsin a state investment board of seven, and Montana a state investment board of five. These are all voluntary investment programs which are growing because of their success.¹⁷ There is no state pooled investment program known to this researcher which has an advisory board as large as that contemplated for Kentucky and, as Table I indicates, Wisconsin, Massachusetts, Montana and Illinois do not have local government advisory boards at all.

While the function of representation on the policy board that will govern the pooled pension fund is important and should be maintained, it is the opinion of this writer that the size of the board should be reduced. Perhaps this could be accomplished by limiting each group which has been granted two representatives on the board to a single representative instead. Another approach might be the appointment of a small investment committee from among the larger board membership. The full board would meet periodically to establish basic investment objectives and to evaluate the performance of the investment manager. The investment committee would be charged with making general decisions to achieve the investment objectives, such as determining the types of securities to be purchased and the scheduling of maturities. It would meet more frequently than the full board and consult directly with the investment manager. The investment manager, in turn, would be responsible for the specific investment decisions necessary to achieve the objectives determined by the board and refined by the investment committee. Ideally the investment manager would be given the authority to execute specific transactions on a timely basis without prior consultation. A procedure such as this would preserve broad representation, but would streamline decision-making and allow the flexibility an investment manager needs to maximize returns.

CHAPTER V

PRESENT STATUS OF THE PROPOSED FUND AND FUTURE ACTION

The Advisory Committee on City Pension Fund Investment completed action on its concept bill draft for a consolidated pension investment fund at a meeting on the morning of November 28, 1978. That afternoon the Co-Chairmen of the Committee, Mr. David Graham, city manager of Richmond, and Mr. Ken Alexander, patrolman from Paducah, presented the concept to a meeting of the Interim Joint Committee on Cities. In making their presentation, Mr. Graham and Mr. Alexander stressed the fact that their proposal had been approved unanimously by the Advisory Committee, representing one of the few occasions on which city management and city labor have taken the same position on a matter of mutual concern.

The Cities Committee responded positively to the Advisory Committee proposal and asked that it be put in bill draft form. This was done and 80 BR 84 is the result of that effort.

The future of the Advisory Committee proposal depends upon the general support which may be generated among those individuals and organizations which stand to benefit from it, and upon reaction to specific provisions and details which are found in 80 BR 84. As a body representative of all interested parties, the Advisory Committee has performed its first task—preparing a pension investment proposal which is acceptable to its members. The second task, informing the wider constituency and enlisting their support, remains to be done. For this effort the members of the Advisory Committee have at their disposal the draft itself, 80 BR 84, and a set of informative questions and answers on the proposal prepared by Meidinger and Associates. These two items are included in this report as Appendices 3 and 5, respectively. Assuming adequate support is generated and 80 BR 84 or a similar piece of legislation is enacted by the 1980 General Assembly, the task of implementation will remain. Implementation will require the close cooperation of those parties represented on the Advisory Committee, and perhaps the appropriation of funds to meet start-up costs.

The questions of implementation and funding have not been a major consideration of this study. Except for the provision in 80 BR 84 for a temporary council to precede the creation of the fund board [Appendix 5, Section 4(1)], they are not addressed in this report. It is conceivable, however, that the financial assistance of state government might be required in several areas in order to facilitate the creation and initial operation of the fund. For example, the members of the temporary council which precedes the creation of the fund board, and the members of the board themselves, will incur expenses prior to the time when the fund can generate revenue to meet those expenses. An initial state appropriation, repayable at a later date, could be used to meet those expenses. An additional possibility is that the board of the fund will consider it advisable in the long run to employ a consultant to assist them in the initial selection of an investment advisor. If so, funds would be required for the consultant's fee. Once again, these costs could be met through a repayable appropriation.

Finally there is the consideration that the success of the fund would be promoted if the state were to invest some of its own surplus funds in it on a temporary basis, in order to provide at the outset the fund magnitude likely to attract qualified investment managers. This proposal would not require an appropriation, but the temporary reallocation of a given amount of state funds from existing investment programs to the pension investment fund. An amendment of KRS 41.380 would be required, however, in order for the pension investment fund to be a legal investment medium for the state government.

If 80 BR 84 reaches the point of probable enactment, the members of the General Assembly may want to request a fiscal note addressing the costs of implementation, and necessary amendments to the bill to provide for any appropriations or investment of state funds.

FOOTNOTES

1. Within the past five years the cities of Paducah, Lexington, Newport, Covington, Maysville and Paris have closed locally administered pension systems to new employees and have opted for the County Employee's Retirement System. New employees in Ashland have been given the opportunity to enter the CERS.
2. Thomas P. Bleakney, *Retirement Systems for Public Employees* (Homewood, Illinois: Irwin, 1972), p. 133.
3. The Council of State Governments, *Investing State Funds: The Wisconsin Investment Board* (Lexington, Kentucky: Council of State Governments, 1976), p. 14.
4. Advisory Commission on Intergovernmental Relations, *Understanding State and Local Cash Management* (Washington, D.C.: 1977), pp. 43-35, 67-70.
5. The Council of State Governments, pp. 12-16.
6. Conversation with Gerald T. Mahaffey, Administrator of the Wisconsin Investment Board, 20 October 1978.
7. *Illinois Public Treasurers' Investment Pool*, Office of the Illinois State Treasurer, December 1975.
8. *Massachusetts Municipal Depository Trust Investment Circular*, Office of the Massachusetts Commonwealth Treasurer, September 1978.
9. Conversation with a representative of Fidelity Management and Research Company, investment advisors for the Massachusetts Municipal Depository Trust, October 20, 1978.
10. *Short Term Investment Fund*, Office of the Connecticut State Treasurer, October 1978.
11. Conversation with investment officer, Connecticut Short Term Investment Fund, October 9, 1978.
12. State of Montana Board of Investments, *Fiscal Year Report*, 1976-77.
13. See also *Informational Bulletin No. 78-1* (Advisory Commission on Intergovernmental Relations), October 1978, p. 9.

14. The Council on State Governments, p. ix.
15. Advisory Commission, p. 28.
16. Charles K. Coe and David B. Pinson, "State-Sponsored Local Government Investment Pools," *Governmental Finance*, May 1978, p. 49.
17. *Informational Bulletin No. 78-1*, p. 6.

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APPENDIXES

APPENDIX 1



**GENERAL ASSEMBLY
COMMONWEALTH OF KENTUCKY**

REGULAR SESSION 1978

HOUSE RESOLUTION NO. 72

FRIDAY, MARCH 3, 1978

The following bill was reported to the Senate from the House and ordered to be printed.

A CONCURRENT RESOLUTION directing the Legislative Research Commission to conduct a study of alternate methods of pooling city pension funds to increase investment yields.

WHEREAS, financial liabilities incurred through pension fund obligations have become of increasing concern to Kentucky city officials and members of the various pension systems; and

WHEREAS, earning adequate returns on pension fund investments is an important method of reducing the costs of pension plans; and

WHEREAS, survey results from a study of city pension systems conducted pursuant to 1976 HR 104 revealed that many Kentucky cities are earning inadequate returns on their pension fund investments; and

WHEREAS, many city pension systems are too small to economically employ professional investment counsel; and

WHEREAS, pooling of city pension funds for investment purposes would enable cities cooperatively to achieve the scale necessary to employ professional investment counsel on an economical basis; and

WHEREAS, the governments of Kentucky cities and their employees both have a vital interest in improving yields on invested pension funds;

NOW, THEREFORE,

Be it resolved by the House of Representatives of the General Assembly of the Commonwealth of Kentucky, the Senate concurring therein:

Section 1. The Legislative Research Commission is directed to conduct a study of alternative methods for pooling the investment funds of city administered pension systems for the purpose of earning greater yields on investments for each participating pension system.

Section 2. The Kentucky Municipal League, the administrators of the various city pension systems, the Associated Professional Firefighters of Kentucky, the Fraternal Order of Police, and representatives of

non-uniformed members of the various city pension plans are requested to cooperate in this study by providing to the Legislative Research Commission all necessary information on their city pension fund investment practices and preferences.

Section 3. To assist in this study the Legislative Research Commission shall employ a consultant qualified to advise on investment practices.

Section 4. The Legislative Research Commission shall complete the study and report its findings to the appropriate interim committee no later than April 1, 1979.

Section 5. Staff services and consulting fees to be utilized in completing this study are estimated to cost \$11,000. These staff services shall be provided from the regular commission budget and are subject to the limitations and other research responsibilities of the commission.

APPENDIX 2

MEMBERSHIP, ADVISORY COMMITTEE ON CITY PENSION FUND INVESTMENT

Associated Professional Firefighters

Mr. Les Walker, Paducah

Mr. Robert Wheeler, Mayfield

Mr. Denis Decker, Silver Grove

Fraternal Order of Police

Mr. Ken Alexander, Paducah

Mr. Martin Scott, Bowling Green

Mr. Gene Weaver, Fort Wright

City Pension System Administrators

Mr. David Graham, Richmond

Mr. Ralph Mussman, Newport

Mr. David K. Noran, Ft. Thomas

Kentucky Municipal League

Mr. Michael Amyx, Executive Director, Kentucky Municipal League

Non-Uniformed Employee Representatives

Mr. Ron Payne, Owensboro

Mr. Earl Freeman, Glasgow

Lexington-Fayette Urban-County Government

Mr. Robert Griffin

Mr. Joe Jasper

Mr. Harry Reams

POOLING PENSION PLAN ASSETS -

IS THE CONCEPT FOR YOU?

Elsewhere in the nation, administrators of public and private pension systems are combining the assets of their respective plans in order to take better advantage of investment opportunities. Kentucky statutes may be amended during the next legislative session to allow the asset-pooling concept to become law and thus permit voluntary participation in the program by municipal plans throughout the Commonwealth. Questions you may have about the pending legislation and how it might affect your pension system are dealt with in this article.

What is the Pension Investment Fund?

The Pension Investment Fund (the Fund) is based on the concept that pooling municipal pension plan assets for investment purposes will increase investment earnings as well as reduce administrative expenses. Combining the resources of each plan's pension system with the assets of others participating in the Fund will enhance investment potential as well as make centralized administrative and accounting services possible.

Does the Fund exist right now?

No. Legislation to create it is being considered, however, and you may have an opportunity to participate in the near future.

Speaking of legislation, does recent federal pension legislation cover my pension plan?

No. Private pension plans are strictly controlled by the new federal laws, but a pension law for public plans is still pending. The legislation currently proposed calls for safeguards and controls for public plans. The Pension Investment Fund concept dovetails with the intent of the pending legislation because it requires professional money managers to handle the money in a "prudent" manner and would provide record keeping in accordance with proposed regulations.

What if I don't want to participate in the Fund?

Fine. Participation in the Fund will be strictly voluntary on the part of each city pension system.

If I choose to join the Fund, do I have to place all my plan's assets in the Fund?

No. Various investment pools within the Fund will be established offering you a different level of anticipated return and risk. You choose which of these pools to invest in and how much of your assets you want to turn over. You may wish to "phase in" your plan on a limited basis initially and turn over more of your assets as favorable experience gives you confidence.

What kind of "pools" are we talking about?

Ultimately, a wide variety of pools will be set up, each with a specific purpose and goal and managed by professionals who will strive to provide the most attractive

return on each pool of assets. At the onset, an attempt will be made to offer pools which are on the conservative side and which aren't readily available at present. During the first year or so, you can expect a certificate-of-deposit pool and a government-backed mortgage pool; soon thereafter, the Fund should include marketable bonds, common stock, and real estate.

Once I'm in, do I have to stay in?

No. mechanics of the Fund allow you to enter or withdraw all or part of your plan's assets on a monthly basis. You can also switch your money from one pool to another.

Other plans participating in the Fund may have liabilities. Will these liabilities affect my plan?

Absolutely not. The fund has nothing to do with plan liabilities. Just assets. And the assets aren't actually "shared" -- just pooled to increase their earnings' potential.

Might I lose control of the management of the assets of my plan?

Not at all. Your plan's controlling body (Board of Trustees, Retirement Committee, etc.) decides which pools in the Fund to use and the percentage of assets to be placed in each pool. Participation in the Fund will in no way affect your plan's autonomy.

Will the Fund effect the retirement and benefit provisions of my plan?

No. The Fund deals only with investments and optional accounting and administrative services.

Who will manage the Fund?

A Board of Directors will be comprised of representatives of those plans which participate in the Fund, such as representatives of the Fraternal Order of Police, Associated Professional Firefighters, Kentucky Municipal League, non-uniformed city employees, and local government pension system administrators. The Board will be responsible for overseeing the entire Fund as well as each investment pool component.

Who will invest the money?

The Board will employ one or more qualified investment organizations to invest and reinvest the Fund's assets in accordance with policies adopted by the Board. These policies will not deviate from the sole purpose of obtaining the highest possible investment yield in the wisest possible fashion.

Who will keep the records?

A custodian employed by the Board will safeguard the assets, keep track of each pension system's assets and earnings, handle entries and withdrawals, and either pay or reinvest earnings as directed by the system. The custodian will make monthly summary reports to the Board as well as monthly reports of individual assets and

earnings to each participant. Provision can also be made to have the custodian prepare annual audits for various systems and supply other services.

Once again, strict accounting of each plan's assets will guarantee that these assets are available to support the obligations of that plan alone. Each plan's liabilities will remain separate and supported only by the assets of that particular plan.

Who pays for managing the Fund?

Charges for investing the money, keeping the necessary records, and generally administering the Fund will be allocated among all plan participants in proportion to their actual use of these services. Participants in a specific pool will share the expenses of maintaining that particular pool. The Board must approve all bills before they're submitted to participants for payment. (Your share of the Fund's administrative expenses may well be a good deal less than what it's costing now to manage your plan's investments.)

What's in it for me?

The primary reasons for considering the pooling concept are to increase the yield to be earned on investments, reduce expenses involved in investing the money (which would have the same effect on a pension system as an increased yield), offer a wider variety of investment alternatives to each plan, and provide record keeping facilities.

The result of increased yield on your plan's investments might be a reduction in the funding required to produce a particular benefit or, as an alternative if legislation allows, might be used to provide higher benefit levels.

Would you please go over again--in general--the advantages of the pooling concept?

Ok--here they are:

1. Increased investment yield or return resulting from professional management of each type of pool
2. Lowering of expenses
3. More efficient administration and control
4. Availability of new types of investments
5. Added ease of converting assets into cash (liquidity)
6. A more consistent method of reporting among the cities
7. Better compliance with anticipated regulatory legislation
8. More effective methods of investment performance measurement and evaluation

What are the possible disadvantages?

None that we can think of.

How can I be sure the Fund is a good idea for my plan?

Pooling has increased earnings and cut costs for others who have tried this approach. Certainly, you must first determine if you and your plan hold a common desire that plan assets earn a favorable return.

Before the Fund is actually set up, you'll be given a set of guidelines to help you decide whether you should invest, how much you should commit, and which pools will best suit your particular plan's needs and objectives.

If I like the asset-pooling idea, what can I do to help the legislation get passed?

You have more than a year before the state legislature meets again. During this period, you can review your plan's present investment capabilities, consider its potential if assets are pooled, and discuss the Fund concept with members and sponsors of your plan. If you decide that you like the idea, communicate your preferences to your legislative representatives.

In the meantime, direct any questions you may have to:

Advisory Committee
Pension Investment Fund

APPENDIX 4

POOLING OF ASSETS FOR INVESTMENT PURPOSES

JULY 25, 1978

VERNON S. HODGE
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INTRODUCTION

The General Assembly of the Commonwealth of Kentucky, by passage of House Resolution 72, directed the Legislative Research Commission (LRC) to conduct a study of alternative methods for pooling of the assets of city-administered pension systems for the purpose of producing greater earnings on these assets. Meidinger & Associates, Inc. was retained by the LRC to serve as a consultant in this project. An advisory committee was also established whose purpose is to work closely with the LRC and the consultant to insure that the needs of the various pension systems which might participate in this pooling concept are appropriately represented. The advisory committee includes representatives from the uniformed employee pension systems, non-uniformed employee systems, city pension system administrators, LRC appointees, and a representative of the Kentucky Municipal League.

The first meeting of the advisory committee was conducted on June 29, 1978. The main purpose of this meeting was to discuss the concept of "Pooling of Assets" for investment purposes in general terms, and to allow members of the advisory committee to provide input enabling Meidinger to prepare a report which would outline the procedures by which this concept would be implemented. This report represents our current thoughts as it relates to the design and implementation of the pooling concept. This report will be presented to the advisory committee and reviewed with members of that committee. A subsequent report, incorporating the additional input from members of the advisory committee, may then be prepared.

It should be noted that House Resolution 72 calls for a study to determine alternatives as it relates to the pooling of investment resources. The scope of this report, therefore, is limited to investment considerations and is not concerned with such items as plan designs or funding requirements for these plans. It should further be noted that, while assets from these various plans may be pooled for investment purposes, appropriate accounting for these assets will insure that the assets of each plan are available to support the obligations of only that plan. The pooling of assets for investment purposes does not, and in fact, the accounting for these assets will insure, that the liabilities and obligations of each plan remain separate and supported only by those assets attributable to that particular plan.

It should further be noted that Meidinger is functioning in a role as investment advisor to the LRC. We have not researched the various state and local statutes under which these plans were established. As such, we have assumed that the assets supporting these plans could be pooled for investment purposes. Prior to any implementation, of course, any statutes which deal with the area of investments should be researched by appropriate legal counsel.

I. GENERAL INFORMATION AND SUMMARY

This report is divided into nine sections, including the Introduction. Section IX indicates several key areas of discussion for the August 9 meeting of the advisory committee. Sections II - VIII deal with the various elements of the pooling concept.

The purpose of this report is to communicate our recommendations, as the consultant to the LRC, concerning how the pooling of investments might be implemented. This report was influenced by the needs of the various municipal pension systems as expressed by the members of the advisory committee at the June meeting of that committee.

As indicated in Resolution 72, the primary reason for consideration of the pooling concept is to increase the yield which might be earned on these investments. In addition to increasing the yield, if the total cost associated with investing the assets can be lowered, this would have a similar impact on a pension system as an increased yield. A third purpose of the pooling concept is to make available to the various plans a wider variety of investment alternatives than perhaps had been available to those plans heretofore. Each of these three reasons is achievable primarily as the result of the greater amount of money which can be accumulated by pooling as opposed to each individual plan providing its own investment resources, and by a systematic and detailed establishment of the investment alternatives.

Below, we have listed a brief summary of Sections II - VIII of this report.

II. SERVICES TO BE OFFERED

There are two basic services which we envision this concept providing those plans which participate: investment services and administrative services.

III. PARTICIPATION

Participation in this concept will be on a strict voluntary basis whereby each plan may position all or a portion of its assets into the various pools which will be established.

IV. BOARD OF TRUSTEES

A Board of Trustees will be selected by representatives of those plans participating in the pools. The Board will be charged with responsibilities such as: selection of investment managers and custodians, monitoring the performance of these managers, making amendments to the operational structure of the concept, including such items as the structure of the various investment pools, and the addition of new pools.

V. TYPES OF INVESTMENT
POOLS

It is anticipated that a number of pools will eventually be established, each of which will have a specific purpose and goal, and therefore, a defineable list of assets which might be purchased for that pool. These would include, but are not limited to, a Certificate of Deposit Pool, a Government-Backed Mortgage Pool, a Marketable Bond Pool, a Common Stock Pool, and a Real Estate Pool.

VI. OPERATIONAL PROCEDURES

There will be a strict accounting of the assets which are deposited to each pool to insure that the fair value of each participating plan is allocated to that particular plan. To insure the economies of scale, all assets should be held in custody by a corporate custodian.

VII. DETERMINATION OF POOLS
TO BE USED FOR EACH
PLAN

The controlling mechanism of each plan will determine which pools that plan will use, as well as the percent of assets which will be placed in each pool. Thus, each plan will retain its autonomy.

VIII. ADVANTAGES

The advantages of the pooling concept are many, including: a better and more consistent method of reporting among the cities, lowering of expenses, increased yield or return on the investments as a result of the attention of professional management for each type of pool, ease of administration, the availability of new types of investments, and added liquidity.

II. SERVICES TO BE OFFERED

We envision two primary services which would be offered to the various municipal plans as a result of the establishment of the pooling concept for investment purposes. These two services are: the investment of assets by professional investment managers (bank trust departments, registered investment counselors, insurance companies), and administrative services, which would include record keeping as well as ancillary services such as performance measurement.

The single most important aspect of this study is to design investment pools which can be utilized by the various plans and which will be managed by professional investment organizations to insure that the most attractive return available can be earned by these plans. Estimates of the effect that an incremental return of 1% might have on reducing the required funding of a retirement plan vary greatly, depending upon the design and funding characteristics of that plan. As an alternative to reducing contributions, increased yield could be used to increase benefit levels without an increase in the funding for the retirement plan. The ultimate costs of any retirement plan, which are often referred to as contributions, can be expressed by the following formula.

$$\text{Contributions} = \text{Benefits Paid} + \text{Expenses} - \text{Investment Income}$$

The selection of appropriate organizations to be responsible for the management of these assets would be designed to improve the investment income, on the particular type of assets placed under that manager's control. It should be noted that the decision to pool these assets does not preclude the use of any qualified investment manager, regardless of their organizational structure, location, size, etc.

The second basic service which would be provided to the various plans are the administrative services. The most fundamental of the administrative services would be the custody of securities and the record keeping, or accounting function. Here the organization which was selected to hold these securities in custody, referred to as the custodian, would establish a system by which contributions could be received from the various plans, and disbursements made to the various plans (either for retirement benefits, expenses, or any other distributional item) insuring that the assets which were attributable to each particular plan were correctly accounted for. The record keeping function also entails the distribution of investment income among the various plans which are participating in each pool. As custodian, this organization would collect all income, and effect all principal and cash transactions.

It should be noted that each pool which will be established would function as a separate entity with participation in that pool open to each plan. In addition to accounting for the activity within each pool, the custodian would also be charged with the responsibility of accounting for the activity among

the various pools for each plan which is participating in this concept. Thus, there are two levels of reporting which will be established: the first level is to account for each pool as a separate investment entity; the second level is to account for each plan which will own a portion (typically referred to as units) of each of the investment pools.

In addition to the record keeping function, the custodian may provide additional ancillary services which will be utilized by the various plans participating in the concept and by the Board of Trustees, who will oversee the operation of this concept. These ancillary services would be made available to the plans on a voluntary basis and might include such items as: check writing for benefit payments, preparation of detailed activity reports to assist in the financial reporting of the plan administrator, and performance monitoring.

III. PARTICIPATION

There are approximately 50 plans throughout the Commonwealth of Kentucky which would be available to participate in the pooling concept. It is recommended that participation in the concept be on a strict voluntary basis. We believe this to be essential to the adoption of the concept and believe that the demonstrated advantages of the pooling concept will be such that a high level of participation will eventually be achievable. In addition, the existing structure of the asset bases of various plans may prohibit some plans from immediate participation.

We believe that participation in each pool should be available to each plan to any extent that particular plan desires. It may be that some plans will choose to place all of a particular type of their assets into a pool. For example, a plan with a relatively small common stock commitment may choose to place its entire common stock commitment in the Common Stock Pool. This would be especially attractive to those municipalities who have relatively small plans and are in need of pooling to provide ample diversification of investments of a particular type. It is further envisioned that some plans may choose to place a portion of each type of asset in which they invest into each of the pools. For example, a plan may choose to place 20% of its certificate of deposit money into the Certificate of Deposit Pool, 30% of its marketable bonds in the Marketable Bond Pool, etc.

As mentioned earlier, the current investment posture of various plans may prohibit their participation in the pools at this time. For this reason it will be essential to allow a particular plan to "phase in" to the use of each pool based on that plan's particular situation as it relates to existing asset structure and anticipated cash flows. The operational procedures involving the accounting of the pools will insure that the phased-in participation of a particular plan is on a fair and equitable basis. It is also recognized that some plans, which may be in a position to participate to a significant extent, might choose to participate on a limited basis initially, and increase their participation as favorable experience increases their confidence.

Ideally, based on a survey of the plans which are available to participate, a number of pools could be established which would provide investment alternatives for all types of vehicles. Realistically, it is recognized that in the initial stages the amount of assets available to the pooling concept may be limited, this based on the two items referenced in the previous paragraph. For this reason, we recommend that a limited number of pools be established initially with additional pools added in the future as participation on both an absolute dollar basis and a type of security basis is increased. We further recommend that the pools to be established initially reflect those types of securities which are not readily available to these plans at the present time. These pools should also reflect relatively conservative investment opportunities. These two items will insure a greater participation which will allow a more effective and economical management of the pool, as well as providing a short-term barometer by which the various plans can analyze the effectiveness of the pooling concept.

IV. BOARD OF TRUSTEES

It is essential that a Board of Trustees, or other such designated body, be established to oversee the operation of this concept. This Board would be selected by those organizations which are currently utilizing the pooling concept. The structure of the Board would be similar to the makeup of the advisory committee. This committee represents the employee groups which are covered by these plans as well as the administrators of these plans. This Board would have the responsibility for overseeing the operation of the entire concept as well as each investment pool.

The structure and makeup of the Board would, of course, be controlled by its by-laws. Detailed decisions regarding this Board need not be made at this time.

The Board should be elected by the representatives from those plans who are participating in the pooling concept.

Members of the Board may, but need not be, limited to representatives from the various plans. For example, Board representation might include a corporate trustee, or independent counsel, or other representatives from the financial community.

The Board should provide adequate representation for both the large and small plans who are participating in the concept.

Membership on the Board should reflect representation of each of the four major groups of effected participants: the Association of Professional Firefighters, Fraternal Order of Police, City Pension System Administrators, and non-uniformed employees.

The Board's responsibilities would include such items as the selection of an organization to serve as the custodian of the assets and the selection of organizations to manage each of the pools. In addition to the initial selection of organizations to serve for the Board, the Board would be responsible for the ongoing operation of the plan, which would include monitoring of performance, potential amendments to the operational structure, and decisions regarding the addition, deletion, or changes in any of these investment pools.

V. TYPES OF POOLS

In general, a variety of pools will be needed to meet the objectives of all the plans who participate in this concept. As mentioned earlier, while the concept would gravitate to a number of investment pools, initially the number of pools may be limited. In conjunction with assets which a particular plan would have outside of the pooling concept, there must be adequate pools offered to insure the objectives of each plan can be met. Each plan could have a unique asset mix, representing different percentages of its assets committed to each of the pools.

There are two basic ways in which to proceed with the establishment of pools. The first would be to establish a pool for each type of investment and have each city select specifically the proportion of their assets they wish to place in each of those respective types of investments. Thus, each city would determine its own unique asset mix. This particular method provides the most flexibility as well as the ability to tailor a specific asset mix for a plan. The second approach is to establish a group of "balanced pools". The securities each pool will utilize will be outlined in general terms, and then, on a day-to-day basis, the investment manager would make the decision regarding the funds' current posture. A number of balanced pools could be established, ranging from an extremely conservative pool to a moderately aggressive pool. Each plan then would choose the percentage of its assets which it desires to position in any one or a variety of these balanced pools.

At the present time we believe that a limited number of pools should be established, combining the above-mentioned approaches. These would include a Balanced Pool with relatively conservative objectives; a Certificate of Deposit fund; and a Government-Backed Mortgage Pool. In the near term we would envision establishing a Marketable Bond Pool, a Common Stock Pool, and a Real Estate Pool. Depending upon the results of a survey of the plans, which would be conducted prior to the establishment of the pools, the pools referenced above are, of course, subject to change.

A Balanced Pool With
Moderately Conservative
Objectives

This would be a balanced fund, investing primarily in common stocks and bonds plus cash equivalents, depending upon the fund manager's outlook for the market. A volatility guideline would be established for this fund such that it would have a high probability of obtaining a minimal rate of return, say 6%, over a time horizon of three to five years. This particular pool could be used by relatively small plans which desired the balanced approach to investing and which desired to place the asset mix at the discretion of the investment manager. This pool might also be utilized for a portion of the assets of the larger plans to serve as an indicator of how the pooling concept would work.

Certificate of Deposit Pool

This pool would consist of investments in certificates of deposit with a stipulated maximum maturity, suggested to be 5 years. These certificates would be in excess of \$100,000 and therefore, the rates which they paid would be subject to negotiation as opposed to being limited by Regulation Q. The goal of this fund would be to provide maximum security and stability of earnings, in that a positive earnings rate in excess of the savings rate would be achievable in each year. Volatility would be experienced only as the result of a change in the interest rates which would be paid from one year to the next. This particular pool could be used as a liquid investment vehicle as well as one offering maximum security.

Government-Backed Mortgage Pool

Within the last several years, investments in government and government agency backed mortgage pools have become very attractive to retirement plans. These particular pools offer the advantages of high interest rates coupled with intermediate-term maturities. Because the underlying investment of these securities are guaranteed, they offer a secure investment vehicle but one whose market value return does fluctuate with the current status of interest rates.

Marketable Bond Pool

The Marketable Bond Pool would be structured to provide participants with an "actively managed" bond account. By active management, it is implied that the investment manager will make purchases and sales in a manner to anticipate changes in the value of the underlying debt securities. The intent is to produce a return over and above the current yield of those securities. The second objective of this strategy is to reduce the volatility of performance, that is, to preserve capital on the downside by avoiding unrealized market value depreciation. This particular fund could serve as the debt sector for a balanced account of a larger plan, or for the sole investment vehicle for the smaller plan which does not wish to participate in the equity market. It is hoped that the return on this pool will be in excess of that available in the government bond marketplace.

Common Stock Pool

This particular type of fund represents an extremely volatile performance alternative. Common stocks have historically produced returns in excess of bonds, but the performance of these securities is very unpredictable, often producing losses, sometimes very large losses, in any one year. Conversely, some years this type of investment can produce extremely attractive gains. It is not envisioned that this fund would be used as the sole investment vehicle for any plan, but could serve as the equity portion of a balanced plan's assets. The investment manager would be given discretion in this particular pool to increase or decrease the equity exposure, by use of cash equivalents, at times the investment manager felt that these offered an attractive vehicle to the Pool.

Real Estate Pool

Participation in real estate ownership can offer retirement plans a significant hedge against inflation pressures. This pool would be a non-leveraged participatory real estate program which would offer stability of income with hoped-for appreciation based upon increases in the value of property. Similar to the Common Stock Pool, this pool would represent a minor portion of the total assets of a plan and would only be used for assets for which there were no liquidity demands.

VI. OPERATIONAL PROCEDURES

The scope of this report is not to address in great detail the operational procedures. These procedures will be finalized in conjunction with the selection of appropriate organizations to handle the custody of securities and the investment of assets. However, a brief discussion of the key ingredients of these operating procedures is warranted. It should be re-emphasized at this point that, while the assets will be pooled for investment purposes, accounting will be established such that there will be an exact determination of the proportion of assets of each pool which are "owned" by each plan. As was mentioned, there will be no sharing of liabilities or obligations from the plans. Each plan will stand alone, and is merely investing assets with other plans to effect higher yields and economy of investment and administration services.

In order to offer economies of scale, it will be necessary that there be a single custodian selected to hold the assets. As mentioned earlier, this custodian will have record keeping responsibilities as well as the capability of providing ancillary services to each plan and the Board. It is essential that all assets be in the custody of one organization so that organization can provide complete record keeping procedures. In the corporate area, this is typically referred to as a Master Trustee. In this case, the organization would serve as master custodian.

In addition to a single custodian, it is anticipated that the number of investment managers will be significantly reduced. At the current time, one would suspect that there are probably 30 - 40 organizations managing money for the 50-odd systems which would be available to participate in this concept. With pooling, a different investment manager may be selected to manage each investment pool. It is possible that a manager might be selected to manage more than one of the pools. In any event, each pool will have one investment manager responsible for the total assets of that pool.

The accounting of these securities will be on a strict market value basis for both entry and withdrawal from the pool. This is a requirement to insure that each plan receives its fair value of securities. While the value will be computed at market for entry and withdrawal from the pool, it will also be accounted for on a book value basis. The book value accounting may be helpful as it relates to the valuation of securities for actuarial purposes. In addition, the return on book value is helpful in understanding performance.

It is anticipated that the accounting period for entry and withdrawal from the pool, as well as the reporting period to each plan, will be on a monthly basis. It would be possible to establish weekly, or even daily, accounting, but we believe this to be overly costly and unwarranted. It is essential that there be monthly allocations to insure that each plan may make timely deposits and withdrawals and to accommodate the various plan year-ends for each plan.

We would anticipate that income from each fund would be payable to each plan on a monthly basis, though many plans may choose to automatically reinvest this income. Income would be distributable in order to provide for greater liquidity without necessitating the sale of a plan's participation in that particular pool.

We anticipate that all charges associated with the investment pools and the custody of securities would be billed separately to each plan. Alternatively, these charges may be paid by merely reducing an organization's participation in a particular pool, but would be billed separately for those plans who prefer to pay expenses outside of the investment pool.

The expenses associated with the maintenance of each investment pool should be borne by those plans which utilize that pool. In addition to these expenses, there would be an overall charge for the custody of securities, and that charge would be spread among all participating plans. It is anticipated that charges would reflect both an asset charge (dependent upon the amount of assets which the plan had invested) and a fixed charge (a flat fee associated with participation in any magnitude). These charges are indeterminable at this time, but they will be dependent upon the size of the pools and the complexity of the management of the pool. They will, of course, be determinable prior to the actual commitment of any plan to participate in the pool or in the concept in its totality.

VII. DETERMINATION OF POOLS TO BE USED BY EACH PLAN

Regardless of the types and varieties of pools which are established, the controlling factor over which pool will be used by a particular plan will rest with the appointed organization in control of that particular plan. This authority will not rest with the other plans who are participants in the pooling concept, nor with the Board of Trustees which has been established to oversee the concept. Thus, identical to the current posture where each plan's controlling body (often its Board of Trustees) decides which manager will be given what portion of assets, or what investments are to be made, the controlling body for each plan will make the decision regarding the pools to be used and the percentage of assets of that plan to be placed in the pool.

The procedural mechanics will allow for monthly entry and withdrawal from a pool at the discretion of the plan.

There are a number of items which should be analyzed by a particular plan in attempting to determine how that plan's assets should be invested. While this type of decision is currently being made by each plan, we anticipate that the pooling concept will tend to strengthen the discipline surrounding this decision. Some of the items which should be considered are:

Type of Plan

Determine whether the plan is a defined benefit plan (guaranteeing a stated benefit at retirement for participants) or a defined contribution plan (providing the participant with the value of the contributions made on his behalf); and whether the plan is in conjunction with Social Security or is independent of Social Security.

Amplification

This is a measure of the plan's sensitivity to volatile performance; the greater the asset base in relation to anticipated annual contributions, the greater the impact of the asset base's performance on the required contribution rate.

Liquidity Coverage

This is a measure of anticipated outflows (benefit payments), to inflows (contributions); this is affected by the census of employees covered by the plan as well as such features as the predictability of benefit payments (normal retirement, disability retirement, etc.).

Employee Contributions

In plans which are contributory, where the employee contributes a portion of his salary, guarantees concerning the return on the portion attributable to the employee contribution are often made; in addition to these guarantees, when an employee terminates, he can typically receive a return of contribution which affects the liquidity ratio.

Sponsor Sensitivity

Many plan sponsors are forced to adhere to a very strict budget; they cannot accept unpredictability in future contributions. If this is the case, the plan must have an asset structure which will provide consistent and predictable earnings.

The key ingredient is that each particular plan, and each particular sponsoring organization of the plan, may have a different set of needs and desires. While a common desire is that all assets in a particular pool earn a favorable return, the actual percentage of assets that would be committed to each pool would vary among the plans. As a part of the implementation phase, it is suggested that guidelines be developed to assist each plan in determining what types of pools that particular plan should use.

VIII. ADVANTAGES

There are a number of advantages to the pooling concept. We have listed several of the major advantages and a brief explanation of each. It is recognized that this concept will need to be presented in a professional fashion to the various governing bodies of these plans prior to the plan committing to the concept.

Reporting	The record keeping and reporting function, since it will be coming from a common source, will be identical for all participating plans. This should enable the financial reporting among the various cities to be more consistent and will enable us to develop a reporting system from the master custodian which will fit the needs of municipal plans domiciled in Kentucky.
Lower Investment Expenses	Typical investment fees are quoted on a sliding scale (for example, .5% on the first \$1 million, .25% on the next \$4 million). By pooling the assets, the combined assets are such that the lower percentage will be applicable.
Professional Management	By establishing significant pools of money in each type of security, we can assure that professional management is available for each type of security in which an investment will be made.
Availability of Alternatives	There are a number of "kinds of securities" which require a large investment pool, and are not available to small plans. For example, it is virtually impossible to actively manage fixed income securities unless the portfolio consists of at least \$1 million.
Fiduciary Aspects	A pension law was passed in 1974 for the private retirement sector. A pension law for public plans has not yet been passed, but the establishment of practices which would be in keeping with the anticipated regulations would begin to prepare these plans for a public retirement law. Additionally, the professional selection and retention of investment managers seems to more closely satisfy the common law requirement of prudence.

Added Liquidity

Pooling of resources can assist in adding liquidity to each plan. If additional liquidity can be developed, the maturity of the investment structure can be lengthened. In a typical interest rate pattern, a higher yield can be generated by longer-term securities.

Existing Pool of Managers

Implementation of the pooling concept will not preclude the use of any manager who is currently managing money for municipalities, nor will it preclude the use of any pool, or type of security, which is currently being used. Rather, it could offer the potential usage of the services of a particular manager or type of security to all municipal plans.

IX. KEY ITEMS OF DISCUSSION FOR THE AUGUST 9 MEETING

Services	Are there any particular ancilliary services that you believe the custodian might provide? These may be services which your custodian is currently providing, which you feel should continue, or ones which would be helpful to you in your particular situation. Do you have any unique record keeping requirements or requirements concerning your reporting and disclosure of activity relating to the asset base?
Participation	To what extent do you believe your organization would participate in this concept on an initial basis? To what extent would your organization participate eventually, should the concept prove to meet its objectives of increasing yield, lowering costs, and offering additional alternatives?
Board of Trustees	Please be prepared to comment on any specific requirements or duties of the Board which you think are necessary or would be helpful.
Types of Pools	What specific pools do you feel would be most attractive at this time? Though we have recommended a balanced pool plus several specific types of pools, do you believe a group of balanced pools would be more appropriate?
Operational Procedures	Are there any specific operational procedures which you believe need to be established which were not discussed in general terms under this section? What types of securities has your plan been invested in which have performed relatively well over the last several years?, relatively poorly?

APPENDIX 5

80 BR 84

AN ACT relating to pensions.

Be it enacted by the General Assembly of the Commonwealth
of Kentucky:

1 SECTION 1. A NEW SECTION OF KRS CHAPTER 95 IS
2 CREATED TO READ AS FOLLOWS:

3 For the purposes of Sections 2 through 12 of this
4 Act, the following terms shall have the following mean-
5 ings:

6 (1) "Beneficiary" shall mean a member, either
7 active or retired, of a local government pension system
8 which participates in the local government pension
9 investment fund;

10 (2) "Board" shall mean the governing body of the
11 local government pension investment fund, as provided for
12 in Section 4 of this Act;

13 (3) "Fund" shall mean the local government pension
14 investment fund, as created by this Act;

15 (4) "Qualified investment manager" shall mean a
16 bank or trust company as defined and regulated in KRS
17 Chapter 287, or an investment adviser as defined in KRS
18 292.310 and registered under KRS 292.330, or an invest-
19 ment adviser registered under the federal Investment
20 Advisers Act of 1940, or an insurance company certified
21 pursuant to KRS 304.3-160;

1 (5) "Participant" shall mean a locally administered
2 public pension system, created pursuant to KRS 95.290,
3 95.520 to 95.620, 95.621 to 95.629, 95.767 to 95.785,
4 95.851 to 95.885, 67A.320, 67A.340, 67A.360, 90.400,
5 90.410, 96.180, 79.080, or 70.580 to 70.598, which
6 chooses to invest in and thereby become a member of the
7 local government pension investment fund.

8 SECTION 2. A NEW SECTION OF KRS CHAPTER 95 IS
9 CREATED TO READ AS FOLLOWS:

10 The governing bodies of local government pension
11 systems which can qualify as participants may create a
12 local government pension investment fund, comprised of
13 assets and earnings thereon which participants invest in
14 the fund. Membership in the fund shall be a voluntary
15 act by a participant. A participant may invest its
16 assets in the fund in accordance with procedures adopted
17 by the board.

18 SECTION 3. A NEW SECTION OF KRS CHAPTER 95 IS
19 CREATED TO READ AS FOLLOWS:

20 The purposes of the fund shall be to enable each
21 participant to enhance its investment power through
22 aggregation of its resources with the resources of other
23 participants, and to avail itself of options for central-
24 ized administrative and accounting services relating to
25 pension system management. Participants shall be allo-
26 cated units of participation in the fund representing the

1 value of assets which they invest in the fund. Earnings
2 of the fund shall be allocated to participants uniformly
3 on the basis of degree of ownership of units of parti-
4 cipation. There shall be no sharing of the pension
5 liabilities of the various participants within the frame-
6 work of the fund.

7 SECTION 4. A NEW SECTION OF KRS CHAPTER 95 IS
8 CREATED TO READ AS FOLLOWS:

9 The fund shall be governed by a board created in the
10 following manner:

11 (1) A temporary council, comprised of the executive
12 director of the Kentucky Municipal League or his desig-
13 nee, the president of the Fraternal Order of Police or
14 his designee, and the president of the Associated Profes-
15 sional Fire Fighters or his designee shall exist for the
16 purpose of receiving appointments to the board, estab-
17 lishing a date for receipt of moneys into the fund, and
18 scheduling the first meeting of the board. Organizations
19 or entities authorized to make appointments to the board
20 shall submit those appointments to the temporary council.
21 The temporary council shall cease to exist when the board
22 has met and selected a chairman.

23 (2) Two (2) board members shall be appointed by the
24 Kentucky State Lodge, Fraternal Order of Police, from
25 among policemen whose local government pension systems
26 have pledged to invest assets in the fund on the date

1 established by the temporary council.

2 (3) Two (2) board members shall be appointed by the
3 Associated Professional Fire Fighters from among fire
4 fighters whose local government pension systems have
5 pledged to invest assets in the fund on the date estab-
6 lished by the temporary council.

7 (4) Two (2) board members shall be appointed by the
8 Kentucky Municipal League from among elected city offi-
9 cials or appointed city administrators whose city pension
10 systems have pledged to invest assets in the fund on the
11 date established by the temporary council.

12 (5) Two (2) board members shall be appointed from
13 among employees whose city pension systems for
14 non-uniformed employees have pledged to invest assets in
15 the fund on the date established by the temporary coun-
16 cil. The participants in this category shall consult
17 among themselves to select their two (2) board members.
18 Should there be only one (1) participant in this cate-
19 gory, only one (1) member shall be appointed.

20 (6) One (1) board member shall be appointed by the
21 board within three (3) months of the first board meeting
22 from among persons who have demonstrated competence in a
23 fiduciary capacity.

24 (7) In addition, any participant which has invested
25 or pledged to invest at least two hundred thousand
26 dollars (\$200,000) in the fund, or fifteen (15) percent

1 of the total assets of the fund, whichever is greater
2 shall appoint one (1) board member from among its
3 employes covered by the pension system, but no partici-
4 pant shall appoint a member under the provisions of this
5 subsection if a member from the city of the participant
6 has already been appointed under the provisions of sub-
7 sections (2), (3), (4) or (5) of this section. Initial
8 appointments pursuant to this subsection shall be effec-
9 tive upon the date when the board first meets. Appoint-
10 ments made pursuant to this subsection shall be reviewed
11 on June 30 of each succeeding year, at which time new
12 appointments shall be made and old appointments termi-
13 nated as required by the criteria of this subsection.

14 SECTION 5. A NEW SECTION OF KRS CHAPTER 95 IS
15 CREATED TO READ AS FOLLOWS:

16 (1) Board members shall serve without compensation,
17 but may be reimbursed for their reasonable and necessary
18 expenses out of the earnings of the fund.

19 (2) The board shall at their first meeting select
20 one (1) of their number to serve as chairman, and such
21 other officers as they may deem necessary. The board may
22 adopt bylaws to govern their internal affairs. The board
23 may create committees from among its members to act in
24 the name of the board.

25 (3) Except for board members selected pursuant to
26 subsection (7) of Section 4 of this Act, board members

1 shall be appointed for two (2) year terms. Initially,
2 however, one (1) of the two (2) members appointed pur-
3 suant to each of subsections (2), (3), (4), and (5) of
4 Section 4 of this Act shall be appointed for one (1)
5 year. Subsequent appointments pursuant to these subsec-
6 tions shall be for two (2) years. Board members may be
7 reappointed.

8 (4) In the event of a vacancy on the board, an
9 appointment shall be made for the remainder of the unex-
10 pired term by the entity making the original appointment.
11 Withdrawal of all assets by a participant shall cause any
12 board member representing that participant to vacate his
13 seat on the board.

14 (5) There shall be regularly scheduled periodic
15 meetings of the board and the schedule shall be adopted
16 in the bylaws. The chairman may call special meetings at
17 times other than those adopted in the bylaws. In the
18 absence of a call by the chairman, twenty-five percent
19 (25%) of the membership of the board may call a special
20 meeting. All board members shall be notified by mail of
21 each meeting at least one (1) week prior to the meeting.

22 (6) No board member shall participate in any deci-
23 sion if he is in a position to benefit substantially from
24 that decision. Substantial benefit shall not mean bene-
25 fit derived through status as a beneficiary.

26 (7) Any board member convicted of a felony shall be

1 removed from the board automatically upon his conviction.

2 SECTION 6. A NEW SECTION OF KRS CHAPTER 95 IS
3 CREATED TO READ AS FOLLOWS:

4 The board shall employ one (1) or more qualified
5 investment managers, who shall invest and reinvest the
6 assets of the fund. The qualified investment managers
7 may make any investments which are allowed, at the time
8 of making the investment, to fiduciaries in this state,
9 except that the board may at its discretion authorize the
10 qualified investment managers to purchase common stocks
11 in corporations that do not have a record of paying divi-
12 dends to their stockholders. Qualified investment man-
13 agers operating pursuant to the provisions of this Act
14 shall not be required to seek district court approval of
15 investments authorized by KRS 386.020(h) and (i). The
16 board may grant the qualified investment managers author-
17 ity to make timely investments. In investing and re-
18 investing moneys and in acquiring, managing and disposing
19 of investments, the qualified investment managers shall
20 discharge their duties with respect to the fund solely in
21 the interest of the participants and their beneficiaries
22 and:

23 (1) For the exclusive purpose of providing benefits
24 to participants and their beneficiaries and defraying
25 reasonable expenses of administering the fund;

26 (2) With the care, skill, prudence, and diligence

1 under the circumstances then prevailing that a prudent
2 man acting in a like capacity and familiar with such mat-
3 ters would use in the conduct of an enterprise of a like
4 character and with like aims;

5 (3) By diversifying the investments of the fund so
6 as to minimize the risk of large losses, unless under the
7 circumstances it is clearly prudent not to do so; and

8 (4) In accordance with the documents and instru-
9 ments governing the fund as found in this Act or policies
10 adopted by the board.

11 SECTION 7. A NEW SECTION OF KRS CHAPTER 95 IS
12 CREATED TO READ AS FOLLOWS:

13 (1) The board shall employ a single custodian for
14 the assets held by the fund. The custodian shall be
15 responsible for:

16 (a) Physical safekeeping of all securities;

17 (b) Collection of all income;

18 (c) Effecting all principal and income trans-
19 actions;

20 (d) Maintenance of a complete set of accounting
21 records, including reporting to the board and partici-
22 pants on the assets, earnings and activity of each pool
23 of the fund on a monthly basis, and reporting individual
24 assets, earnings and activity to each participant on a
25 monthly basis;

26 (e) Making principal payments to participants no

1 later than forty-five (45) days after receipt of a
2 request; and

3 (f) Making available earnings to participants on a
4 monthly basis, or returning earnings to the fund for
5 reinvestment as directed by the participant.

6 (2) The custodian may upon request of a participant
7 perform optional services such as but not limited to the
8 following:

9 (a) Make disbursements for the participant; and

10 (b) Prepare reports to beneficiaries or units of
11 government.

12 SECTION 8. A NEW SECTION OF KRS CHAPTER 95 IS
13 CREATED TO READ AS FOLLOWS:

14 The board may employ other persons to perform appro-
15 priate services for the fund, and may prescribe their
16 responsibilities and compensation out of the earnings of
17 the fund.

18 SECTION 9. A NEW SECTION OF KRS CHAPTER 95 IS
19 CREATED TO READ AS FOLLOWS:

20 The board may create various investment pools within
21 the fund, restricted to certain types of investments, or
22 combining various investments in order to offer different
23 levels of return and risk. Each participant may choose
24 those pools in which it will invest, and the degree of
25 investment.

26 SECTION 10. A NEW SECTION OF KRS CHAPTER 95 IS

1 CREATED TO READ AS FOLLOWS:

2 The board shall arrange for an annual audit of the
3 fund and pools thereof, and a copy of the audit report
4 shall be given to each participant.

5 SECTION 11. A NEW SECTION OF KRS CHAPTER 95 IS
6 CREATED TO READ AS FOLLOWS:

7 The board shall require the qualified investment
8 manager, custodian, or any person who has charge of,
9 handles or has access to any of the moneys or other
10 assets of the fund to be bonded in an amount of not less
11 than the amount of fund assets normally in his possession
12 or control.

13 SECTION 12. A NEW SECTION OF KRS CHAPTER 95 IS
14 CREATED TO READ AS FOLLOWS:

15 (1) Charges for investment and custodial or other
16 services which by nature benefit all fund participants
17 shall be allocated by general rules over all fund par-
18 ticipants enjoying those services:

19 (a) Charges for investment services shall be allo-
20 cated among the participants in direct proportion to
21 their degree of ownership of the assets invested;

22 (b) Charges for custodial services may include both
23 an asset charge directly proportional to the degree of
24 ownership of the assets held, and a fixed charge associ-
25 ated with participation of any magnitude.

26 (2) Charges for services which clearly benefit

1 individual participants, such as accounting services or
2 preparation of reports for individual participants, shall
3 be paid for by the individual participant.

4 (3) The board shall approve all charges prior to
5 payment. In no event shall charges pursuant to subsec-
6 tion (1)(a) of this section exceed one (1) percent of the
7 principal amount of the fund.

8 Section 13. KRS 95.600 is amended to read as fol-
9 lows:

10 The board of trustees in cities of the third class
11 may draw the pension fund from the treasury and shall
12 invest it, in whole or in part, in the name of the board
13 or nominee name as provided by KRS 287.225, as the board
14 deems most advantageous for the objects of the fund, in
15 interest-bearing bonds of any county, or any city of the
16 first, second or third class in this state, or in any
17 securities in which trustees are permitted to invest
18 trust funds under the laws of this state, including a
19 local government pension investment fund created pursuant
20 to Section 2 of this Act. The securities [shall be depos-
21 ited with the treasurer of the board, and] shall be
22 subject to the order of the board.

23 Section 14. KRS 95.622 is amended to read as fol-
24 lows:

25 (1) There shall be created in cities of the third
26 class a policemen's and fire fighter's pension fund, and

1 a board of trustees for that fund.

2 (2) In cities of the third class the board of
3 trustees of the policemen's and fire fighter's pension
4 fund shall be composed of the mayor, city treasurer,
5 chief of the police department, chief of the fire depart-
6 ment and one (1) member each from the police and fire
7 departments shall be elected by the respective members of
8 those departments annually by ballot, one (1) from each
9 department, and shall serve for one (1) year and until
10 their successors are elected and qualified. The board
11 shall select from their number a president and a secre-
12 tary. The board of trustees shall be the trustees of the
13 pension fund and of all moneys donated or paid for the
14 relief or pensioning of members of the police and fire
15 departments. It may do all things necessary to protect
16 the fund.

17 (3) The board of trustees may draw the pension fund
18 from the treasury and invest it, in whole or in part, in
19 the name of the board or nominee name as provided by KRS
20 287.225, as the board deems most advantageous for the
21 objects of the fund, in a local government pension
22 investment fund created pursuant to Section 2 of this Act
23 or in any other securities in which trustees are permit-
24 ted to invest trust funds under the laws of this state.
25 The securities shall be subject to the order of the
26 board.

1 Section 15. KRS 95.772 is amended to read as fol-
2 lows:

3 The said board of trustees of the policemen's and
4 fire fighter's pension fund shall have the power to draw
5 such pension fund from the treasury and may invest the
6 same, or any part thereof, in the name of the board of
7 trustees of the policemen's and fire fighter's pension
8 fund or nominee name as provided by KRS 287.225, in
9 interest-bearing bonds of the United States or the state
10 of Kentucky, or any county or city of the first, second,
11 third or fourth class in the state of Kentucky, or in any
12 securities in which trustees or guardians are permitted
13 to invest trust or guardianship funds under the laws of
14 this state including a local government pension invest-
15 ment fund created pursuant to Section 2 of this Act, and
16 all such securities [shall be deposited with the treasur-
17 er of said city as ex officio treasurer of said board
18 and] shall be subject to the order of said board. Both
19 the principal and interest of said pension fund shall be
20 applicable to the payment of pensions under KRS 95.761 to
21 95.785.

22 Section 16. KRS 95.852 is amended to read as fol-
23 lows:

24 There is hereby established in cities of the second
25 class, a retirement and benefit fund for members of the
26 police and fire departments, their dependents and bene-

1. ficiaries. The fund shall be established as of July 1,
2 1956, and shall be known as the "Policemen's and Fire
3 fighter's Retirement Fund of the City of" In such
4 name all of its business shall be transacted, and in such
5 name or nominee name as provided by KRS 287.225 all of
6 its moneys invested and all of its accumulated reserves
7 consisting of cash, securities, and other property shall
8 be held.

9 Section 17. KRS 95.873 is amended to read as fol-
10 lows:

11 The board may invest the moneys accruing to the
12 fund, in interest-bearing bonds of any county,
13 urban-county government or city of the first, second, or
14 third class in this state, or in any securities in which
15 trustees are permitted to invest trust funds under the
16 laws of this state including participation in a local
17 government pension investment fund created pursuant to
18 Section 2 of this Act. Such bonds shall be registered in
19 the name of the board to the extent possible. The securi-
20 ties acquired by the board [shall be deposited with the
21 treasurer and] shall be subject to the order of the
22 board. The board may, at its own cost, employ or engage
23 consultants to provide investment advice to aid the board
24 in its determinations.

25 Section 18. KRS 67A.570 is amended to read as fol-
26 lows:

1 The board may invest the moneys accruing to the
2 fund, in interest-bearing bonds of any county,
3 urban-county government or city of the first, second or
4 third class in this Commonwealth, or in any securities in
5 which trustees are permitted to invest trust funds under
6 the laws of this Commonwealth including participation in
7 a local government pension investment fund created pur-
8 suant to Section 2 of this Act. Such bonds shall be
9 registered in the name of the board to the extent pos-
10 sible. The securities acquired by the board [shall be
11 deposited with the director of finance and] shall be
12 subject to the order of the board. The board may at the
13 cost of the government employ or engage consultants to
14 provide investment advice to aid the board in its
15 determinations.

