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CHILDREN'S TRUST FUND INVESTMENTS

Senate Bill 472 as passed by the Senate
First Analysis (12-6-01)

Sponsor: Sen. Shirley Johnson
House Committee: Appropriations
Senate Committee: Appropriations

THE APPARENT PROBLEM:

The Children's Trust Fund was established by the legislature in 1982 to fund efforts to prevent child abuse and neglect. The fund supports 69 local child abuse and neglect prevention councils that serve 79 Michigan counties. Local councils are community-based organizations that identify needs and facilitate collaborative prevention programs in their communities. The CTF also funds 56 local direct service prevention programs across the state, which provide a wide range of services to families, helping them to understand the developmental stages of children, how to cope with the stress of parenting, and where to find support and resources.

The CTF has been funded by a check-off on the state income tax form, by which taxpayers could designate $2 or more of their refund to be credited to the fund. The enacting legislation specified that this would continue until the fund assets reached $20 million. In a supplemental appropriation made during fiscal year 1999-2000, the legislature allocated $13.1 million to the corpus of the trust fund, bringing the balance of the endowment fund up to $20 million. At that time, the income tax check-off was removed from the state income tax form. From this point forward, the CTF is to pay for its programs and operations through fund raising and from the interest earned on the trust account.

The Children's Trust Fund act requires the state treasurer to invest the trust fund in the same manner as surplus state funds are invested. Statute allows surplus funds to be invested in bonds, notes, and other debt instruments of the U.S. government and its agencies, in prime commercial paper, and in financial institutions whose principal office is in the state. Legislation has been proposed to broaden the investment options for several of the state's trust funds, including the CTF, in order to maximize earnings.

THE CONTENT OF THE BILL:

The bill would amend the Children's Trust Fund act to specify that the state treasurer, in investing the assets of the trust fund, would have the same authority as is granted to an investment fiduciary under the Public Employee Retirement System Investment Act. Further, the bill would require the state treasurer to annually prepare an accounting of revenues and expenditures from the trust fund. The accounting would have to specifically identify the interest and earnings of the trust fund, describe how the amount of interest and earnings had been affected by the expanded investment options allowed for under the bill, and identify how the increased interest and earnings, if any, had been expended. The accounting would have to be provided to the Senate and House Appropriations Committees.

The bill would also amend the act to specify that the trust fund would be a "charitable and educational endowment" fund in the Department of Treasury. Current law simply says that the fund is created as a separate fund in the department.

MCL 21.171

BACKGROUND INFORMATION:

Article IX, Section 19 of the State Constitution states:

The state shall not subscribe to, nor be interested in the stock of any company, association or corporation, except that funds accumulated to provide retirement or pension benefits for public officials and employees may be invested as provided by law; and endowment funds created for charitable or educational purposes may be invested as provided by law governing the investment of funds held in trust by trustees and other state funds or money may be invested in accounts of a bank, savings and loan association, or credit union organized under the laws of this state or federal law, as provided by law.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the bill would have an indeterminate impact on Children's Trust Fund revenue. From 1999 through 2001, the trust fund had an annualized investment rate of return of 8.4 percent. From 1982 through 2001, the Michigan Public School Employees Retirement System (MPSERS) had an annualized rate of return of 12.2 percent. The HFA notes that if this rate of return were realized in future years, and if the investment of the CTF was directed in the same manner as the retirement system, the investment earnings from the trust fund's $20 million principal would increase by an average of $760,000 annually.

However, the HFA notes that given the inherent nature of investments, past rates of return cannot necessarily be assumed for the future. A more conservative estimate for investment return in future years would be the MPSERS actuarial assumption of 8 percent. Using this figure, investment earnings could decrease slightly.

Regardless of the actual rate of return, investment of the fund's assets in the stock market would increase investment risk and result in larger differences in investment return from year to year – with the potential for negative earnings in any given year. (12-5-01)

ARGUMENTS:

For:

The assets of the Children's Trust Fund are, by law, invested in the same manner as state surplus funds. The types of investments allowed are primarily in bonds and other "safe" but lower yield investments. In order to increase the rate of return on the trust fund's investments, the bill would allow the fund's assets to be invested in the same manner as state pension funds can be invested. The Public Employee Retirement System Investment Act allows up to 70 percent of retirement fund assets to be invested in domestic stocks, and also allows for investments in a broad array of other investments, including mortgages, real estate, international equities, and alternative investments. In fact, the legislature recently amended the act to increase the allowable investment in stocks, in recognition that this additional flexibility would allow pension managers to maximize investment returns to produce the greatest benefit for the state's pension systems. It makes sense to allow this expanded investment authority to the state treasurer to also maximize the investment returns of the Children's Trust Fund.

Against:

As the recent volatility of the stock market has demonstrated, the kinds of investments contemplated for CTF assets by proponents of the bill may not produce the bountiful returns that are anticipated by the bill's proponents; it is indeed possible that investments in stocks could produce a *negative* earnings amount in a given year. Is this wise, given that now the CTF is entirely dependent on investment earnings and fundraising for its program expenditures?

POSITIONS:

A representative of the Children's Trust Fund Board testified in support of the bill. (12-5-01)

Analyst: D. Martens

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.