WISCONSIN LEGISLATIVE COUNCIL
STUDY COMMITTEE MEMORANDUM

TO: MEMBERS OF THE STUDY COMMITTEE ON THE INVESTMENT AND USE OF THE SCHOOL TRUST FUNDS

FROM: Zach Ramirez and Rachel E. Snyder, Staff Attorneys

RE: Topics for Committee Discussion

DATE: October 4, 2018

This memorandum summarizes potential topics of discussion for the October 11, 2018 meeting of the Study Committee on the Investment and Use of the School Trust Funds. The memorandum provides a preliminary, non-exhaustive list of topics, compiled from issues raised by presenters and committee members during the study committee's August 16 and September 5 meetings.

THE LOAN PROGRAM

At the first two meetings, the committee discussed the benefits of the Board of Commissioners of Public Lands (BCPL) loan program, as well as concerns relating to the general topics listed below.

The Effect of the Loan Program on the Overall Return Achieved by the School Trust Funds

Current statutes require the BCPL to charge at least 2% interest on all loans. [s. 24.63 (3), Stats.] In practice, the BCPL sets interest rates for general obligation loans based on the term of the loan. Currently, the interest rate for a general obligation loan is 4% for a term of two to five years, 4.25% for a term of six to 10 years, and 4.5% for a term of 11 to 20 years. The BCPL sets the interest rate for any particular revenue obligation loan based on the term and the BCPL's analysis of the specific risks involved in the project. Of the 21 revenue obligation loans the BCPL has issued, the lowest interest rate was 2.25%, the highest was 5.75%, and the average was 4.32%.

Current statutes allow a borrower to prepay in advance of a payment due date, and allow the BCPL to charge a borrower a fee to cover any administrative costs incurred by the board in originating and servicing the loan. [s. 24.63 (4), Stats.]

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As of January 2016, 41% of the assets of the Common School Fund and 47% of the assets of the Normal School Fund were invested through the BCPL loan program. In November 2016, the BCPL adopted its current investment policy, which states that its target shall be to have 40% of the assets of the Common School Fund and 45% of the Normal School Fund invested through the BCPL loan program. The investment policy states that, if the demand for loans exceeds the asset allocation target, the BCPL will make room for new loans by selling some of its existing loans to other creditors.

The committee could discuss amending the statutes to cap the portion of the school trust funds that the BCPL may invest through the loan program. A discussion could include consideration of: (1) whether the target in the BCPL's investment policy is appropriate; (2) whether to establish a timeline or interim targets for use in reaching an allocation target; (3) whether to identify any extenuating circumstances, under which the BCPL would be permitted to exceed the target; and (4) whether any statutory changes are needed to facilitate or regulate the BCPL's sale of loans to other creditors.

In addition, or alternatively, the committee could discuss amending the statutes in a manner intended to increase the return achieved through the loan program itself. A discussion could include consideration of: (1) whether to modify the minimum interest rate set forth in statute, such as by increasing it, requiring that it be indexed to interest rates, or specifying the procedure that the BCPL must follow in setting loan interest rates; (2) whether to modify the statutes to require, rather than permit, the BCPL to charge a borrower a prepayment fee; and (3) whether to prohibit or limit a borrower's ability to prepay a loan.

The Effects of the Loan Program on Private Lending to Municipalities and School Districts

The committee heard testimony and expressed concerns regarding how the BCPL loan program competes with the private lending industry. Expressed concerns included: (1) that BCPL loans include features that private lenders cannot offer; (2) that local governments are not always aware of the private lending options available to them; and (3) that certain statutes limit a private lender's ability to offer long-term loans to local governments.

The committee could discuss amending the statutes to prohibit the BCPL from issuing loans with features that private lenders are unable to offer. A discussion could include consideration of: (1) whether to modify the minimum interest rate set forth in statute, such as by increasing it, requiring that it be indexed to interest rates, or specifying the procedure that the BCPL must follow in setting loan interest rates; (2) whether to modify the statutes to require, rather than permit, the BCPL to charge a borrower a prepayment fee; and (3) whether to prohibit or limit a borrower's ability to prepay a loan.

The committee could discuss amending the statutes to require that the BCPL serve as a "lender of last resort." A discussion could include consideration of: (1) whether to require, as a condition of obtaining a BCPL loan, that a borrower demonstrate that it has attempted to obtain a loan from a private lender; or (2) whether to narrow the list of municipalities and school districts that are permitted to borrow from the BCPL.

The committee could discuss amending the statutes to allow municipalities to obtain, from a private lender, a loan with a term greater than 10 years. Current statutes allow a municipality to obtain from the BCPL a loan with a term greater than 10 years, if the loan proceeds are used for a "public purpose project." [s. 24.61 (3) (a) 2., Stats.] However, the statutes do not allow a municipality to obtain a loan with a term greater than 10 years from a private lender. [ss. 67.04 and 67.12 (12), Stats.] Alternatively, the committee could discuss amending the statutes to repeal the BCPL's authority to issue a loan with a term of greater than 10 years.

The Extent to Which the Statutes Enable Municipalities to Use the Loan Program to Finance Expenditures That Committee Members Think Should Not Be Financed Through Borrowing

Under current law, the BCPL may issue either general obligation loans or revenue obligation loans. General obligation loans are subject to a municipality's constitutional debt limit and are secured by the municipality's general taxing authority. Revenue obligation loans are issued outside of a municipality's constitutional debt limit and are secured by the revenues to be generated by a specific project. State law requires that a revenue obligation loan be used to finance or refinance the costs of a tax increment finance (TIF) project or for the "acquisition, leasing, planning, design, construction, development, extension, enlargement, renovation, rebuilding, repair or improvement of land, waters, property, highways, buildings, equipment or facilities." [ss. 24.60 (1w) and (2m), 60.85 (1) (h) 1., 66.1105 (2) (f), and 67.04 (1) (ar), Stats.]

State law requires that the application for a revenue obligation loan include the following: (1) the amount of money requested; (2) the purpose for which the loan proceeds will be used; (3) the time and terms of repayment; (4) a statement of the revenue or tax increments that the applicant anticipates receiving from the project; (5) proof of the amount of annual shared revenue that the applicant receives; and (6) proof that the application has been approved at the local level, in the manner prescribed by statute. [s. 24.66 (1) (ag) and (cg), Stats.]

Except for the application elements, state law does not prescribe loan underwriting requirements, nor does it explicitly limit to whom the loan proceeds may be paid once secured by a municipality. Therefore, as long as the loan is made and the proceeds are generally used in support of a statutorily permissible municipal function or project, a municipality may distribute the funds directly to developers or other private entities as incentive to proceed with a project.

The committee could discuss amending the statutes regarding revenue obligation loans. A discussion could include consideration of: (1) whether to add statutory underwriting requirements that specify how revenue streams must be analyzed; (2) whether to prohibit loan proceeds from being used to fund incentive payments to private developers; and (3) whether to eliminate the BCPL's authority to issue revenue obligation loans.

OVERALL FUND INVESTMENT

Each of the four funds has a distinct history and legal structure that must be analyzed individually, in order to determine the extent of the Legislature's and the BCPL's authority. For purposes of providing context to aid the committee's discussion, this section of the memorandum provides general information on current law governing the investment of the

funds. This context is relevant as the committee considers whether to pursue options through statutes or amendments to the constitutional provisions governing the investment of the funds.

Background on Current Law Governing the Investment of the School Trust Funds

The Wisconsin Constitution vests the Legislature with authority regarding the investment of the Common and Normal School Trust Funds by directing that "The commissioners…shall invest all moneys arising from the sale of such lands, as well as all other university and school funds, in such manner as the legislature shall provide . . . ." [Wis. Const. art. X, s. 8.] It also vests the Legislature with authority regarding the distribution of the income of the Common School Fund by providing that "[p]rovision shall be made by law for the distribution of the income of the school fund among the several towns and cities of the state for the support of common schools therein . . . ." [Wis. Const. art. X, s. 5.]

Both the Legislature's and the BCPL's authority over the investment and distribution of the funds is constrained by the provisions of the Wisconsin Constitution mandating that "the proceeds" of certain lands and moneys "shall be set apart as a separate fund" but that "the interest of which and all other revenues derived from the school lands" must be distributed to the beneficiaries. [Wis. Const. art. X, s. 2.]

The Wisconsin Supreme Court has held that moneys considered "proceeds" must be retained as principal and may not be distributed to beneficiaries. [*State ex rel. Owen v. Donald*, 162 Wis. 609, 634 (1916).] Whereas, moneys considered "revenues derived from the school lands" must be distributed to beneficiaries, and may not be withheld as principal. [*Id.* at 630.] Specifically, the Court has held that "the principal [is] to be kept intact but not increased by its earnings, all of which are to be exclusively applied to the support and maintenance of schools and libraries." [*Id.* at 645.]

In 1916, the Court specifically identified certain trust fund moneys as "proceeds" and certain moneys as "revenues." However, the Court only applied these designations to the types of money that the funds were receiving at that time, such as money from the sale of lands and interest on loans. The Court also admitted that certain moneys could arguably be treated as either "proceeds" or "revenues." [*Id.* at 638.] As a result, complying with the constitutional constraints has entailed exercising judgment when deciding which moneys must be treated as principal and which may be distributed.

How moneys are categorized is an important issue in discussing the overall investment of the school trust funds. As described in more detail below, it has been a significant factor in how the BCPL has structured its investment policy. Some options relating to the investment of the funds may be accomplished through making changes to how moneys are categorized, and some changes may be prohibited unless changes are made to how moneys are categorized.

Investment and Accounting Requirements

In 2015, the Legislature mandated that the BCPL invest the school trust funds in accordance with the Uniform Prudent Management of Institutional Funds Act (UPMIFA). [ss. 24.61 (2) (a) and 112.11 (3), Stats.] The UPMIFA requires that investment decisions be based,

among other considerations, on the effects of inflation, the expected total return from income and the appreciation of investments, and the need to make distributions and preserve capital. [s. 112.11 (3) (e), Stats.]

The BCPL's Investment Policy presents the BCPL's interpretation of the manner in which the Constitution constrains the BCPL's implementation of this mandate:

> The Wisconsin Constitution requires that all Common School Fund income is distributed to beneficiaries, with principal balances maintained within the fund. Most other endowments distribute both interest and principal to meet the needs of beneficiaries, and pay out a fixed percentage of the beginning principal balance regardless of investment results. The inability to distribute Common School Fund principal is critical to asset management policy, and requires that Common School Fund assets are managed differently than the peer group of endowments. [*BCPL Investment Policy,* 26 (November 2016).]

Because only "income" may be distributed to beneficiaries, the BCPL's decisions regarding how to invest its assets are influenced not only by the anticipated risk and return of a potential investment, but also whether the moneys generated by the investment will qualify as "principal" or as "income." Some types of investments, such as loans, generate income, while others, such as equity investments, are more likely to generate moneys that do not qualify as income. To accommodate for these constitutional constraints, the BCPL must determine which moneys qualify as "principal" or "interest."

As discussed in the previous section, the Constitution provides that moneys which are "proceeds" must be "set apart" as principal but moneys which are "revenues" (i.e., income) must be distributed. To implement this distinction, the investment policy states that interest, dividends, and short-term capital gains, less management expenses will be treated as income and distributed or added to smoothing accounts. But, "long-term capital gains (gains and losses on the sale of assets held one year or longer) shall be retained and added to the principal of each School Trust Fund at the time earned." The policy calls for the creation of smoothing accounts from moneys that the BCPL considers to be income, as opposed to principal. Although current statutes require that any money recorded as income in a year be distributed to the beneficiaries in that year, the policy states that accounts will be held in reserve indefinitely, until they are distributed in a year in which income is insufficient to meet beneficiary needs. [ss. 20.255 (2) (s) and 43.70 (3), Stats.; *BCPL Investment Policy* 14 (November 2016).]

The BCPL explained that it classified moneys based on its practices for handling timber sales on its land and on accounting standards. [*BCPL Investment Policy* 16 (November 2016).] Most other trust funds that are required to comply with the UPMIFA are required to distinguish between principal and income based on criteria set forth in the Uniform Principal and Income Act (UPAIA), which is the accounting law that was designed to accompany the UPMIFA. The UPAIA was developed "to provide a means for implementing the transition to an investment regime based on . . . the principle of investing for total return rather than a certain level of

'income' as traditionally perceived in terms of interest, dividends, and rents." [1997 UPAIA, Prefatory Note.] The UPAIA arose from concerns that a trustee's duty to invest for total return often conflicts with the duty to make distributions to beneficiaries, when a trust may only distribute moneys meeting the strictest definition of "income."[*Restatement (Third) Trusts, ch. 23,* Introductory Note.]

When Wisconsin adopted the UPAIA, it appears that it brought the school trust funds under the UPAIA. However, it appears that the BCPL Investment Policy was not referring to the UPAIA when it mentioned accounting standards. [ss. 701.0102, 701.1101, 701.1103, 701.1109, and 701.1205, Stats.; *State ex rel. Sweet v. Cunningham*, 88 WI 81, 83, (1894); *State v. Milwaukee*, 152 WI 228, 233 (1912); *State v. Milwaukee,* 158 Wis. 564, 575 (1914): *State ex rel. Owen v. Donald*, 160 Wis. 21, 65 (1915); *State ex rel. Owen v. Donald,* 162 WI 609, 642 (1916); *In re Allis' Will,* 6 Wis.2d 1 (1959); *Wis. Med. Soc'y, Inc. v. Morgan*, 2010 WI 94,¶¶ 73 and 83.]

No court has analyzed the extent to which applying certain provisions of the UPAIA to the school trust funds would violate the Wisconsin Constitution. Some provisions appear to be within the bounds of the constitutional constraints and would provide the BCPL with more detailed guidance in applying the UPMIFA. However, other provisions provide flexibility in dealing with trust principal that may be impermissible under the Constitution.

Options for Discussion

The committee could discuss ways of facilitating the BCPL's implementation of investment practices that are consistent with the UPMIFA duties. A discussion could include consideration of the following:

- Whether to authorize the BCPL to defer the distribution of income by holding it in smoothing accounts.
- Whether to authorize the BCPL to use more sources of moneys to fund smoothing accounts.
- Whether to authorize the BCPL to reinvest income that it considers to be in excess of the amount needed by beneficiaries in a given year, under the condition that the income remains eligible for distribution in a subsequent year.
- Whether to grant the BCPL flexibility to either reinvest or distribute as income the net capital gains from investment for a year.
- Whether to codify the BCPL's current asset allocation policy, with or without modification.
- Whether to codify the BCPL's distribution targets, with or without modification.

Delegation of Investment Management

In 2005, the Legislature authorized the BCPL to delegate to the State of Wisconsin Investment Board (SWIB) investment of the school trust funds, but it has not authorized the

BCPL to delegate investment management responsibilities to any other entity. [2005 Wisconsin Act 25; s. 24.61 (2), Stats.] The BCPL's Investment Policy states that "[m]anagers may be hired to provide specialized asset management capabilities, and will . . . select, buy, and sell specific securities or investments . . . ." [*BCPL Investment Policy* 11 (November 2016).] The policy does not specify whether the BCPL intends this statement to apply just to delegation to SWIB, or to other investment managers as well.

Since 2015, the statutes have provided the BCPL with broad discretion to invest the trust funds in any type of investment, as long as it invests "with the care an ordinarily prudent person in a like position would exercise under similar circumstances." [ss. 25.61 (2) (a) and 112.11 (3), Stats.]

Although current statutes also provide that the BCPL "may delegate to the investment board the authority to invest part or all of the moneys belonging to the trust funds," the statutes significantly constrain how SWIB may invest the funds. Unlike the BCPL, SWIB may only invest the trust funds in a "fixed income investment or fund that invests only in fixed income instruments." [s. 25.61 (2) (c), Stats.] This standard differs not only from the standard that applies to the BCPL's investment of the school trust funds, but also from the standard that applies to SWIB's investment of other funds.

Options for Discussion

The committee could discuss investment functions provided by entities other than the BCPL. A discussion could include consideration of: (1) whether to modify the standard that applies to SWIB's investment of the school trust funds; and (2) whether to authorize the BCPL to delegate to investment managers other than SWIB.

Funding for Investment Expenses

For most of the history of the BCPL, its administrative expenses were funded through general purpose revenue appropriations. In 1937 and 1944, the BCPL requested attorney general opinions regarding whether the BCPL could use school trust fund moneys to fund the expenses of administering its property and investments. In both instances, the attorney general opinions stated that the Wisconsin Constitution prohibits using trust fund moneys to fund administrative expenses. [26 Op. Att'y Gen. 202 (1937); 33 Op. Att'y Gen. 217 (1944).]

The issue was discussed again in 1979, "when an assistant attorney general stated in a memorandum to the Attorney General that the Legislature could, in fact, change the source of financing the board costs to trust fund income . . . ." based on the rationale that "since the Constitution gives the Legislature the authority to direct the nature of trust fund investments, this implies permitting the Legislature the authority to direct how investment costs will be financed." [Legislative Audit Bureau, *An Audit of the Board of Commissioners of Public Lands*, Audit Report 83-9 (March 1983).] In the same year, the statutes were amended to authorize the BCPL to fund its administrative costs using the "gross receipts" of the funds. [Ch. 34, Laws of 1979.] Since that time, the BCPL's expenses have been funded entirely from the BCPL's program

revenue. In 2018, the BCPL reported that its annual expenses are equal to approximately 0.13% of the value of the funds. [BCPL Agency Budget Request 2019-2021.]

Options for Discussion

The committee could discuss modifying how investment expenses are funded. A discussion could include consideration of: (1) whether to provide additional funding sources; (2) whether to place conditions related to hiring internal or external investment managers, such as SWIB, on the BCPL's authority to use school trust fund moneys for administrative expense; or (3) whether to place conditions related to the qualifications of the BCPL's investment staff on the BCPL's authority to use school trust fund moneys for administrative expenses.

Investment Governance

Because the BCPL has been authorized to engage in a broader scope of investment activity than was authorized prior to 2015, the committee could discuss whether any aspects of governance that have applied to SWIB should be applied to the BCPL.

With regard to SWIB, prior to the adoption of 2007 Wisconsin Act 212, the statutes listed the types of investments SWIB was authorized to make, specified the types of actions SWIB was empowered to take to manage assets under its control, and limited the extent to which SWIB could use external managers. Although these provisions remain in the statutes, Act 212 provided that SWIB could act notwithstanding these limitations, as long as its actions are in keeping with the general standard of prudence for SWIB set forth in the statutes. [OAG 11-08.]

SWIB remains subject to other provisions relating to its investment activities, including: (1) goals and reporting requirements relating to working with minority- and disabled veteran-owned investment firms and financial advisers; (2) restrictions on the personal investments of employees; (3) restrictions on employee acceptance of gifts or favors; (4) guidelines for voting proxies; (5) annual financial audits; and (6) biennial performance audits. [ss. 13.94 (1) (df), 25.17 (51), 25.185, 25.156 (4), Stats.; chs. IB 1 and 2, Wis. Adm. Code.]

Options for Discussion

The committee could discuss prescribing governance measures relating to the BCPL's investment function. A discussion could include consideration of: (1) whether to apply to the BCPL any of the governance provisions that applied to SWIB prior to 2007 Wisconsin Act 212; and (2) whether to apply to the BCPL any of the governance provisions that currently apply to SWIB.

REVENUE FROM FINES, FORFEITURES, AND ESCHEATS

The Wisconsin Constitution requires that the following be deposited as principal in the Common School Fund: (1) all moneys and the clear proceeds of all property that may accrue to the state by forfeiture or escheat; and (2) the clear proceeds of all fines collected in the several counties for any breach of the penal laws. [Wis. Const. art. X, s. 2.]

Forfeitures and Escheats

Asset Forfeiture

Generally, state law provides that all property, real or personal, including money, may be subject to forfeiture if it was used in the course of, intended for use in the course of, or directly or indirectly derived from or realized through the commission of a crime. [ss. 961.55 (1) (f) and 973.075 (1) (a), Stats.] A forfeiture action may be commenced either as part of a criminal prosecution, by alleging the forfeiture in the criminal complaint or as a civil action, independent of a criminal case. Under current law, a law enforcement agency make take the following actions with respect to property seized by the agency and forfeited under the applicable statutory proceedings:[1]

- For both drug- and non-drug-related crimes, sell any forfeited property, other than vehicles or money. The agency may retain up to 50% of the proceeds for its publicly reported actual forfeiture expenses and must deposit the balance in the Common School Fund.
- If the property is a vehicle, the agency may retain the vehicle for official use for up to one year. By the end of the year, the agency must choose to either sell or keep the vehicle. If the agency sells the vehicle, then it may retain up to 50% of the proceeds and must deposit the balance in the Common School Fund. If the agency retains the vehicle, it must deposit 30% of the vehicle's value in the Common School Fund and must deposit proceeds from any future sale that exceed that amount in the Common School Fund.
- If the property is money, and the underlying charge is a drug-related crime, an agency may retain up to 50% for its publicly reported actual forfeiture expenses. For a non-drug-related crime, an agency must deposit 100% in the Common School Fund.

[ss. 961.55 (5) and 973.075 (4), Stats.]

As a result of 2017 Wisconsin Act 211, which took effect on April 5, 2018, law enforcement agencies may keep the statutorily authorized portion of forfeitures to offset expenses as described above only if they submit an itemized report of actual forfeiture expenses to the Department of Administration (DOA) for publication on DOA's website. Except for this new expense reporting requirement, state law does not appear to provide a standardized method or timeframe for deposit of forfeitures from law enforcement agencies in the Common School Fund. Based on conversations with the BCPL, funds are deposited from law enforcement agencies on an ad hoc basis.

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[1] For a more thorough explanation of asset forfeiture proceedings, see Legislative Council, 2017 Wisconsin Act 211, Act Memo, available at: https://docs.legis.wisconsin.gov/2017/related/lcactmemo/act211.pdf.

Unclaimed Property

Personal property, not real property,[2] that escheats to the state or is otherwise abandoned is administered under the Uniform Unclaimed Property Act, ch. 177, Stats. Under current law, property is presumed abandoned if unclaimed by its owner for a certain period of time. The time period of inactivity giving rise to the presumption varies depending upon the type of property at issue. For example, intangible property[3] is generally presumed abandoned if unclaimed for five years from the date upon which it became payable or distributable. However, a deposit made by a subscriber for a utility service is presumed abandoned if unclaimed for more than one year after termination of the service for which the deposit was made. [ss. 177.02 and 177.08, Stats.]

Annually, by November 1, holders of unclaimed property that is presumed abandoned must report and generally deliver such property to the Department of Revenue (DOR). The report must cover the previous fiscal year and must include the name and last-known address of any person appearing from the holder's records to be the owner of unclaimed property, if known. Within 120 days before filing the report with DOR, the holder must generally send a notice to the apparent owner, if the holder has an address in its records for the owner, informing him or her that the holder has property in its possession that may be subject to state unclaimed property law. [s. 177.17, Stats.]

Upon receipt of unclaimed property, DOR publishes on its website the names of persons appearing to be owners of unclaimed property worth at least $50 along with the last-known address of each person. DOR also attempts to return unclaimed property to owners by matching state tax return information with the names and addresses provided by holders. According to DOR, after it attempts to match property to owners using tax returns, it then publishes a Class 1 notice of the unclaimed property in newspapers. State law requires that notice be published in a newspaper of general circulation in the county in which the last-known address of the person named as owner is located. If property from a deceased person's estate escheats to the state, DOR must publish notice, including specific provisions, in the official state newspaper at least annually for 10 years. [ss. 177.18 and 177.19, Stats.]

State law requires that DOR retain securities for at least one year before selling them. According to DOR, securities in the agency's possession are systematically liquidated on a rolling basis. State law requires that DOR liquidate other abandoned property within three years after receipt. [s. 177.22, Stats.] According to DOR, it regularly posts property to the state's surplus website for online auction in the third year of possession. Proceeds from liquidated property are divided between the state general fund and the Common School Fund.

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[2] The BCPL is authorized under state law to take possession of any real estate believed to have escheated to the state or to sell the right, title, and interest of the state in any such property. [s. 24.03, Stats.]

[3] "Intangible property" includes money, checks, drafts, deposits, interest, dividends, income, stocks, bonds, amounts due and payable under the terms of insurance policies, and amounts distributable from various trusts. For a full definition, see s. 177.01 (10), Stats.

Current law authorizes DOR to retain, as part of the general fund, a portion of proceeds from unclaimed property to cover the expenses of operating the unclaimed property program and to satisfy any legitimate claims made by property owners in the future. In general, no statute of limitations applies to a claim to recover abandoned property, except that property that escheats to the state from a deceased person's estate must be claimed within 10 years from the date that DOR first publishes the notice described above. [ss. 177.23 and 863.39 (3), Stats.]

According to DOR, in April of 2014, it entered into a memorandum of understanding with the BCPL under which it retained the greater of the three-year average of claims paid or 10% of the value of all property held in the program as a fund balance to satisfy future claims. However, the amount retained under that agreement tended to be significantly more than the average amount of claims paid per year, which has been about $30 million. At the request of the BCPL, a new arrangement was made. Between now and fiscal year 2020, DOR will retain incrementally less for future claims until it reaches a retention rate of $30 million.

DOR is generally authorized to inspect a holder's records in order to determine compliance with state unclaimed property law. However, DOR does not employ any auditors to complete this task and recent changes to state law limit the authority of DOR to engage third-party auditors to search for unreported abandoned property. As a result of 2017 Wisconsin Act 235, DOR may not enter into a contract with a third-party auditor on a contingent fee basis unless the entity or person to be audited is not domiciled in Wisconsin. [s. 177.30, Stats.]

Options for Discussion

The committee could discuss amending statutes relating to the process by which and timeframe in which law enforcement agencies must deposit forfeiture proceeds into the Common School Fund. A discussion could include consideration of: (1) whether to require that forfeiture funds available for deposit in the Common School Fund be reported and remitted on a particular time schedule; (2) whether to require that any such reports and remittances be certified and, if so, by whom; and (3) whether to require or recommend that the Legislative Audit Bureau conduct an audit of how forfeitures are being collected and deposited in the Common School Fund.

The committee could also discuss options for increasing disbursements to the BCPL from the unclaimed property program. A discussion could include consideration of the following: (1) making changes to requirements regarding auditing holders of abandoned property; and (2) requiring that interest earned on the balance retained by DOR to satisfy future claims be deposited in the Common School Fund rather than the general fund.

Monetary Fines and Forfeitures for Breach of the Penal Laws

County Circuit Courts and State Administrative Agencies

Monetary fines and forfeitures may be imposed as penalties for criminal and civil violations of state law, respectively. In certain circumstances, state administrative agencies may directly assess civil forfeitures for violations of the laws under their respective jurisdictions.

Wisconsin circuit courts, located in each county, may impose both civil forfeitures and criminal fines for state law violations, as prescribed by statute.

A person convicted of a fine or forfeiture offense may also be required to pay a variety of costs, fees, and surcharges. In general, such costs are in addition to the base fine or forfeiture amount and are directed towards various administrative expenses and program costs instead of being deposited in the Common School Fund.[4] In certain circumstances, state law also authorizes the agency enforcing the law to retain a portion of an assessed fine or forfeiture to offset the expense of enforcing the law and collecting the penalty.

The Wisconsin Supreme Court has determined that the "clear proceeds" of fines and forfeitures collected for state law violations means net proceeds, calculated by deducting "the actual or reasonably accurate estimate of the costs of the prosecution" from the base amount of the fine. Because the Constitution is generally silent on the definition of "clear proceeds," the Court has stated that the Legislature has the implied power to determine what amount of a fine or forfeiture constitutes "clear proceeds" in a particular circumstance. The Court will generally uphold the Legislature's determination as long as the estimate of costs to be withheld from deposit in the Common School Fund is reasonable. The Court also made clear that the amount left for the school fund may not be merely nominal, and the amount withheld as a deduction must not be for any purpose other than reimbursement of prosecution expenses. [*State ex rel. Commissioners of Public Lands v. Anderson*, 56 Wis. 2d 666 (1973).]

In partial reaction to this constitutional provision, surcharges on statutory fines and forfeitures have been used to generate revenue for specific state or local programs. These surcharges are listed in ss. 814.75 to 814.86, Stats., as created by 2003 Wisconsin Act 139.

With limited exceptions, state law permits counties to retain 10% of base fines and forfeitures for state law violations and requires that 90% be deposited in the Common School Fund. Counties may retain 50% of base fines and forfeitures for state traffic, motor vehicle, and driver's license violations. Fines and forfeitures collected for vehicle size, weight, and load violations are divided as follows: (1) 50% to the Common School Fund; (2) 40% to the state transportation fund; and (3) 10% to the county in which the citation was issued.[5] [s. 59.25 (3) (j) and (k), Stats.]

The portion of fines and forfeitures to be deposited in the Common School Fund are reported to DOA and paid to the BCPL on a monthly basis. [ss. 59.25 (3) (f) 2. and 59.40 (2) (m), Stats.] According to the BCPL, forfeitures imposed by state administrative agencies are deposited in the Common School Fund on a less regular basis than those payments received from the court system.

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[4] For a full list of court fees and surcharges, see the Wisconsin Circuit Court fee, forfeiture, fine, and surcharge tables, available at: https://www.wicourts.gov/courts/circuit/docs/fees.pdf.

[5] For a chart explaining the distribution of fines and forfeitures collected by state courts, see Appendix V of Legislative Fiscal Bureau, Wisconsin Court System, Informational Paper 57 (Jan. 2017), available at: https://docs.legis.wisconsin.gov/misc/lfb/informational_papers/january_2017/0057_wisconsin_court_system_informational_paper_57.pdf.

Municipal Courts

Municipal courts may assess civil forfeitures for violations of municipal ordinances, but do not have jurisdiction over violations of state law. Because such penalties are imposed under municipal ordinance rather than state law, the municipality in which a citation was issued retains 100% of the base forfeiture. [s. 778.105, Stats.; *President & Trustees of Platteville v. Bell*, 43 Wis. 488 (1878).]

Certain activities may be regulated both under state law and under municipal ordinance. Therefore, whether conviction of a certain violation will result in a deposit in the Common School Fund depends upon a variety of factors, including under which authority a citation is issued. This commonly arises, for example, in circumstances involving traffic or parking violations. State law authorizes municipalities to adopt ordinances regulating traffic and parking as long as those ordinances are in strict conformity with state statutes regarding the same, noncriminal activities. [s. 349.06, Stats.]

In a municipality that has adopted such ordinances, a person could be cited either under state law or municipal ordinance for a noncriminal traffic violation. If the citation is issued under state law, then it would be prosecuted in a circuit court and any assessed forfeiture would be divided between the county and the Common School Fund, as described above. If, however, the citation is issued under a municipal ordinance, then it would be prosecuted in the applicable municipal court and the assessed forfeiture would be retained by the municipality.

Options for Discussion

The committee could discuss options relating to fines and forfeitures. A discussion could include consideration of: (1) whether to modify the amount of a given fine or forfeiture that is to be retained by the counties or deposited in the state transportation fund; (2) whether to require or recommend that the Legislative Audit Bureau conduct an audit of how fines and forfeitures are being collected and deposited in Common School Fund; and (3) whether to modify the process by which administrative agencies remit forfeitures to the BCPL.

ZR:RES:jal