



**STATE OF WISCONSIN  
DEPARTMENT OF JUSTICE**

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November 13, 2018

**SENT VIA INTERDEPARTMENTAL MAIL**

The Honorable Terry Katsma  
Chair, 2018 Legislative Council Study Committee on the Investment and Use of the School  
Trust Funds  
State Representative  
Room 208 North, State Capitol

The Honorable Lena C. Taylor  
Vice-Chair, 2018 Legislative Council Study Committee on the Investment and Use of the  
School Trust Funds  
United States Senator  
Room 5 North, State Capitol

**SENT VIA US MAIL**

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**SENT VIA EMAIL**

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Re: BCPL

Dear Members of the 2018 Legislative Council Study Committee on the Investment and Use  
of the School Trust Funds:

Thank you for your service on this important committee. As Chairman of the Board of  
Commissioners of Public Lands for the past 4 years, I am doubly interested in the findings of  
your study. As you are heading into the decision-making stage of the process, I would like to  
offer you some of my thoughts and insights from the past four years.

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1. MANAGEMENT OF BCPL TRUST FUNDS / INVESTMENT POLICY

With respect to the management and investment of our trust funds, BCPL is bound by the limitations of constitutional provisions that were adopted a long time ago. It is also true that for many years, we were bound by statutory investment limitations that were even more restrictive than the constitution. It was only recently that legislation was passed that opened up BCPL's investment opportunities to the prudent person standard.

To implement this new investment authority, BCPL staff, pursuant to direction from the Board, worked with experts from the UW School of Business to develop an investment policy and asset allocation model that fit within our constitutional constraints while considering the needs and concerns of our stakeholders. The resulting investment policy:

1. Provides diversification of trust fund investments;
2. Has a goal of increasing the total return of the trust funds;
3. Maintains a steady stream of distributable income for the beneficiaries; and
4. Provides protection from future volatility by deferring some distributable income into a smoothing fund that could be used to enhance distributions in years where investment returns were lower.

We noted that the principal growth of the Common School Fund was slowing down. We listened to our beneficiaries' concerns and considered the generational equity aspects of a permanent fund. We were convinced that we needed to diversify the portfolio and take on more risk while still taking our constitutional constraints into consideration. This meant changing our investment mix in a way that maintained a reliable stream of distributions that did not expose the beneficiaries all at once to the volatility of the markets. In essence, we thought it was important to implement our prudent investment authority in a prudent manner.

All of us would love to have more income and less risk. But that's not quite how the world works. Higher returns generally come with higher risk and volatility. In a world with no external limitations, a total return endowment model that allows distributions of principal is an interesting option. However, we have external limitations here. Wisconsin's constitutional restrictions prevent us from reaching into principal to make distributions during years of low or negative returns. The bottom line is that our investment policy is designed to allow more investment flexibility within our constitutional constraints.

Our investment policy includes target allocations for stocks and other categories of investments. We have been selective in buying when opportunities arise, but we have not yet reached our goals. Considering the current markets' high prices and volatility, I believe that

caution is warranted. We will continue on this path toward diversification in a prudent manner.

## 2. STATE TRUST FUND LOAN PROGRAM

The State Trust Fund Loan Program is a key piece of the BCPL's investment policy. For many years, the program has provided municipalities a simple way to borrow money for public projects while providing a low-risk, reasonable rate of return for the trust funds. I understand some committee members see this as a problem, but I am struggling to understand the nature of that perceived problem. I believe that during my tenure, BCPL has done a reasonable job of setting interest rates that provide a fair return for trust funds based on the level of overall risk of the loans and the availability of prepayment options. It is my understanding that only one banker testified at your hearings and his testimony stated that his bank's interest rates were lower than BCPL and his institution was more flexible than BCPL. Based on his testimony, why would the committee feel the need to restrict or otherwise amend the statutes governing State Trust Fund Loan Program? This seems to fall into the category "If it's not broke, why fix it?"

## 3. OPTIONS FOR FURTHER REVIEW OR PROPOSED LEGISLATION

It is my understanding that Leg Council has presented the committee with three distinct roadmaps.

1. Draft legislation that expressly authorizes BCPL to conduct its business in accordance with its new investment policy.
2. Draft "messy legislation" (in the words of Legislative Council staff attorney) with a goal to getting BCPL closer to the "foundation model"
3. Amend the constitution to expressly authorize BCPL to manage its trust portfolio in accordance with a total return model.

With respect to #1, I believe that BCPL has properly managed and distributed its trust funds within the constraints of current law. I acknowledge the current statutes do not expressly prescribe every action taken by BCPL (such as the establishment and funding of a "smoothing account"). However, I am confident that BCPL's actions have been done in accordance with reasonable interpretations of the pertinent statutes. If the committee determines that additional statutory guidance is advisable, as a believer in limited government, I urge caution to avoid the development of an overly restrictive statutory structure.

I do not support option #2. I have sworn an oath to protect and uphold the Wisconsin Constitution. I am concerned about the prospect of having to defend legislation that affects

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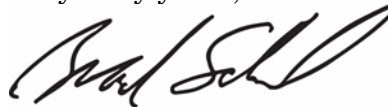
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my own agency if that legislation is so “messy” that its constitutionality is in question right from the beginning. This sounds like a cure that is worse than any underlying disease.

As for option #3, I would encourage caution. Our constitution is the foundation upon which we build our framework of laws. I believe that we should not change that foundation unless we are clear on our understanding of the path forward and we have given our citizens and stakeholders the opportunity for input and answers. Our citizens recently rejected a proposed constitutional amendment and it would be worthwhile to develop an understanding on why such amendment was so soundly rejected by our citizens. While I appreciate the time and effort this committee has already invested in this study, I believe more avenues for citizen input should be available before we start drafting a constitutional amendment. BCPL’s investment policy is still relatively new and the financial markets still volatile. I think it would be far more prudent to give BCPL the opportunity to proceed with its transition under its investment policy before starting down a different path.

In summary, I believe that BCPL’s current course of action in managing its trust funds and distributing the interest has proven to be prudent under the law and under market conditions. I believe that BCPL should be given more time to transition its investment portfolio before considering significant changes to statutes or the constitution. I thank you again for your service on this committee and thank you for consideration of my comments.

Very truly yours,



Brad D. Schimel  
Wisconsin Attorney General

BDS:JB:alm

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