STATE OF KANSAS

OFFICE OF THE ATTORNEY GENERAL

2ND FLOOR, KANSAS JUDICIAL CENTER, TOPEKA 66612

ROBERT T. STEPHAN
ATTORNEY GENERAL

MAIN PHONE: (913) 296-2215
CONSUMER PROTECTION: 296-3751

June 5, 1980

ATTORNEY GENERAL OPINION NO. 80-119

John E. Lang
Pottawatomie County Counselor
405 Lincoln Avenue
Wamego, Kansas

Re: Cities and Municipalities--Investment of Idle Funds--Amount of Interest Rates on Investments

Synopsis: When the state treasurer, pursuant to K.S.A. 12-1676a, issues weekly advisory memorandums to county treasurers that specify rates of interest that are equivalent to the most recent bank discount rates on 91-day U.S. Treasury bills, the state treasurer is complying with the requirements of that statute. Such bank discount rates constitute the "average yields" on said treasury bills, as determined by the federal reserve banks, and the amounts thereof provide the benchmark for the rates of interest specified in clauses (b), (d) and (e) of K.S.A. 1979 Supp. 12-1675, which is the first in a series of statutes governing the investment of idle funds by local units of government. Cited herein: K.S.A. 1979 Supp. 12-1675, 12-1676, K.S.A. 12-1676a, 75-4212.

*   *   *

Dear Mr. Lang:

Based on advice and information provided you by Pottawatomie County's financial advisor, you have requested our opinion as to whether the state treasurer is providing county treasurers with the information required by K.S.A. 12-1676a, which states:

> "The state treasurer shall issue a weekly advisory memorandum to county treasurers concerning _rates of interest to be paid under this act_." (Emphasis added.)

It is the emphasized portion of this statute that has prompted your inquiry, since you indicate that your county's financial advisor suggests that this statute requires the state treasurer to furnish county treasurers weekly with the "yield rate" on 91-day U.S. treasury bills, whereas in fact the state treasurer has been furnishing the "discount rate" on said treasury bills. You have indicated that there is a significant difference between the amount of interest to be earned by applying the "yield rate" to invested idle funds and the amount of interest presently earned by applying the "discount rate" to the same funds. For example, you note that for one weekly period the difference between the "yield rate" and the "discount rate" (using a $10,000 treasury bill for purposes of computation) amounted to .473%. That is, you suggest that moneys invested under that "discount rate" as prescribed by the state treasurer earned .473% less than the amount statutorily authorized, and you have observed that this difference would "amount to a substantial increase in the amount of moneys a municipality could expect and seek from investment of idle funds." In a letter subsequent to your initial letter of inquiry, you have indicated that "the difference on idle fund investments in Pottawatomie County alone amounts to $92.00 per day."

It is in light of these observations that you have requested our opinion. Specifically, you have asked whether the "rates of interest" referred to in K.S.A. 12-1676a are the "discount rates" presently furnished by the state treasurer thereunder or the higher "yield rates" your financial advisor has suggested is intended by the legislature under K.S.A. 12-1675 et seq.

Initially, it should be noted that the legislative "act" referred to in K.S.A. 12-1676a, as quoted above, is Chapter 394 of the 1974 Session Laws of Kansas. K.S.A. 12-1676a was enacted as section 3 thereof, with the other two substantive sections of that enactment effecting amendments to K.S.A. 1973 Supp. 75-4212 and 12-1676. Included in 75-4212 by these amendments was the following:

> "Interest on time deposit, open accounts shall be at a rate equal to the average yield before taxes received on ninety-one (91) day United States treasury bills as determined by the federal reserve banks as fiscal agents of the United States at its most recent public offering of such bills prior to each particular deposit."

Very similar language was included by the 1974 enactment in 12-1676, as follows:

> "Interest paid by commercial banks on time deposit, open accounts and certificates of deposit as authorized herein shall be at a rate equal to the average yield before taxes received on ninety-one (91) day United States treasury bills as determined by the federal reserve banks as fiscal agents of the United States at its most recent public offering of such bills prior to the inception of such deposit contract."

It is clear, therefore, that the phrase "rates of interest to be paid under this act" in K.S.A. 12-1676a was intended by the 1974 Legislature to refer to the rates of interest specified in the foregoing quoted provisions of 75-4212 and 12-1676, i.e., the rate of interest on a time deposit, open account of state moneys and the rates of interest to be paid by commercial banks on time deposit, open accounts and certificates of deposit under the laws governing investment of idle funds by local units of government (K.S.A. 12-1675 et seq.). The rate of interest in each instance was to be equal to the "average yield" on 91-day treasury bills as determined by the federal reserve banks.

It should be noted that, even though the 1974 amendment to 75-4212 remains substantially unchanged, the previously quoted language in 12-1676 was removed in 1976 (L. 1976, ch. 79, §3). Notwithstanding this amendment, however, it is our opinion that the state treasurer's duty under 12-1676a was not altered thereby. The requirements of 75-4212 still necessitate a weekly reporting of the "average yield" on 91-day treasury bills, and such information also still has relevance to the laws governing the investment of idle funds by local governments. K.S.A. 1979 Supp. 12-1675 is the first of a series of statutes governing the investment of moneys by local political subdivisions. By this statute, specified local governments are authorized to invest "moneys which are not immediately required for the purposes for which the moneys were collected or received." It also specifies in clauses (a) through (e) the types of investments which may be made. Clauses (b), (d) and (e) thereof have pertinence to the questions at hand; they authorize the following investments:

> "(b) time deposit, open accounts or certificates of deposit for periods of not less than thirty (30) days in commercial banks or trust companies located in such investing governmental unit; or if no commercial bank or trust company is located in such investing governmental unit, then in commercial banks or trust companies located in the county or counties in which all or part of such investing governmental unit is located; or if such appropriate eligible commercial banks or trust companies cannot or will not make such deposits available to the investing governmental unit at <u>interest rates equal to or greater than the average yield before taxes received on ninety-one day United States treasury bills as determined by the federal reserve banks, as fiscal agents of the United States, at its most recent public offering of such bills</u> prior to the inception of such deposit contract or the maximum rates such banks or trust companies may pay on such deposits under applicable law or regulation, whichever is lower, then in commercial banks or trust companies located within the county or in the counties of the state of Kansas adjacent to the county or counties in which all or part of such investing governmental unit is located; . . . (d) repurchase agreements of less than thirty (30) days' duration with commercial banks or trust companies, located in such investing governmental unit, for direct obligations of, or obligations that are insured as to principal and interest by, the United States government or any agency thereof; if no commercial bank or trust company is located in such investing governmental unit, or if no commercial bank or trust company located in such investing governmental unit is willing to enter into such an agreement with the investing governmental unit

at an interest rate equal to or higher than a rate equal to two (2) percentage points below the average yield before taxes received on ninety-one day United States treasury bills as determined by the federal reserve banks, as fiscal agents of the United States, at its most recent offering of such bills prior to the inception of such contract, then such repurchase agreements may be entered into with commercial banks or trust companies located in county or counties in which all or part of such investing governmental unit is located; if no bank in such county or counties is willing to enter into such an agreement with the investing governmental unit at an interest rate equal to or higher than rate equal to two (2) percentage points below the average yield before taxes received on ninety-one day United States treasury bills as determined by the federal reserve banks, as fiscal agents of the United States, at its most recent offering of such bills prior to the inception of such contract then such repurchase agreements may be entered into with commercial banks or trust companies located in the state of Kansas; or (e) United States treasury bills or notes with maturities as the governing body shall determine, but not exceeding six (6) months. The investment authorized in clause (e) herein shall be utilized only if the appropriate eligible commercial banks or trust companies, located in the investing governmental unit or in the county or counties in which all or a part of such investing governmental unit is located if no such bank or trust company is located within such governmental unit, cannot or will not make the investments authorized in clause (b) herein, available to the investing governmental unit at interest rates equal to or greater than the average yield before taxes received on ninety-one day United States treasury bills as determined by the federal reserve banks as fiscal agents of the United States at its most recent public offering of such bills prior to the inception of such deposit contract or the maximum rates such commercial banks or trust companies may pay on the investments authorized in clause (b) herein under applicable law or regulation, whichever is lower." (Emphasis added.)

The emphasized language in each of the foregoing quoted clauses provides the key to your inquiry. It is abundantly clear from these emphasized provisions that the legislature intended that the benchmark interest rate in each of the instances described in these clauses is in an amount related to the "average yield" on 91-day treasury bills, as determined by the federal reserve banks. That is, the legislature has tied the interest rates applicable to the investment of idle funds under clauses (b), (d) and (e) of 12-1675 to the federal reserve's determination of the average yield on 91-day treasury bills. The question then becomes one of ascertaining whether such "average yield" is the "bank discount rate" or the "yield rate" on such treasury bills.

Such determination necessarily involves an understanding of this terminology. As to the "bank discount rate," we reviewed numerous resource materials containing substantially identical formulas and explanations as to the calculation of the "bank discount rate" or "discount yield" on treasury bills. One such explanation was found in the excerpts from the Thorndike Encyclopedia of Banking and Financial Tables, 1979 Yearbook, which you provided us; in quoting from Treasury Department Circular No. 300, Fourth Rev., March 9, 1973, it states as follows:

> "'The bank discount rate on a Treasury bill may be ascertained by (1) subtracting the sale price of the bill from its face value to obtain the amount of discount; (2) dividing the amount of discount by the number of days the bill is to run to obtain the amount of discount per day; (3) multiplying the amount of discount per day by 360 (the number of days in a commercial year of 12 months of 30 days each) to obtain the amount of discount per year; and (4) dividing the amount of discount per year by the face value of the bill to obtain the bank discount rate.'" Id. at Part II, p. 20.

On the other hand, it is our understanding that your county's financial advisor distinguishes the "discount yield" derived by the foregoing formula from the "yield rate" (sometimes referred to as "investment yield" or "coupon equivalent rate"), which reflects a true annualized percentage rate of return. We certainly agree with your county's financial advisor that the "discount yield" does not represent a true annualized percentage rate of return. This difference is acknowledged by all of the materials concerning such computations that we reviewed, including documents issued by federal reserve banks. The excerpts from Thorndike's you provided us also indicates that treasury bills "are widely quoted and traded on a rate basis often called 'yield,'" even though such bills "are actually quoted and figured on a bank discount basis." Id. at Part II, p. 17. Furthermore, as subsequently noted in that same excerpt, "[t]he investment return or yield on a Treasury bill is at a higher rate than the discount basis." Id.

We do not quarrel with this differentiation between the "discount yield" and the "investment yield." Nor do we take issue with the fact that, in a strict accounting sense, the term "yield" more accurately refers to the annualized rate of return or "investment yield," rather than the "discount yield" or "bank discount rate." However, the legislature did not use "average yield" in an unqualified way in 12-1675; rather, it required that the particular interest rates referenced in clauses (b), (d) and (e) of that statute be based upon the "average yield" on 91-day treasury bills as determined by the federal reserve banks. Thus, the most important element necessary to resolving your inquiry is the determination of the federal reserve's interpretation of "average yield."

In resolving this question, we have reviewed and analyzed materials provided us by you and your county's financial advisor, as well as other materials and information supplied through the Kansas Bankers Association. Particularly relevant to our consideration were the documents and notices published or issued by the federal reserve banks. For example, The Wall Street Journal of Tuesday, January 22, 1980, reported the federal reserve's notice as to the "yields" on the U.S. Treasury's sale of short-term bills pursuant to the auction held on January 21, 1980. The "average rate" (average yield) stated therein for 13-week (91-day) bills was the "bank discount rate." This is evident from the following explanation in this article as to the computation of such "rates" or "yields":

> "Yields are determined by the difference between the purchase price and face value. . . . The percentage rates are based on the discount from par and are calculated on a 360-day year rather than the 365-day year on which yields of bonds and other coupon securities are figured."

We reviewed numerous other similar notices in the Journal, and all of them were of essentially the same format, provided the identical type of information and included the foregoing explanation as to the computation of "yields."

In conjunction with one such notice in the Journal as to the yield on 13-week bills maturing on April 10, 1980, we examined the Federal Reserve Bank of Kansas City's "Notice of Acceptance" of the subscription for certain of these bills. The "average yield" shown on this notice for bills with this maturity date was identical to the average rate stated in the Journal. Our computations revealed that this "average yield" was in fact the bank discount rate. In addition, our random examination of several issues of the Federal Reserve Bulletin revealed that the average yields for treasury bills reported in these bulletins are quoted on a bank discount basis.

Finally, we have noted the explanation offered to your county's financial advisor in a letter dated March 12, 1980, from James F. Kichline, Director, Division of Research and Statistics, Federal Reserve System. Mr. Kichline was responding on behalf of Paul A. Volcker, Chairman, Board of Governors, Federal Reserve System, to an inquiry substantially the same as the one under consideration here. In his letter, Mr. Kichline acknowledged that "other sources often report Treasury bill rates on a 'bond-equivalent' basis," but he states that "[b]oth the Federal Reserve Board and the U.S. Treasury Department publish the average yield established at Treasury bill auctions on a 'bank discount' basis." (Emphasis added.)

Therefore, it is our opinion that when the state Treasurer, pursuant to K.S.A. 12-1676a, issues weekly advisory memorandums to county treasurers that specify rates of interest that are equivalent to the most recent discount yields (bank discount rates) on 91-day treasury bills, the state treasurer is complying with the requirements of that statute. Such discount yields are, in fact, the "average yields" on said treasury bills, as determined by the federal reserve banks, which yields provide the benchmark for the rates of interest specified in clauses (b), (d) and (e) of K.S.A. 1979 Supp. 12-1675.

Before concluding, we believe it appropriate to acknowledge and express our appreciation for the significant amount of research supporting your request. In particular, your financial advisor was most helpful in providing us with resource materials, and through periodic consultations and communications, he has assisted in defining the various issues attending your request. Such assistance has greatly facilitated our consideration of your inquiry.

Very truly yours,

Robert T. Stephan

ROBERT T. STEPHAN
Attorney General of Kansas

W. Robert Alderson

W. Robert Alderson
First Deputy Attorney General

RTS:WRA:phf