Senate Bill 2330
North Dakota Retirement and Investment Office (RIO)
Testimony in support of SB 2330 before the House Finance & Taxation Committee
Representative Craig Headland, Chair
Representative Jared Hagert, Vice Chair

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I. <u>Introduction</u>

The Retirement and Investment Office (hereinafter "RIO") was created by the 1989 Legislative Assembly to capture administrative and investment cost savings in the management of the investment program of the State Investment Board (SIB) and the retirement program of the Teachers' Fund for Retirement (TFFR). Statutory authority for the agency is found in North Dakota Century Code chapter 54-52.5 and the programs are governed by chapters 21-10 (SIB) and 15-39.1 (TFFR).

The State Investment Board has the statutory responsibility to administer the investment program for 28 funds including the Legacy Fund, TFFR, PERS, and WSI. It also maintains contractual relationships for the investment management of multiple political subdivisions and governmental funds. Currently the SIB is responsible for the investment of the Legacy Fund, seven pension funds and 20 other non-pension funds for a total of 28 separate client funds with an overall fund value of more than $19.2 billion as of January 31, 2023.

II. <u>Testimony in support of S.B. 2330</u>

During 2022 the Legacy and Budget Stabilization Fund Advisory Board (Advisory Board) selected a consultant, RVK, Inc. to assist with a Legacy Fund Asset Allocation Study. As a result of this study and recommendations by RVK, changes to the Legacy Fund Investment Policy Statement were approved by both the Advisory Board and the SIB in December 2022. At the last meeting, it was discussed that RVK and the Advisory Board intend to meet in Q2 2023 to review recommendations for updates to the Legacy Fund asset allocation and discuss a pacing schedule. RVK did note in their presentations to the Advisory Board that changes to the structure of the instate investment program in code could improve returns for the Legacy Fund and enhance opportunities for the in-state investment program. S.B. 2330 represents such improvements.

The bill as presented enables larger investment returns for the Legacy Fund which in turn enable a higher level of earnings and a greater capacity for future in-state investments. The bill obtains these benefits by increasing the capacity to invest in higher earning investments as part of its general allocation, by scaling the in-state equity investments to align with the expected pacing of their investment, and by creating a more predictable stream of earnings with a percent of market value definition for earnings.

These structural changes include removing the infrastructure revolving loan fund. To date no loans have been made under this section. These loans have a fixed rate in statute of 1.5% and as such repress the earning potential of the in-state investment program. The legislature could allocate funding for such loans from other sources of income, this change merely reflects that at 1.5% rate the loans should not be considered an investment. The remainder of the fixed income portion of the in-state investment program will continue to be managed by the Bank of North Dakota.

The change of in-state equity allocation from 10% to 3% recognizes that the pacing of in-state equity investments will be slow (only a portion of the 10% capacity would be invested over the next ten years given the opportunity set) and tilted towards early stage and growth investments for the next few years as there are initially fewer equity investment opportunities in-state than fixed income opportunities. By reducing the percentage of in-state equity, more investment capacity is available for longer term higher earning private market investments that have returns that will grow the eventual capacity for in-state equity investments to a larger amount than otherwise would be given the anticipated pace of equity investment. It is estimated that in a ten-year investment horizon, the expected pacing of equity investments, the amount of capacity for in-state equity investment would double given the larger Legacy Fund returns enabled by this change.

A percent of market value definition of earnings, much like the Land Trust definition of earnings, provides a much more predictable earnings stream for spending and enables more asset allocation options to maximize returns for a given level of risk and better fund implementation options. The result would be higher Legacy returns over time. The current realized gains and income definition requires the asset allocation to focus on income and capital gains generation with the asset allocation and implementation plans. Freeing the Legacy fund from this constraint increases the potential earnings stream and reduces uncertainty for allocating earnings.

III. Summary

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