Senate Bill 2330
Neutral Testimony relating to SB 2330 before the Senate Industry and Business Committee
Senator Doug Larsen, Chair
Senator Greg Kessel, Vice Chair

RVK, Inc. is currently engaged by the Legacy Fund Advisory Board on a project basis to assist with a strategic asset allocation study, inclusive of in-state investments. RVK Principals, Jim Voytko (President) and Josh Kevan (Sr. Consultant), are available to offer expert testimony on Senate Bill No. 2330 as it relates to investment implications for the Legacy Fund. We appreciate the potential opportunity to offer our thoughts based on the extensive analysis we have conducted for the Legacy Fund Advisory Board over the past year.

As it relates to the contents of SB 2330, as we understand, it makes the following changes, which we believe in sum are both material and generally positive to the investment of Legacy Fund Assets, including the probable future returns of the Legacy Fund.

Section 1.

21-10-11

Fixed Income Investments within the state – target allocation is reduced from ten percent to six percent.

RVK Note: *A reduction of this requirement adds to expected long-term returns for the Legacy Fund, as it reduces the required allocation to lower returning investments. Over the long-term, this should increase the flow of returns to the state via the spending policy (discussed below)*

Infrastructure loans to political subdivisions, at a fixed target rate of 1.5 % - is removed.

RVK Note: *Removal of this provision increases expected long-term returns to the Legacy Fund, as it (a) eliminates a required allocation to loans that would generate very low investment returns and (b) also removes a potential liquidity constraint related to the potential call on these funds allowing incrementally greater use of higher returning illiquid private investments.*

Equity investments in the state – target allocation is reduced from ten percent to three percent.

RVK Note: *A reduction of this requirement adds to expected long-term returns to the Legacy Fund, as it significantly enhances the flexibility to pursue the highest returning investments regardless of domicile and does not force as large of a pre-specified % of assets into a particular market without prior knowledge of the eventual opportunity set. It also reduces the compounding liquidity constraints placed on legacy fund assets from the potential call on these assets. Yet, given the size of the Legacy Fund, the 3% target represents a substantial pool of capital for potential investment within North Dakota, a pool in-state capital pool that will grow in dollar terms along with the future growth of the Fund.*

Section2.

21-10-12

Earnings – definition is changed from a net income approach to a percentage of market value approach.

RVK Note: *We believe this is an important change to the structure of the Legacy Fund. This adjustment is beneficial to the investment strategy and operation of the investment portfolio and provides greater predictability of distribution amounts. By removing the net income approach to distributions, the strategic asset allocation decision can be focused on maximizing long-term wealth that the Legacy Fund represents for North Dakota by eliminating the need to make explicit trade-offs between current income and future growth.*

Additional Considerations

We offer the following points of consideration as potentially beneficial further enhancements:

1) *Targeting in state investment as a specific $ amount rather than a % target of the strategic asset allocation.*
    a. *This could allow for greater precision in targeting an appropriate investment sizing. Percent of market value of the legacy fund assets at any point in time is not necessarily related to the size of the opportunity set for investment in the state.*
2) *Benchmark return for in state **equity investments** set as the same for other **similar equity investments**.*
    a. *As currently drafted, in state equity investments will target a return that is lower than other similar non-in-state investments as it will be set against a diversified portfolio that includes equity and debt. This is a mismatch. All equity investments, ideally, should require the same rate of return as similar equity investments.*

Josh Kevan, Senior Consultant, RVK, Inc.