2011 SENATE INDUSTRY, BUSINESS AND LABOR

SB 2312

2011 SENATE STANDING COMMITTEE MINUTES

Senate Industry, Business and Labor Committee
Roosevelt Park Room, State Capitol

SB 2312
February 1, 2011
Job Number 13795

☐ Conference Committee

Committee Clerk Signature	Eva Lubelt

Explanation or reason for introduction of bill/resolution:

Relating to the investment of funds in the legacy fund

Minutes: Testimony Attached

Chairman Klein: Called the hearing to order.

Senator Robinson: Introduced the bill. He stated that it is straight forward, that there was just confusion in the wording. He handed out amendments to fix the wording. He commented that capitol is hard to come by and that the bill isn't suggesting that we invest all but a portion of it. He stated that because these dollars were generated within the state that a portion should be used to benefit the state.

Senator Schneider: Has a question about the last two lines, would this have to pass with a super majority?

Senator Robinson: Those two sentences are what they would like to have changed with the amendment and do away with the set percentage.

Senator Schneider: Be invested for the purpose of a return on an investment to the fund or general economic development?

Senator Robinson: It could be both. The need for capitol is often the stumbling block and capitol is the key to economic development. If they expect a return on their investment or a tool to spur economic development, in either case they would be benefitting the state. They would send these dollars elsewhere to benefit economic development in other states, should they not be thinking about some portion being spent here.

Chairman Klein: Commented that the money that is sent out-of-state is because they want to make money to improve the funds they are managing and want to see growth.

Senator Robinson: We have had many good years with the state investment board but I think the last couple of years have not been very good. There have been years we have been struggling as a Legislature to access economic development funds.

Chairman Klein: Said that there are some people who feel that any state dollars should not be used for economic development and to take what they would believe is their dollars would be an issue.

Senator Robinson: Said that is right but that you would think they would also be excited about growth and prosperity for the state.

Senator Laffen: Asked if the state investment board made investments in things that are not really guaranteed like economic development.

Senator Robinson: Said that they are not guaranteed.

Senator Andrist: Said that he believed in aggressive economic development. He feels that people perceive the legacy fund as not something that should not be used for risk based investments. The permanent oil and gas trust fund would be a better vehicle for risk based investments and economic development projects.

Senator Robinson: Said that it's his understanding that there is another bill with that concept built into the bill. He agrees that people want security with that legacy fund but doesn't think they suggested that it be invested in CD's.

Senator Grindberg: He shares his perspectives and lends his support to the bill. He feels that some of this should be used for North Dakota. He continues with how he thinks it can be used for North Dakota.

Questions and Discussion on the fund and how it can be used.

Opposition

Bill Shalhoob, North Dakota Chamber of Commerce: He said with the added amendment he doesn't feel he is in as much disagreement with the bill. He hopes the fund continues to grow.

Neutral

Connie Flanagan, Fiscal and Investment Officer: Testimony Attached. Talked also about not knowing who would be making the decisions for the asset allocation and the investment policy for that fund, which will be the governing body.

Comments

Chairman Klein: Closed the hearing.

2011 SENATE STANDING COMMITTEE MINUTES

Senate Industry, Business and Labor Committee
Roosevelt Park Room, State Capitol

SB 2312
February 2, 2011
Job Number 13882

☐ Conference Committee

Committee Clerk Signature	Eva Lubbert

Explanation or reason for introduction of bill/resolution:

A Bill for an Act to create and enact a new section to chapter 21-10 of the North Dakota Century Code, relating to the investment of funds in the legacy fund

Minutes: Discussion and Vote

Chairman Klein: Opened the hearing on Senate Bill 2312.

Discussion

Senator Andrist: Motioned a do not pass.

Senator Nodland: Seconded the motion.

Discussion

Roll Call Vote: Yes-6 No-1

Senator Nodland to carry the bill

Date: 2/2/2011
Roll Call Vote # 1

2011 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 2312

Senate Industry, Business and Labor Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken: ☐ Do Pass ☑ Do Not Pass ☐ Amended ☐ Adopt Amendment

☐ Rerefer to Appropriations ☐ Reconsider

Motion Made By Senator Andrist Seconded By Senator Nodland

Senators	Yes	No	Senators	Yes	No
Chairman Jerry Klein	✓		Senator Mac Schneider	✓	
VC George L. Nodland	✓		Senator Philip Murphy		✓
Senator John Andrist	✓				
Senator Lonnie J. Laffen	✓				
Senator Oley Larsen	✓				

Total (Yes) 6 No 1

Absent 0

Floor Assignment Senator Nodland

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

SB 2312: Industry, Business and Labor Committee (Sen. Klein, Chairman) recommends **DO NOT PASS** (6 YEAS, 1 NAYS, 0 ABSENT AND NOT VOTING). SB 2312 was placed on the Eleventh order on the calendar.

2011 TESTIMONY

SB 2312

SB 2312
North Dakota Retirement and Investment Office
Testimony to Senate IBL Committee
Connie Flanagan, Fiscal and Investment Officer
February 1, 2011

Good morning Mr. Chairman and Members of the Committee. My name is Connie Flanagan and I am the Fiscal and Investment Officer for the Retirement and Investment Office (RIO), the agency which administers the State Investment Board's (SIB) investment program. I am here today to provide testimony in a neutral position on Senate Bill 2312.

The SIB is currently responsible for guiding the investment of approximately $5.2 billion in assets for eight pension funds and 17 other insurance-type funds. Their investments are divided into two investment trust funds – the Pension Trust and the Insurance Trust. The Pension Trust is made up of only qualified pension funds whose monies must be invested exclusively for the benefit of their participants. The two largest pension funds in the Pension Trust are the TFFR and PERS plans. The Insurance Trust is made up of mainly insurance-type funds, but also includes funds that do not qualify as pension funds and would like to benefit from the cost savings of being pooled with other funds' assets. The largest fund in the Insurance Trust is the Workforce Safety and Insurance (WSI) Fund. Other Insurance Trust funds include the State Fire and Tornado Fund and the State Bonding Fund.

The attached diagram shows the flow of responsibility within the state investment board program, as described in Chapter 21-10 of state law. Section 21-10-02.1 indicates that "(t)he governing body of each fund enumerated in section 21-10-06 shall establish policies on investment goals and objectives and asset allocation for each respective fund." Section 21-10-06 includes a list of the funds that must be invested with the SIB and also indicates that other state agencies, institutions and political subdivisions may request the services of the SIB if they so desire.

The top section of the attached diagram shows all of the "governing bodies" that currently utilize the services of the SIB. Each of these governing bodies has provided the SIB with a Statement of Investment Goals, Objectives and Policies, which includes their desired asset allocation and other pertinent information regarding the investment of the fund. The asset allocation of each fund is based on that fund's liabilities, income requirements, risk tolerance and liquidity needs. The governing bodies present their investment policies and asset allocations to the SIB for implementation.

As indicated in sections 21-10-02 and 21-10-06, the SIB is responsible for implementing the asset allocations within the parameters of the governing bodies' investment policies. To accomplish this, the SIB hires external investment managers to invest portfolios under specific mandates. The staff of RIO assists the SIB in choosing investment managers and strategies by researching firms and conducting due diligence which are provided to the SIB prior to them making a hiring decision. No direct investing is performed by RIO staff.

When determining investment manager mandates, the SIB is governed by section 21-10-07 of the ND Century Code which states, "The state investment board shall apply the prudent investor rule in investing for funds under its supervision. The "prudent investor rule" means that in making investments the fiduciaries shall exercise the judgment and care, under the circumstances then prevailing, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to

speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income."

It is our observation that the first sentence (beginning on line 7) of SB 2312 contradicts the existing laws in chapter 21-10 governing the SIB, as under current law it is not the SIB who establishes the policies and asset allocations for the funds it invests, but rather the governing bodies of those funds.

The second sentence of the bill, relating to the investment of at least fifteen percent of the legacy fund balance in projects and investments based in the state, may cause a conflict with the Prudent Investor Rule as previously defined. This requirement may force the SIB to make investments that do not meet the Prudent Investor Rule due to the limited opportunities available for investment in North Dakota. RIO staff has only been able to identify six publicly traded companies based in North Dakota. The total market capitalization of these six companies is approximately $6 billion with approximately $4 billion of that being MDU Resources. Additionally, the reference to "projects" in the bill is unclear. As stated earlier, the SIB only invests through external investment managers.

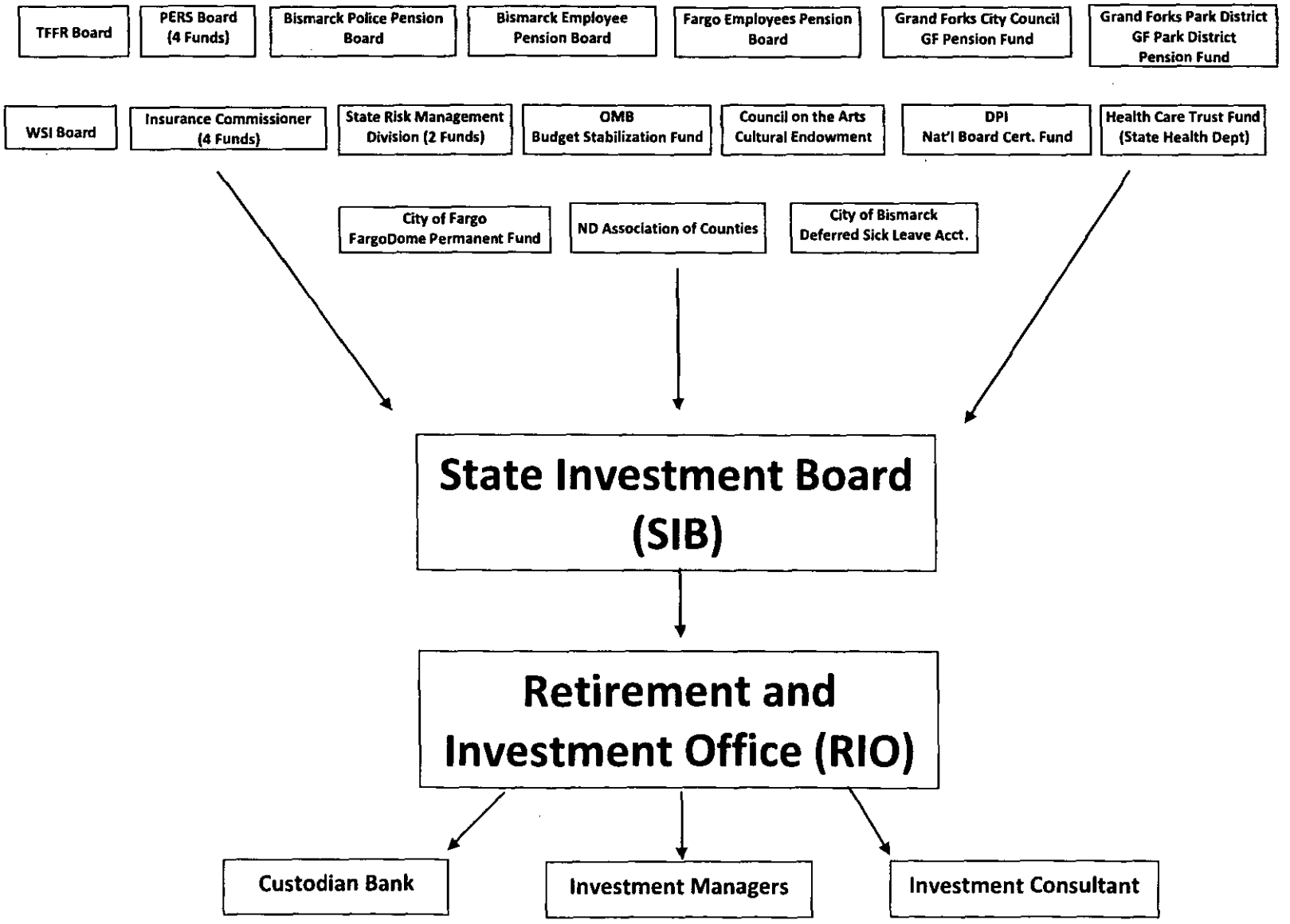
The SIB has been cognizant, however, of the advantage of identifying investments that benefit North Dakota companies while still meeting the Prudent Investor Rule. The SIB has investments in two limited partnerships that target investment opportunities in the Midwest, including North Dakota. The limited partnerships are managed by the InvestAmerica family of funds and are supported by its Fargo, North Dakota office. I have attached a description of the investments made through this relationship in which the SIB committed $22.5 million.

Additionally, the SIB also participates in the Bank of North Dakota (BND) Match Loan program. Businesses that are either starting or expanding their operations within North Dakota are eligible to receive loans from BND with very competitive rates that are tied to Treasury rates. BND determines the credit worthiness of the business and makes the final decision on whether or not to grant the loan. Once approved, the SIB provides the funding for the loan in exchange for certificates of deposits (CDs) that match the rate and duration of the loan. These CDs are backed by the full faith and credit of the bank and the State of ND. BND assumes all the risk of the loans and charges an additional amount to the borrower above the rate on the CDs. The SIB has committed $200 million in revolving capital to this program with $120 million currently invested.

The SIB also utilizes BND to manage fixed income portfolios for both the pension and insurance trust. The portfolios are separately managed index funds benchmarked against the Barclays Government/Credit index. This relationship has been in place since the 1980s. The total assets under management in the two accounts total $163.7 million. The SIB pays an investment management fee of 6 basis points or $98,000 to BND annually.

To conclude my testimony, RIO staff is available to provide assistance with any amendments the Committee may wish to draft relating to SB 2312. Thank you for your time and consideration.

State Investment Board Process



State Investment Board Process

Client Responsibilities: (Per NDCC 21-10-02.1) The governing body of each fund (client) shall establish policies on investment goals and objectives and asset allocation that must include:

- Acceptable rates of return, liquidity and levels of risk
- Long-range asset allocation goals

State Investment Board Responsibilities: (Per NDCC 21-10):

- Implement client asset allocations
- Apply Prudent Investor Rule when investing for fund under its supervision
- Approve general types of securities for investment
- Set policies and procedures regulating securities transactions on behalf of the clients
- Select custodian servicer
- Select investment director and/or investment consulting service
- Create investment pools

State Investment Board Process

Retirement and Investment Office Staff Responsibilities (on behalf of SIB):

- Administer overall investment strategy
- Advise SIB on ways to maximize risk/return opportunities within each asset class
- Act as liaison between SIB and managers, consultant and custodian
- Monitor individual clients' investment guidelines and asset allocations
- Maintain separate accounting for client accounts

Investment Manager Responsibilities:

- Implement specific mandates or "investment missions"
- Make buy/sell decisions based on investment guidelines
- Report to RIO Staff on regular basis
- Provide education to SIB

Custodian Bank Responsibilities:

- Safe-keep assets
- Settle trades
- Record-keeper

Investment Consultant Responsibilities:

- Performance measurement of investment managers
- Manager search assistance
- Provide education to SIB
- Special projects

State Investment Board Investments in North Dakota

InvestAmerica (Lewis and Clark funds I and II)

The SIB is invested directly in Lewis and Clark Private Equities, LP and L&C Private Equities II, LP managed by the InvestAmerica family of funds and supported by its North Dakota office established in 1995. Total capital committed to these two funds is $22.5 million. These funds have invested in a number of ND and upper Midwest regional companies. Investments in particular companies are offered pro rata to each of the Funds that InvestAmerica manages. The following investments with a North Dakota presence have been made from the InvestAmerica Family of Funds that include Lewis and Clark and L&C II.

1. A North Dakota based specialty baking company. The company produced specialty items such as cakes and breads sold through high end retail outlets.
2. An agricultural based Software Company. The investment originated when the company was located in Southern Minnesota. As the company grew, the research and development department was moved to North Dakota. The company was recently acquired by a large national Ag Products company and the research and development team has remained in North Dakota.
3. A specialty employment company that provides employers with a total media access package (print, radio, TV and internet) to advertise for employees. The company's initial market was eastern North Dakota and that market remains the company's most successful market. They have now developed a presence in four other Midwest markets and are gaining momentum as an internet based job search engine.
4. A Wyoming based manufacturer of remote power generation equipment. As this company grew, they expanded into Western North Dakota to serve the rapidly growing oil and gas exploration industry.
5. A highly specialized North Dakota company that provides agricultural and climate modification services throughout the world. This small company that originated in a small Western North Dakota town has grown into an international multimillion dollar company.
6. A strong North Dakota based regional construction company. This Western North Dakota based company provides specialized construction services throughout the Midwest.
7. A growing regional snack food manufacturer located in Western Minnesota that sources many Ag products from North Dakota producers.

Important to the future of venture capital in North Dakota, InvestAmerica has operated a North Dakota office since 1995 and is continually looking to develop investments in the North Dakota region.

Bank of North Dakota (BND)

The SIB also participates in the BND Match Loan program. Businesses that are either starting or expanding their operations within North Dakota are eligible to receive loans from BND with very competitive rates that are tied to Treasury rates. BND determines the credit worthiness of the business and makes the final decision on whether or not to grant the loan. Once approved, the SIB provides the funding for the loan in exchange for certificates of deposits that match the rate and duration of the loan. These CDs are backed by the full faith and credit of the bank and the State of ND. BND assumes all the

risk of the loans and charges an extra 25 basis points to the borrower above the rate on the CDs. The SIB has committed $200 million in revolving capital to this program with $120 million currently invested.

The SIB utilizes BND to manage fixed income portfolios for both the pension and insurance trust. The portfolios are separately managed index funds benchmarked against the Barclays Government/Credit index. This relationship has been in place since the 1980s. The total assets under management in the two accounts total $163.7 million. The SIB pays an investment management fee of 6 basis points or $98,000 to BND annually.

11.0765.01001
Title.

Prepared by the Legislative Council staff for
Senator Robinson
January 28, 2011

PROPOSED AMENDMENTS TO SENATE BILL NO. 2312

Page 1, line 9, replace "include a provision" with "allow"

Page 1, line 9, replace "at least fifteen percent" with "a portion"

Page 1, line 10, after the first "in" insert "economic development"

Page 1, line 10, remove "and investments based"

Renumber accordingly