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## LEGACY FUND EARNINGS COMMITTEE

Tuesday, September 22, 2020  
Roughrider Room, State Capitol  
Bismarck, North Dakota

Representative Chet Pollert, Chairman, called the meeting to order at 10:00 a.m.

**Members present:** Representatives Chet Pollert, Josh Boschee, Jeff Delzer, Craig Headland, Keith Kempenich, Don Vigasaa; Senators Joan Heckaman, Ray Holmberg, Jerry Klein, Jessica Unruh-Bell, Rich Wardner

**Members Absent:** None

**Others present:** See [Appendix A](#)

**It was moved by Senator Wardner, seconded by Senator Klein, and carried on a voice vote that the minutes of the July 8, 2020, meeting be approved as distributed.**

### LEGACY FUND STATUS

Mr. David J. Hunter, Executive Director and Chief Investment Officer, Retirement and Investment Office, presented information ([Appendix B](#)) regarding the status of the legacy fund. He said the legacy fund investment returns for fiscal year 2020 were 4.23 percent, which was 0.16 percent less than the fund's benchmark. He said the legacy fund had a value of \$7.25 billion and earnings available to transfer to the general fund at the end of the biennium of \$339 million as of July 31, 2020. He said the State Investment Board supports the implementation of the percent of market value calculation. He said the 5-year average of the legacy fund balance through June 30, 2020, was \$5.53 billion, which would provide \$332 million of earnings based on a spending rate of 6 percent per biennium. He said the State Investment Board is required to follow the prudent investor rule for managing legacy fund investments. He said the board has authorized up to \$300 million of legacy fund investments in the Bank of North Dakota's match program, which provides loans to North Dakota businesses.

In response to a question from Senator Wardner, Mr. Hunter said legacy fund earnings could be held as cash until required to be transferred to the general fund. He said investment advisers recommend keeping the earnings invested as long as possible because the return potential is higher if the earnings remain invested.

In response to a question from Representative Delzer, Mr. Allen H. Knudson, Legislative Budget Analyst and Auditor, Legislative Council, said the legacy fund earnings are transferred biennially based on the provisions of the constitution. He said annual transfers of legacy fund earnings would require a constitutional change.

Chairman Pollert said the 2019 Legislative Assembly budgeted for \$100 million of legacy fund earnings in the 2019-21 biennium as a part of a plan to transition from spending the earnings in the current biennium to spending the earnings in the subsequent biennium. He said the 2019 Legislative Assembly was prudent to limit the use of legacy fund earnings in the current budget especially with the current economic recession. He said any excess legacy fund earnings in the 2019-21 biennium may be needed to offset any potential general fund revenue shortfall resulting from the Coronavirus (COVID-19) pandemic.

In response to a question from Representative Headland, Mr. Hunter said the investment policy for the legacy fund does not restrict the allowable investments. He said the State Investment Board must consider all possible investments based on risk and returns to comply with the prudent investor rule. He said the board carefully selects fund managers who select investments that comply with the principles for responsible investment established by the United Nations.

Representative Headland said some citizens have expressed concerns about certain foreign investments and a lack of investment within the state.

Representative Kempenich said the Legislative Assembly has considered legislation in the past to restrict the investments of the state's funds and to divest investments in certain countries. He said investments may change over time based on changes to public opinion, regulations, or economic conditions.

In response to a question from Representative Delzer, Mr. Hunter said \$90 million of the \$300 million authorized is currently invested in the Bank of North Dakota's match program.

## BUDGETING INFORMATION

Mr. Adam Mathiak, Senior Fiscal Analyst, Legislative Council, presented a memorandum entitled [Transfer of Legacy Fund Earnings](#). He said transferring legacy fund earnings to a special fund may reduce general fund budgeting uncertainty associated with the volatility of the earnings. He said using a special fund helps to identify how legacy fund earnings are spent. He said the constitution requires legacy fund earnings to be transferred to the general fund but does not restrict the use of legacy fund earnings after being transferred to the general fund.

Mr. Mathiak presented a memorandum entitled [Common Schools Trust Fund - Investments and Distributions](#). He said the percent of market value distribution method became effective in the 2009-11 biennium for the common schools trust fund after voter approval of a constitutional amendment. He said investment earnings of the common schools trust fund, which include unrealized gains and losses, have exceeded the annual distributions since fiscal year 2010, except for fiscal years 2015 and 2016. He said the investment fee rate for the common schools trust fund was 0.49 percent in fiscal year 2019 compared to 0.39 percent for the legacy fund.

In response to a question from Senator Wardner, Mr. Mathiak said the investment earnings of the common schools trust fund exceeded the distributions every biennium since implementation of the percent of market value calculation. He said the principal of the common schools trust fund has not been affected by the distributions or investment losses. He said the potential impact on the principal of the common schools trust fund depends on whether the prior earnings accumulate in the fund or become principal at the end of each biennium. He said principal and earnings for the common schools trust fund are not defined by constitutional or statutory provisions.

Mr. Mathiak presented a memorandum entitled [Percent of Market Value Calculation](#) regarding the estimated amounts that would have been available to spend from a legacy earnings fund if the provisions of proposed bill draft [\[21.0111.02000\]](#) had been implemented for the 2019 legislative session. He said the estimated amount available to spend would have ranged from \$39.5 million based on 1 percent of the 5-year average of legacy fund assets to \$516.2 million based on 10 percent of the 2-year average of legacy fund assets. He said the estimated amounts retained as a reserve in the legacy fund would have ranged from \$415.8 million to a shortfall of \$60.9 million based on the \$455.3 million of legacy fund earnings transferred at the end of the 2017-19 biennium.

Mr. Knudson presented a memorandum entitled [Budget Outlook - 2019-21 and 2021-23 Bienniums](#). He said the general fund revenues are based on the 2019 legislative revenue forecast and adjustments for the Office of Management and Budget's September 2020 revised revenue forecast. He said anticipated deficiency appropriations for the 2019-21 biennium total \$54.4 million which could be offset by estimated unspent appropriations ("turnback") of \$118.4 million. He said estimated cost-to-continue items for the 2021-23 biennium total \$42.8 million in addition to \$35 million of estimated increases for state employee health insurance premiums. He said the projected shortfall at the end of the 2021-23 biennium totals \$735.1 million based on the preliminary budget outlook. He said additional spending requests may increase the shortfall while additional sources of funding may be available to address the shortfall.

## BILL DRAFTS

Mr. Mathiak presented a bill draft [\[21.0111.02000\]](#) relating to the establishment of a percent of market value method for determining the amount of legacy fund earnings available to be spent each biennium and to the creation of a legacy earnings fund. He said the first section of the bill draft requires the State Investment Board to manage the investment of the newly created legacy earnings fund. He said the second section of the bill draft establishes the legacy earnings fund, requires the legacy fund earnings to be transferred to the fund, designates a reserve balance, and provides for the calculation of the amount available for appropriation or transfer based on the percent of market value. He said the percent of market value calculation is based on 6 percent of the 5-year average value of the legacy fund assets.

Senator Wardner said reinvesting a portion of the legacy earnings into the principal of the legacy fund will help the fund to grow and increase the future earnings.

Representative Boschee said a limit on the reserve balance could be considered during the 2021 legislative session.

Representative Kempenich said establishing a spending plan for the legacy earnings fund may address concerns about the legacy earnings fund becoming another general fund.

**It was moved by Representative Delzer, seconded by Representative Kempenich, and carried on a roll call vote that the bill draft [21.0111.02000] relating to the establishment of a percent of market value method for determining the amount of legacy fund earnings available to be spent each biennium and to the creation of a legacy earnings fund be approved and recommended to the Legislative Management.** Representatives Pollert, Boschee, Delzer, Headland, Kempenich, and Vigesaa and Senators Heckaman, Holmberg, Klein, Unruh-Bell, and Wardner voted "aye." No negative votes were cast.

Mr. Mathiak presented a bill draft [21.0178.01000] relating to a legacy fund earnings committee. He said the bill draft would continue the legacy fund earnings committee for the 2021-22 interim with the same committee membership and study purpose.

**It was moved by Representative Headland, seconded by Senator Klein, and carried on a roll call vote that the bill draft [21.0178.01000] relating to a legacy fund earnings committee be approved and recommended to the Legislative Management.** Representatives Pollert, Boschee, Delzer, Headland, Kempenich, and Vigesaa and Senators Heckaman, Holmberg, Klein, Unruh-Bell, and Wardner voted "aye." No negative votes were cast.

**It was moved by Senator Holmberg, seconded by Senator Klein, and carried on a voice vote that the Chairman and the Legislative Council staff be requested to prepare a report and the bill drafts recommended by the committee and to present the report and recommended bill drafts to the Legislative Management.**

**It was moved by Senator Unruh-Bell, seconded by Senator Wardner, and carried on a voice vote that the committee be adjourned sine die.**

No further business appearing, Chairman Pollert adjourned the committee at 12:30 p.m.

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Adam Mathiak  
Senior Fiscal Analyst

ATTACH:2