

House Bill 1400
North Dakota Retirement and Investment Office (RIO)
Neutral Testimony relating to HB 1400 before the House Industry, Business,
and Labor Committee
Representative Scott Louser, Chair
Representative Mitch Ostlie, Vice Chair

Scott Anderson, CFA, MBA – Chief Investment Officer
Janilyn Murtha, JD, MPAP – Executive Director

I. Introduction

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 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 roughly \$18 billion as of October 31, 2022.

These assets under management have grown from about \$4 billion in 2010 and continue to grow from investment returns and contributions to the Legacy Fund, pension plans, and insurance funds. The combination of the growth of AUM, the number of individually managed funds, and the complexity of mandates such as the Legacy Fund have increased the need for staff resources, infrastructure and new scalable investment processes that can enhance the performance of client funds while reducing the net cost of management of those funds when manager fees are considered.

The RIO team worked closely with the SIB and TFFR Boards to evolve the governance structure of both Boards and Board staff relations to establish a foundation of governance that supported program growth. During this past biennium the State Investment Board established two new committees to support this growth including a Governance and Policy Review Committee as well as an Investment Committee to better support the needs of the program. These changes in particular occurred over the course of many meetings as through board discussion the SIB recognized the need to evolve its own governance to provide the agility and ability needed to manage a growing amount of assets in complex investment strategies.

Anticipating that this question might come before the legislature during the current session, the feasibility of management of the Land Trust was referred by the SIB to the Governance and Policy Review Committee and recommendations were brought forward to the full SIB. The SIB discussion focused on whether there was a business case for management of these assets.

II. Neutral to HB 1400

RIO is testifying as a neutral party relating to this bill because we recognize that the decision regarding management of Land Trust assets is a policy decision for the Land Board and the Legislature. We can provide information on the business case prepared by RIO staff relating to management of Land Trust Assets. The attached presentation summarizes this business case. We also recognize that there are existing provisions in NDCC 21-10 that allow the assets of the Land Trust to be outsourced and managed by the SIB. Specifically, NDCC 21-10-06(3) allows any North Dakota government entity to engage the investment services of the SIB. Respectfully, RIO believes that management of the assets of the Land Trust by RIO would have many positive benefits to the State of North Dakota and to the Land Trust itself. The managing of the Land Trust assets by RIO would lower the cost and increase capabilities of the Land Trust by taking advantage of scale benefits as outlined in the attached presentation which will be provided to you.



LAND TRUST INVESTMENT OPPORTUNITIES

Scott M Anderson, CFA

Ryan Skor, CPA

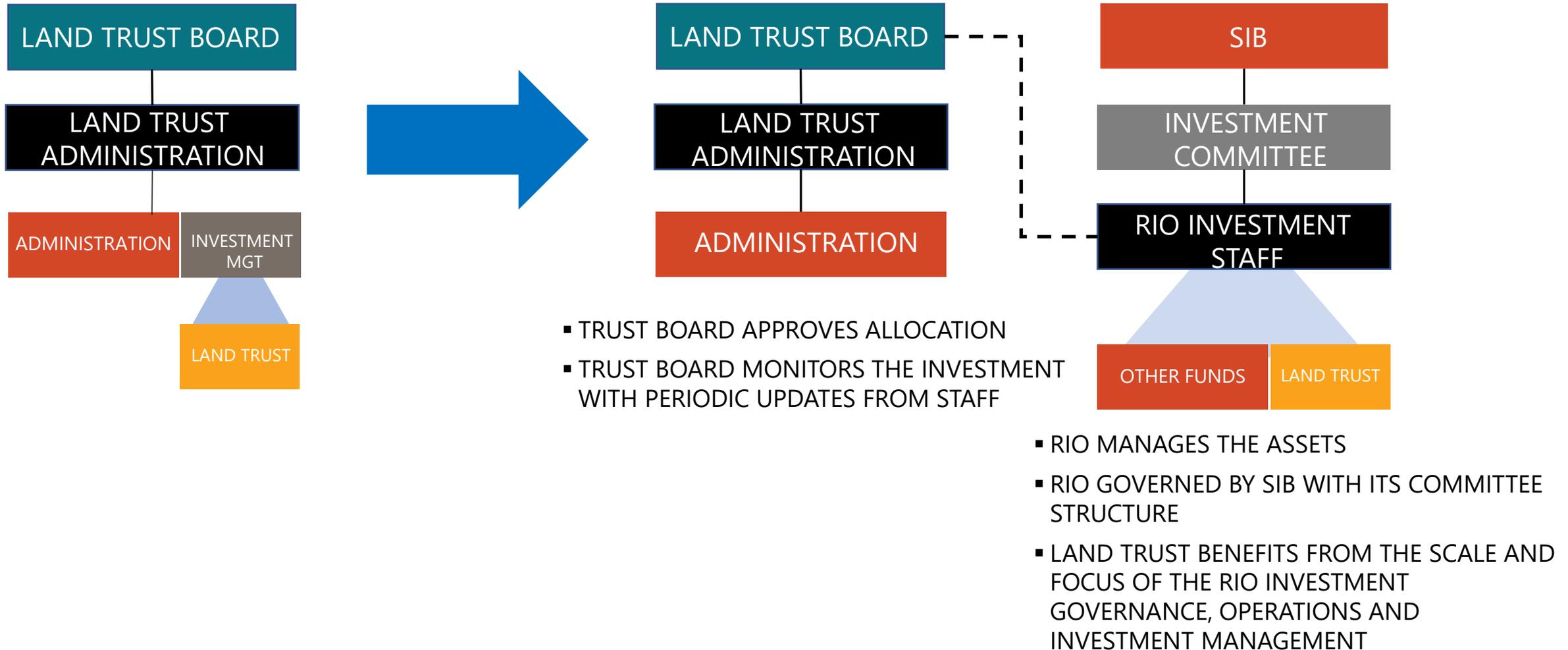
Jan Murtha, JD, MPAP

October 25, 2022

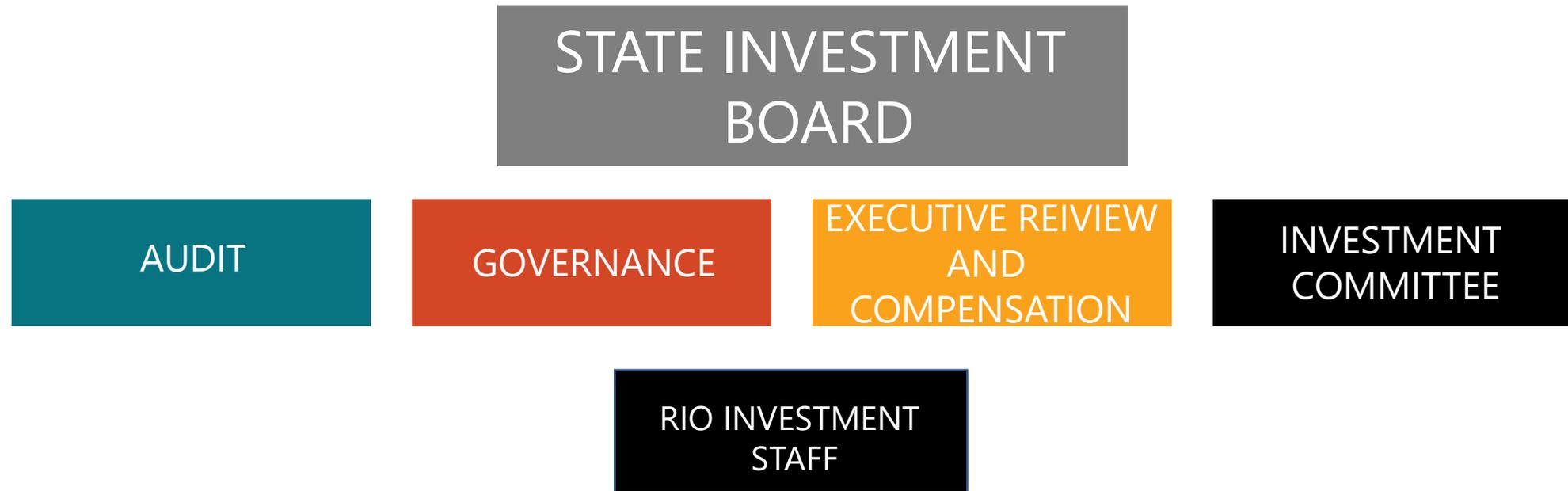
NORTH
Dakota
Be Legendary.

Retirement & Investment

CONCEPT: TRUST FUND OUTSOURCED AS A CLIENT FUND TO THE STATE INVESTMENT BOARD (SIB)

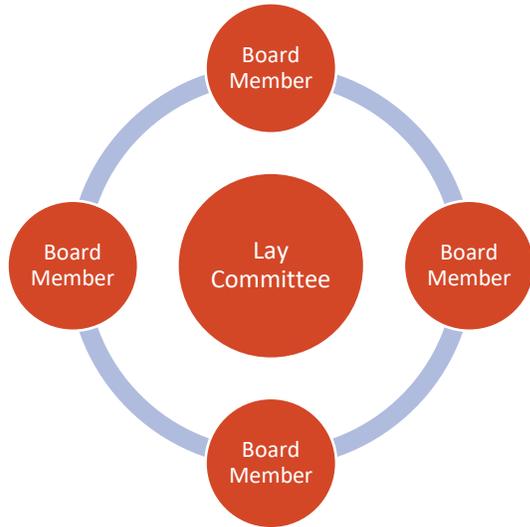


ENABLES A MORE ADVANCED SCALED GOVERNANCE PROCESS AND LOWER GOVERNANCE COSTS



- LAND INVESTMENT PROGRAM CAN GROW WITHOUT NEEDING TO GROW THE SIZE OF THE BOARD AND NUMBER OF COMMITTEES
- SIB GOVERNANCE SPECIALIZES IN ASSET MANAGEMENT AND IS STRUCTURED FOR THAT PURPOSE
- LAND TRUST DOES NOT NEED TO RECREATE OR DUPLICATE ANY GOVERNANCE PROCESSES
- ENHANCEMENTS TO INVESTMENT GOVERNANCE ARE DEVELOPED, RESOURCED AND IMPLEMENTED ACROSS MANY MORE FUNDS AND ASSETS

THREE INVESTMENT COMMITTEE ARCHETYPES



- Operates like the board but can meet more frequently or more quickly
- Able to have focused and in-depth investment conversations
- Able to summarize for full board approval
- Lacks investment expertise
- Most investment decisions are at the board level with little delegation to staff

More Board Level



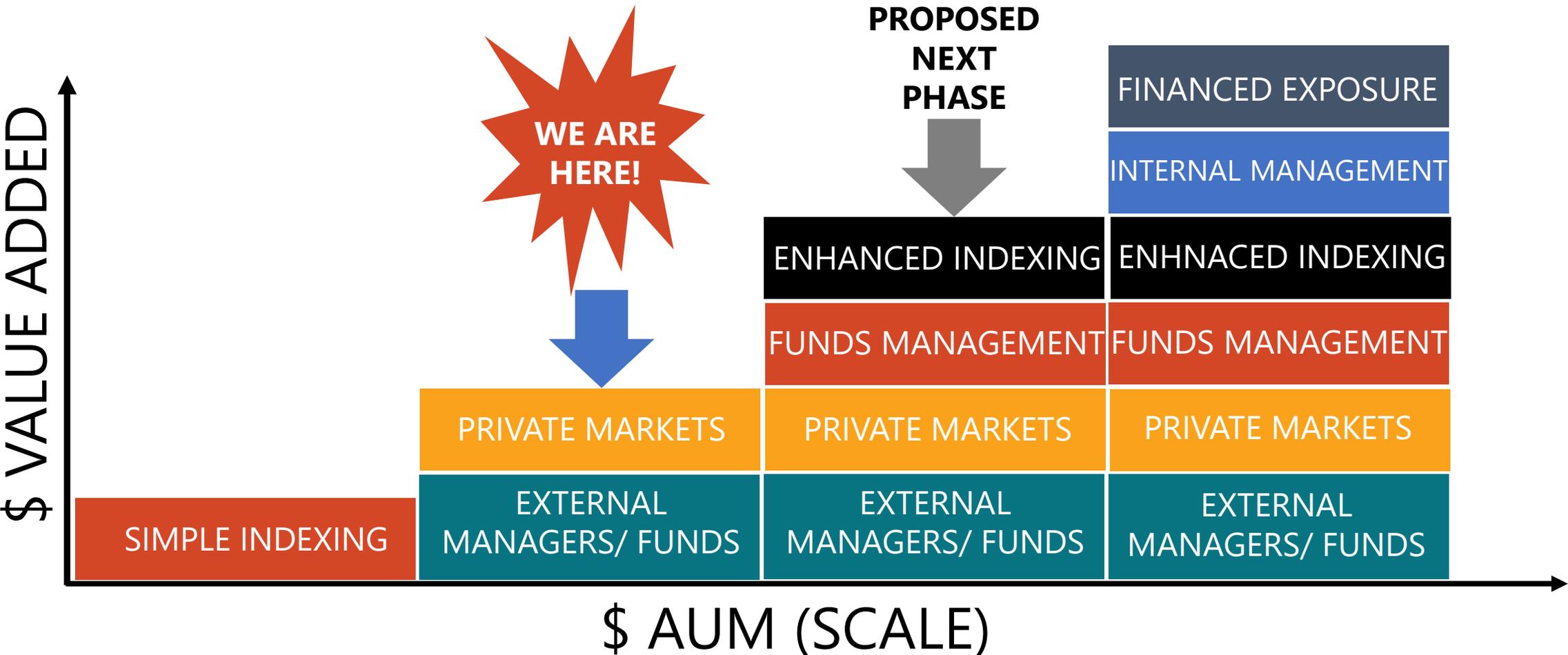
- Able to meet more frequently or more quickly
- Able to have focused and in-depth investment conversations
- Able to summarize for full board approval when necessary but also can delegate decisions to staff
- Staff participation enables delegation, quick decision and better implementation
- Outside and independent investment expertise
- Most investment decisions are at the investment committee or staff level

More Advisory



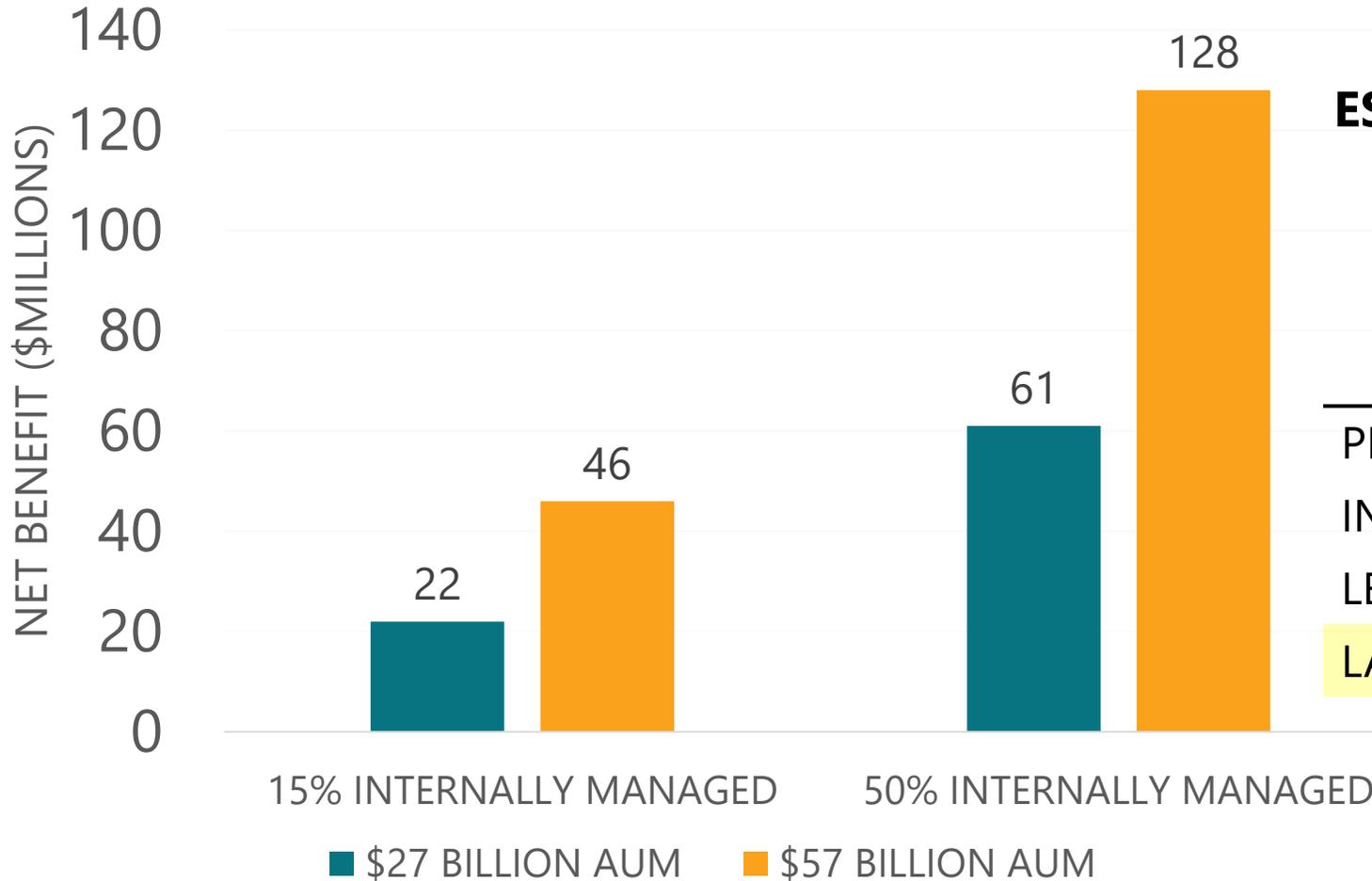
- Can meet more frequently or more quickly
- Able to have focused and in-depth investment conversations
- Able to summarize for full board approval
- Outside and independent investment expertise but need to ensure shared decision making
- Most investment decisions are at the board level
- Less delegation and associated benefits

UNLOCKS SIGNIFICANT OPPORTUNITY FOR IMPROVED RETURNS AND LOWER COSTS



- LOWER COST THAN WITH EXTERNAL MANAGERS
- APPLIED WHERE THERE IS A COST/BENEFIT
- ENABLES ENHANCED LIQUIDITY MANAGEMENT, REBALANCING AND EXPOSURE MANAGEMENT

THE BENEFIT OF INTERNAL INVESTMENT SCALES WITH THE SIZE OF THE COMMITMENT



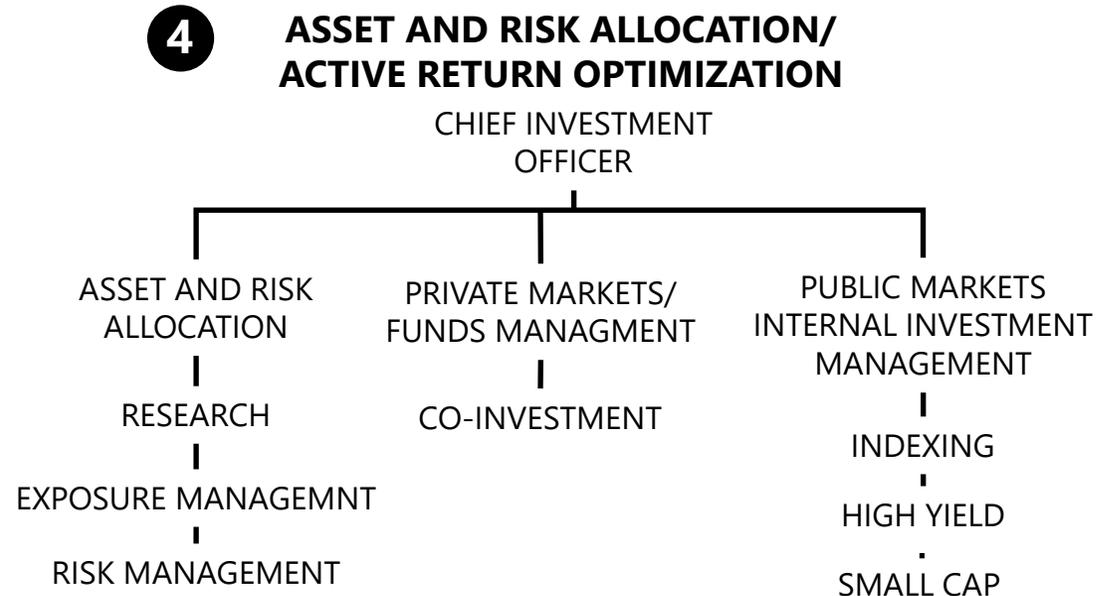
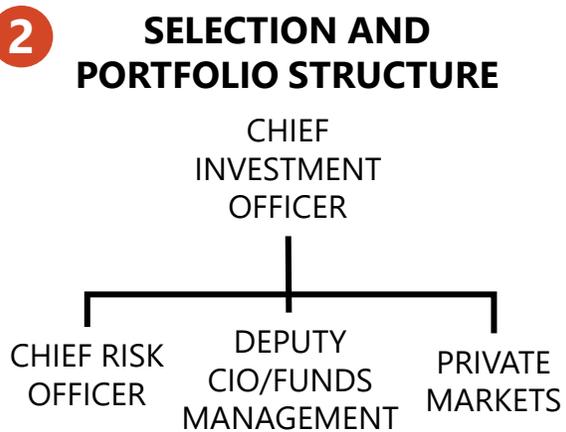
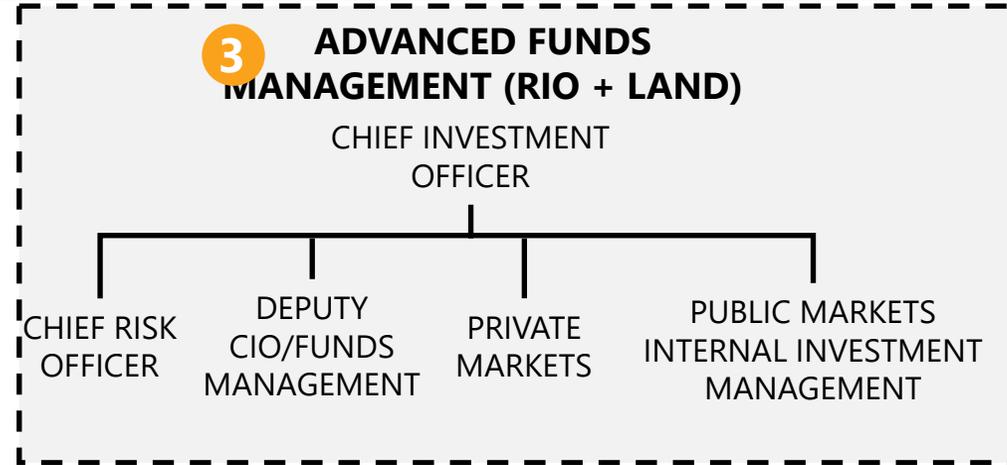
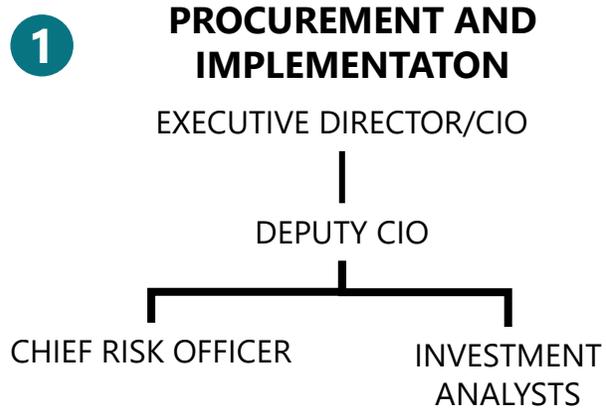
ESTIMATED ANNUAL SAVINGS PER YEAR (\$27 BILLION AUM)

PLAN	15% OF ASSETS		50% OF ASSETS	
	\$(MIL)	%	\$(MIL)	%
PENSION	\$6	0.08%	\$16	0.23%
INSURANCE	\$3	0.10%	\$8	0.26%
LEGACY	\$7	0.09%	\$21	0.25%
LAND TRUST	\$7	0.08%	\$16	0.23%

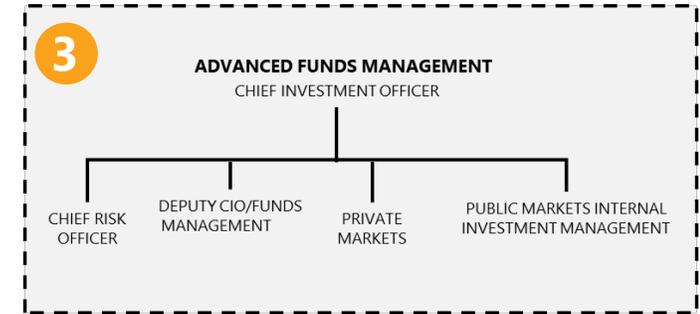
THERE ARE OTHER COST AND RETURN/RISK BENEFITS OF COMBINING ASSETS

1. REDUCED FEES FOR FUND OF FUND MANAGERS, REDUCED FEES ON DIRECT FUND INVESTMENTS FROM SCALE, AND ACCESS TO HIGHER QUALITY MANAGER RELATIONSHIPS FROM A LARGER PORTFOLIO OF COMMITMENTS
2. A DIVERSIFIED PRIVATE MARKETS PORTFOLIO WITH A MORE CONSISTENT ALLOCATION TO MANAGERS, ENCOURAGING ACCESS TO BETTER MANAGERS, HIGHER AVERAGE RETURNS AND LOWER RISK
3. MORE SOPHISTICATED INVESTMENT STRATEGIES ENABLED BY SCALE TO ACHIEVE HIGHER RETURNS PER RISK AT A LOWER COST PER AUM IN BOTH INTERNAL AND EXTERNAL PORTFOLIOS

A COMBINED INVESTMENT PROGRAM COST GROWS AT A LOWER RATE THAN TWO SEPARATE PROGRAMS

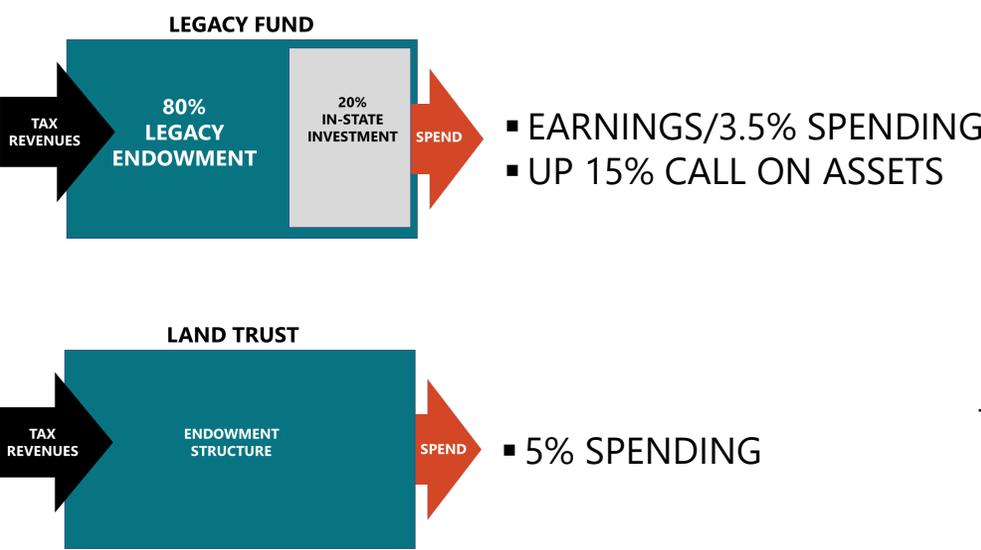


EXAMPLE:
VERSUS
2X PROGRAMS



PLUS
2X PROGRAMS
OPERATIONS

A LARGER COMBINED ENDOWMENT STRUCTURE CAN BE MANAGED WITH A UNITIZED POOLED ALLOCATION



Asset Class	Policy Target
DOMESTIC EQUITY	20% - 30%
INTERNATIONAL EQUITY	20%
FIXED INCOME	25% - 35%
REAL ESTATE	5%
DIVERSIFIED REAL ASSETS	10%
IN-STATE FIXED INCOME	0% - 10%
IN-STATE EQUITY	0% - 10%

Asset Class	Policy Target
DOMESTIC EQUITY	14% - 24%
INTERNATIONAL EQUITY	14% - 24%
FIXED INCOME	17% - 27%
ABSOLUTE RETURN	10% - 20%
REAL ESTATE	10% - 20%
PRIVATE EQUITY	0% - 10%
PRIVATE INFRASTRUCTURE	0% - 10%
OPPORTUNISTIC INVESTMENTS	0% - 5%

ILLUSTRATION

Asset Class	Policy Target
DOMESTIC EQUITY	20% - 30%
INTERNATIONAL EQUITY	14% - 24%
FIXED INCOME	25% - 35%
ABSOLUTE RETURN	0% - 5%
REAL ESTATE	0% - 10%
PRIVATE EQUITY	0% - 10%
PRIVATE INFRASTRUCTURE	0% - 10%
OPPORTUNISTIC INVESTMENTS	0% - 5%
CASH	-15% - 0%
IN-STATE FIXED INCOME	0% - 10%
IN-STATE EQUITY	0% - 10%

- OPPORTUNITY TO POOL ALLOCATIONS AND UNITIZE
- UNIQUE SPENDING FEATURES OF EACH PLAN CAN BE ACCOMODATED
- DYNAMIC LEVERAGE MIGHT BE USED TO OFFSET 15% CALL RISK AND ADD ADDITIONAL DIVERSIFICATION TO INCREASE RETURN PER RISK

BENEFITS FROM RIO MANAGING THE INVESTMENTS OF THE LAND TRUST

- THE LAND TRUST BOARD OUTSOURCES THE TRUST FUND AS A CLIENT FUND TO THE STATE INVESTMENT BOARD (SIB) AND MAINTAINS THE DISCRETION AND CONTROL OF A CLIENT; **EXISTING STAFF CAN BE TRANSFERRED TO RIO**
- AN SIB GOVERNANCE OF THE INVESTMENT MANAGEMENT ENABLES A MORE ADVANCED SCALED GOVERNANCE PROCESS AND LOWER GOVERNANCE COSTS
- A COMBINED INVESTMENT PROGRAM PROVIDES SCALE ADVANTAGES IN OPERATING COSTS, FEES, OPERATIONS, AND INVESTMENT MANAGEMENT STAFF
- A COMBINED INVESTMENT PROGRAM COST GROWS AT A LOWER RATE THAN TWO SEPARATE PROGRAMS
- A LARGER COMBINED ENDOWMENT STRUCTURE CAN BE MANAGED WITH A UNITIZED POOLED ALLOCATION THAT HAS MORE ADVANCED INVESTMENT FEATURES AND IMPLEMENTATION THAN EITHER STAND-ALONE FUND

INVESTMENT ACCOUNTING & PERFORMANCE REPORTING

- RIO CURRENTLY PREPARES AND MAINTAINS SEPARATE ACCOUNTING AND PERFORMANCE REPORTING FOR EACH OF ITS CLIENT FUNDS ON A MONTHLY BASIS.

<u>Financial Statements</u>	<u>Performance Reports</u>
Client* Public Employees Retirement System (PERS) ▼	Client* Public Employees Retirement System (PERS) ▼
▸ FY2023	▸ FY2023
▸ FY2022	▸ FY2022
▸ FY2021	▸ FY2021
▸ FY2020	▸ FY2020

- ABILITY TO ADD LAND TRUST FUNDS TO PORTFOLIO AND SIMILARLY ACCOUNT FOR EACH OF THE 13 PERMANENT TRUSTS AS WELL AS SIIF, CAPITOL BUILDING FUND, COAL DEVELOPMENT TRUST FUND, INDIAN CULTURAL EDUCATION TRUST, AND THEODORE ROOSEVELT PRESIDENTIAL LIBRARY AND MUSEUM ENDOWMENT FUND.

Proposal Summary

- Enhanced Performance Opportunities
- Governance for Growth
- Evolving Operations Support through Collaboration
- ND state government Unification of Efforts

And above all:

- **Control Remains with the Client Board**
 - Per NDCC 21-10-02.1
 - The governing body of each fund... shall establish policies on investment goals and objectives and asset allocation for each respective fund..
 - The asset allocation and any subsequent allocation changes for each fund must be approved by the governing body of that fund and the state investment board.

