

# NORTH DAKOTA LEGISLATIVE MANAGEMENT

## Minutes of the

### LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD

Friday, December 9, 2011  
Harvest Room, State Capitol  
Bismarck, North Dakota

Senator Randel Christmann, Chairman, called the meeting to order at 1:00 p.m.

**Members present:** Senators Randel Christmann, Jim Dotzenrod; Representatives Keith Kempenich, Dave Weiler; Representative of Bank of North Dakota President - Tim Porter; Office of Management and Budget Director - Pam Sharp; Tax Commissioner - Cory Fong

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

**It was moved by Representative Kempenich, seconded by Representative Weiler, and carried on a voice vote that the minutes of the October 27, 2011, meeting be approved as distributed.**

#### LEGACY FUND INVESTMENT POLICY STATEMENT DISCUSSION

Chairman Christmann said the State Treasurer's office has deposited approximately \$100.2 million into the legacy fund to date in the 2011-13 biennium--approximately \$34.3 million in September 2011, \$32.7 million in October 2011, and \$33.2 million in November 2011. He said due to a capacity limit with the Bank of North Dakota, \$48.2 million is in an account with the Bank, and \$52 million is invested in an AAA-rated institutional money market fund managed by JP Morgan. He said due to the capacity limitation, until an investment policy statement is in place, all future deposits will be invested in the JP Morgan institutional money market fund.

Chairman Christmann distributed a document ([Appendix B](#)) to facilitate discussion regarding the investment plan for the legacy fund. He said the investment plan would create two funds--a legacy income fund and a legacy growth fund. He said under the investment plan, deposits into the legacy fund would not be pooled with other funds. He said the legacy income fund would consist of fixed maturity corporate bonds and cash equivalents, and North Dakota offices of qualified brokers and dealers would be solicited to bid on fund purchases. He said the legacy growth fund investment plan would be finalized by the advisory board in the coming months, and the growth fund would receive a set percentage of revenues. He said the plan establishes the risk tolerance as low to ensure funding is available after 2017 if it becomes necessary to utilize up to 15 percent of the principal balance during the 2017-19 biennium.

Ms. Sharp said in determining how to structure the investment of funds, the plan should ensure that

15 percent of the principal of the fund remains liquid without incurring penalties for withdrawal of funds if that amount is needed after 2017. Representative Weiler said he hopes the Legislative Assembly does not rely on using 15 percent of the principal balance every biennium after 2017. He said the intent of the provision allowing 15 percent of the principal to be used was for emergency situations.

Mr. Porter suggested removing the provision from the proposed policy statement under the legacy income fund relating to liquidating bonds downgraded below investment grade immediately. He said it is often possible to incur less of a loss if these types of investments are held for five to six additional months.

In response to a question from Mr. Porter, Chairman Christmann said the legacy income fund strategy intention is to buy and hold bonds to maturity unless a bond's grade decreases to below investment grade. Mr. Porter said a buy and hold strategy removes the component of basing investment decisions on market performance and said not allowing investment managers the flexibility to make decisions based on market performance is a concern.

Ms. Sharp expressed concern that prescribing the investment of funds to be laddered with specific maturity dates and mandating that North Dakota offices of brokers or dealers be solicited to bid legacy income fund purchases is infringing on the responsibilities of the State Investment Board. Chairman Christmann said allowing North Dakota offices of brokers or dealers to be involved may reduce investment fees.

Ms. Sharp asked Mr. John Geissinger, Chief Investment Officer, Retirement and Investment Office, to comment on the ladder approach for the investment of funds. Mr. Geissinger said that a ladder approach of bond portfolios is typically used for small individual investment portfolios with limited resources and is not recommended with the balance available for investment in the legacy fund. He recommended not relying on rating agencies' grade assessment of bonds because the ratings typically lag occurrences in market performance. He said the investment policy statement should provide asset allocation guidelines but not investment strategy.

In response to a question from Representative Weiler, Mr. Geissinger said the plan to buy and hold bonds to maturity negatively impacts the ability to manage risk.

Mr. Fong asked the advisory board to consider an alternative investment policy statement ([Appendix C](#)). He said the draft utilizes the investment policy statement previously provided by Mr. Geissinger as an outline and incorporates advisory board member input from the Legislative Council's board member survey regarding policy development and from prior meeting discussions.

Based on board member input, Chairman Christmann said the board would use the draft statement submitted by Mr. Fong as a basis for developing its policy statement. He asked members for any suggested changes to Mr. Fong's investment policy statement draft.

**It was moved by Representative Kempenich and seconded by Mr. Fong that the language "for the purpose of future infrastructure" be added under the Fund Mission section.** Representative Weiler said he would not support the motion because future Legislative Assemblies may not be limited to spending these funds only on infrastructure. Ms. Sharp said she also would not support the motion, because it is not the role of the advisory board to direct future legislation. **The motion failed.**

**It was moved by Ms. Sharp, seconded by Mr. Porter, and carried on a voice vote to remove the language "provided the investment strategy employed by a professional money manager is consistent with the investment policy" from the Responsibilities and Discretion of the State Investment Board section.**

**It was moved by Ms. Sharp to remove language from the Responsibilities and Discretion of the State Investment Board section regarding not permitting pooling of assets. The motion failed for the lack of a second.**

**It was moved by Mr. Fong, seconded by Ms. Sharp, and carried on a voice vote that language in the Responsibilities and Discretion of the State Investment Board section regarding not permitting pooling of assets be changed to "It is the preference of the board that legacy fund assets may not be pooled with any other fund assets managed by the State Investment Board" and that the provision be moved to the Restrictions section.**

In response to a question from Representative Weiler, Mr. Geissinger said the language in the **Responsibilities and Discretion of the State Investment Board** section relating to notifying the advisory board of significant changes is not a policy of other advisory boards. Chairman Christmann said that advisory boards of other funds managed by the State Investment Board have representatives on the State Investment Board; therefore, there is no need to report significant changes to a separate advisory board. In response to a question from Mr. Fong, Mr. Geissinger said the reporting requirement would not be of concern to the State Investment Board.

Chairman Christmann suggested removing the **Investment Objective** section. Mr. Porter said the

section is standard language used to establish guidelines of how performance is to be measured. Senator Dotzenrod said the **Investment Objective** section establishes a measurable target of performance expectations, and he would prefer the section remain.

**It was moved by Representative Weiler that the Policy Asset Mix section provide that investments be held 75 percent in bonds and 25 percent in cash equivalents. The motion failed for lack of a second.**

**It was moved by Mr. Fong, seconded by Representative Kempenich, and carried on a voice vote to remove the "Cash and cash equivalents" line item and the "Rebalancing Range Percentage" column from the policy asset mix table and provide that investments be 100 percent in bonds and zero percent in stocks and equities.**

**It was moved by Representative Kempenich, seconded by Representative Weiler, and carried on a voice vote that "Bonds" be changed to "Bonds or fixed income" in the policy asset mix table.**

**It was moved by Mr. Fong, seconded by Representative Weiler, and carried on a voice vote that "Bonds" be changed to "Investment grade bonds" in the policy asset mix provisions.**

**It was moved by Representative Weiler, seconded by Representative Kempenich, and carried on a voice vote to remove the language "when the principal of the Fund may be accessed by the legislature" from the policy asset mix provisions.**

In response to a question from Ms. Sharp, Mr. Geissinger said that if the provision in the **Policy Asset Mix** section regarding laddering the investment of bonds is removed, the State Investment Board would have discretion to utilize investment expertise in determining the best strategy for the investment in bonds. He said removing the provision regarding laddering the investment of bonds would not prohibit a laddering strategy but allow the State Investment Board the flexibility to determine which investment strategy is the best investment option for bonds.

Mr. Porter suggested adding a provision that bond duration be no longer than an established number of years. In response to a question from Ms. Sharp, Mr. Geissinger said he agrees with Mr. Porter and recommends a 10-year maximum maturity.

**It was moved by Ms. Sharp and seconded by Mr. Porter that the language regarding the policy asset mix provisions be changed to "It is the preference of the Board that investment grade bonds will be purchased to provide a range of maturity not to exceed 10 years." The motion failed.**

**It was moved by Mr. Porter, seconded by Representative Kempenich, and carried on a voice vote that the language regarding the policy asset mix provisions be changed to "It is the preference of the Board that investment grade bonds will be**

purchased to provide a range of laddered maturities not to exceed 10 years with an effective duration not to exceed 3.5 years."

It was moved by Mr. Fong, seconded by Representative Kempenich, and carried on a voice vote to add language regarding the policy asset mix provisions indicating that the board will finalize plans for including stocks and equities as a part of the asset class mix in the future.

It was moved by Mr. Fong, seconded by Representative Kempenich, and carried on a voice vote that language be added in the Evaluation and Review section to specify that "management" costs associated with various types of investments should be reported.

It was moved by Representative Kempenich, seconded by Representative Weiler, and carried on a voice vote to add language to the Risk Tolerance section indicating that "the board recognizes that the plan will evolve as the fund matures and economic conditions and opportunities change."

It was moved by Mr. Fong, seconded by Representative Weiler, and carried on a roll call vote that the Legacy and Budget Stabilization Fund Advisory Board recommends that the State Investment Board invest money in the legacy fund pursuant to the investment policy statement ([Appendix D](#)) approved by the Legacy and Budget Stabilization Fund Advisory Board on December 9, 2011. Representatives Kempenich and

Weiler, Senator Dotzenrod, Ms. Sharp, Mr. Fong, and Mr. Porter voted "aye." Senator Christmann voted "nay."

### **ADVISORY BOARD DISCUSSION AND STAFF DIRECTIVES**

Chairman Christmann said he would notify the State Investment Board of the advisory board action approving the legacy fund investment policy statement. He asked that the advisory board members consider plans for including stocks and equities as a part of the asset class mix for the legacy fund and to consider changes to be made to the current budget stabilization fund investment policy for discussion at the next meeting.

No further business appearing, Chairman Christmann adjourned the meeting at 5:15 p.m.

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Sara E. Pahlke  
Fiscal Analyst

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Allen H. Knudson  
Legislative Budget Analyst and Auditor

ATTACH:4