

NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD

Tuesday, November 5, 2013
Harvest Room, State Capitol
Bismarck, North Dakota

Representative Keith Kempenich, Chairman, called the meeting to order at 9:00 a.m.

Members present: Representatives Keith Kempenich, Gary Kreidt; Senator Jerry Klein; Citizen members Cory Fong, Eric Hardmeyer, Pam Sharp

Member absent: Senator Carolyn C. Nelson

Others present: See [Appendix A](#)

It was moved by Mr. Fong, seconded by Representative Kreidt, and carried on a voice vote that the minutes of the April 25, 2013, meeting be approved as distributed.

Chairman Kempenich explained to the board that pursuant to North Dakota Century Code Section 21-10-11, a Chairman is to be selected by the board. Chairman Kempenich said because the Legislative Management recently appointed the legislative members to the board for the 2013-15 biennium, the board may wish to consider electing a new Chairman.

With no motion being made to change the board Chairman, Representative Kempenich continues as Chairman.

**CHIEF INVESTMENT OFFICER POSITION -
RETIREMENT AND INVESTMENT OFFICE**

Mr. Darren Schulz, Interim Chief Investment Officer, State Investment Board, provided information ([Appendix B](#)) regarding the status of recruitment of a new Chief Investment Officer. He said the State Investment Board (SIB) completed the executive search, and Mr. Dave Hunter will join the Retirement and Investment Office (RIO) as Chief Investment Officer on December 2, 2013. He said Mr. Hunter has nearly 30 years of professional investment banking, management, and accounting experience and joins RIO from HSBC where he held the position of Vice President - Pension Investments and Director of Asset Securitization.

STATUS OF THE BUDGET STABILIZATION FUND

At the request of Chairman Kempenich, Mr. Schulz provided information ([Appendix C](#)) regarding the status, asset allocation, and returns of the budget stabilization fund. He said in August 2013 approximately \$181 million was transferred from the general fund to the budget stabilization fund. He said the market value of the fund as of August 31, 2013, was \$583.1 million.

Mr. Schulz provided information ([Appendix F](#)) regarding the returns of the budget stabilization fund. He said, since the fund's inception, investment returns on the budget stabilization fund have averaged 2.38 percent, compared to a policy benchmark of 1.74 percent.

In response to a question from Representative Kempenich, Mr. Schulz said in addition to funds managed by Babson Capital and JP Morgan, the fund is invested in a match loan certificate of deposit (CD) program at the Bank of North Dakota.

Chairman Kempenich asked Mr. Schulz to provide information on the basis points charged by investment advisors to advisory board members.

In response to a question from Representative Kempenich, Mr. Schulz said the fund is invested to limit duration or interest rate risk. He said investment in securities with a longer duration pose a risk in the event of a rising rate

market. He said although managers have flexibility, they are limited to securities with shorter durations, and the overall portfolio is limited to no more than three years in duration.

STATUS OF THE LEGACY FUND

Mr. Schulz provided information ([Appendix D](#)) regarding the status, asset allocation, and returns of the legacy fund. He said fiscal year 2013 deposits totaled \$791.1 million, and deposits during the first two months of fiscal year 2014 total \$156.8 million. He provided information ([Appendix E](#)) regarding monthly deposits to the fund from September 2011 through September 2013. He said during the months from February 2013 through July 2013, additional funding was transferred from the strategic investment and improvements (SIF) fund to the legacy fund. He said deposits totaled \$76.2 million in September 2013, and as of the end of September 2013, the balance in the fund was \$1.44 billion.

Mr. Schulz provided information ([Appendix F](#)) regarding the returns of the legacy fund. He said, since its inception, investment returns on the legacy fund have averaged 1.60 percent, compared to a policy benchmark of 0.41 percent. He said returns reflect the conservative asset allocation of the fund.

In response to a question from Mr. Hardmeyer, Ms. Kelly L. Schmidt, State Treasurer, said if the unobligated balance of the strategic investment and improvements fund exceeds \$300 million at the end of any month, 25 percent of any revenues received for deposit in the strategic investment and improvements fund, including oil production and extraction tax and income from the sale, lease, and management of mineral interests, in the subsequent month must be deposited instead into the legacy fund.

Mr. Schulz provided information ([Appendix G](#)) regarding the legacy fund strategic asset allocation and the transition from 100 percent short-term fixed income to a diversified allocation. He said the new policy allocation for the legacy fund approved by the advisory board in April 2013, based on an asset allocation and spending study performed by R.V. Kuhns & Associates, Inc., was approved by SIB. He said the fund will transition from 100 percent short-term fixed income to a diversified policy allocation that includes 50 percent global equity (30 percent United States and 20 percent international), 35 percent fixed income, 10 percent diversified real estate, and 5 percent core real estate. He said RIO consulted with Callan Associates Inc. and R.V. Kuhns & Associates, Inc., to develop a transition timeline, and SIB approved a transition plan to fully implement the new policy allocation over a period of 18 months through the use of existing managers within the insurance trust. He said the transition plan includes depositing, pro rata to the new asset classes, all new money combined with a gradual transfer (\$71 million per month) of funds from short-term fixed income investments. He said benefits of using existing managers within the insurance trust include ease of implementation, lower investment costs, and administrative efficiencies. He said RIO initiated the transition plan in August 2013 and anticipates completing the transition in January 2015. He provided information ([Appendix H](#)) regarding the market value of the legacy fund by asset class as of September 30, 2013.

In response to a question from Representative Kempenich, Mr. Schulz said legacy fund assets are pooled with assets of 14 other insurance clients. He said, although the fund's assets are pooled from the manager's perspective, RIO accounts for each fund separately, and the legacy fund balance is identified.

In response to a question from Mr. Fong, Mr. Schulz said in addition to lower management and trading fees, all of the funds participating in the asset pool realize operational benefits related to common managers, oversight, and administration.

In response to a question from Mr. Hardmeyer, Mr. Schulz said after the new policy allocation is implemented, performance will be measured based on a custom set of benchmarks appropriate for each asset type. He said achieving investment objectives, such as protecting and growing the corpus of the fund, will be a measure of success over the long term.

Representative Kempenich suggested the committee receive information from RIO regarding a comparison of the estimated investment cost of each asset class before and after the phase in of the new policy allocation.

In response to a question from Representative Kempenich, Mr. Schulz said the R.V. Kuhns & Associates, Inc., model considered various spending rates as well as the distribution of interest and dividend income from the fund.

ADVISORY BOARD DISCUSSION AND STAFF DIRECTIVES

In response to a question from Mr. Fong, the Legislative Budget Analyst and Auditor said the advisory board is required to report to the Budget Section semiannually.

Chairman Kempenich asked the Legislative Council staff to prepare a report for presentation to the Budget Section pursuant to Section 21-10-11.

Mr. Hardmeyer said he has been asked to participate in a nonprofit group hosting community discussions regarding the possible uses of funding available in the legacy fund.

At the request of Chairman Kempenich, Mr. Hardmeyer provided information regarding Norway's sovereign wealth fund. He said the balance in the sovereign wealth fund is in excess of \$700 billion. He said periodically, the government determines how much of the fund--up to 4 percent--will be transferred to the country's general fund for general government use.

In response to a question from Senator Klein, the Legislative Budget Analyst and Auditor said the interim Government Finance Committee has been assigned a Legislative Management study of the lasting benefits of the legacy fund.

No further business appearing, Chairman Kempenich adjourned the meeting at 10:19 a.m.

Sheila M. Sandness
Senior Fiscal Analyst

Allen H. Knudson
Legislative Budget Analyst and Auditor

ATTACH:8