

NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD

Tuesday, June 28, 2011
Harvest Room, State Capitol
Bismarck, North Dakota

Senator Randel Christmann, Acting Chairman, called the meeting to order at 10:00 a.m.

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

Others present: See [Appendix A](#)

Acting Chairman Christmann explained to the board that pursuant to North Dakota Century Code Section 21-10-11, a chairman is to be selected by the board and that he was selected as acting chairman by the Legislative Management until the board selects a chairman. **It was moved by Representative Kempenich, seconded by Representative Weiler, and carried on a voice vote that Senator Christmann serve as chairman of the Legacy and Budget Stabilization Fund Advisory Board.**

At the request of Chairman Christmann, the Legislative Council staff presented a memorandum entitled [Legacy and Budget Stabilization Fund Advisory Board - Background Memorandum](#). The Legislative Council staff said the Legacy and Budget Stabilization Fund Advisory Board was created by 2011 Senate Bill No. 2302, codified as Section 21-10-11. The board is established for the purpose of developing recommendations for the investment of funds in the legacy fund and the budget stabilization fund to present to the State Investment Board. The board is required to report at least semiannually to the Budget Section. The Legislative Council staff also provided a history and revenue analysis of the legacy fund and the budget stabilization fund.

BUDGET STABILIZATION FUND

Ms. Pam Sharp, Director, Office of Management and Budget, presented information on the current and projected balance in the budget stabilization fund during the 2011-13 biennium. Ms. Sharp said the budget stabilization fund was established by the 1987 Legislative Assembly and statutory provisions of the fund are included in Chapter 54-27.2. She said the fund balance is limited to 9.5 percent of the general fund budget as approved by the most recently adjourned Legislative Assembly. Any excess amounts in the fund must be deposited in the general fund. Any amount in the general fund at the end of a

biennium in excess of \$65 million must be transferred to the budget stabilization fund, subject to the fund balance remaining under the 9.5 percent maximum allowable balance.

Ms. Sharp said pursuant to Office of Management and Budget policy, an annual transfer of interest earnings is made from the budget stabilization fund to the general fund after May 31 to ensure the balance in the fund does not exceed the statutory cap. She said the 2009-11 biennium beginning budget stabilization fund balance was \$324,936,548. She estimates a transfer of \$61,414,562 in June 2011 to provide a budget stabilization fund balance of \$386,351,110 on June 30, 2011. She said the balance of \$386,351,110 is the maximum balance allowed in the fund, based on 9.5 percent of the general fund budget approved by the 2011 Legislative Assembly (\$4,066,853,792).

In response to a question from Representative Kempenich, Ms. Sharp said statutory provisions provide that interest earned on the fund balance remain in the fund. However, she explained interest earned has been deposited in the general fund because the balance in the fund has been at the maximum allowed under Section 54-27.2-01 since the 2003-05 biennium.

LEGACY FUND

Ms. Carlee McLeod, Deputy State Treasurer, State Treasurer's office, presented information ([Appendix B](#)) on the timing and estimates of deposits into the legacy fund and the budget stabilization fund during the 2011-13 biennium. Ms. McLeod said the legacy fund was created in 2010 when the voters of North Dakota approved a constitutional amendment--Article X, Section 26, of the Constitution of North Dakota. She said 30 percent of oil and gas gross production and oil extraction taxes on oil and gas produced after June 30, 2011, is to be transferred to the legacy fund and that the principal and earnings of the legacy fund may not be spent until after June 30, 2017. She said that deposits of revenue into the legacy fund will begin in September 2011. She said oil revenue distributions lag actual production and extraction by two months. She said \$295,023,719 is estimated to be deposited in the legacy fund in fiscal year 2012 and \$293,688,900 to be deposited in the legacy fund during the first 11 months of fiscal year 2012.

In response to a question from Mr. Hardmeyer, Ms. McLeod said estimates are based on information

provided from Moody's Analytics relating to oil industry trends combined with state production trends provided by the Tax Department. Tax Commissioner Fong added that the assumptions are based on price per barrel ranging between \$65 to \$75 and production rates between 390,000 to 425,000 barrels per day.

INVESTMENT POLICY

Chairman Christmann called on Mr. John Geissinger, Chief Investment Officer, State Investment Board, to provide information regarding:

- Development of an investment policy statement.
- Overview of a Research Foundation of the Chartered Financial Analysts Institute article entitled "[A Primer for Investment Trustees.](#)"
- The current [investment policy statement](#) for the budget stabilization fund and investment history and returns of the fund.

Mr. Geissinger said an investment policy defines how the investment program will be managed, stating expected return and risk tolerance to achieve the fund's objective. Prior to the meeting, he provided the board members with a copy of the article entitled "A Primer for Investment Trustees," to assist the board in understanding the roles and responsibilities the board may assume in making recommendations to the State Investment Board for the investment of budget stabilization fund and legacy fund assets. In his summary of the article ([Appendix C](#)), Mr. Geissinger said an investment policy includes a statement of philosophy and strategic planning, identifies the purpose of the fund, establishes how success is defined, states tolerance for investment losses, and sets forth the process of performance evaluation. He said an investment policy outlines the desired asset allocation, specifying how the fund is allocated to various types of assets and identifying within each asset type the investment strategy to be used and benchmarks for assessing investment results.

Mr. Geissinger said an investment policy is currently in place for the budget stabilization fund and would remain in effect for the investment of budget stabilization fund assets until the board determines otherwise. He said an investment policy needs to be developed for the legacy fund prior to the first deposit of revenue into the legacy fund, estimated to occur in September 2011. He said the current budget stabilization fund objective states that sufficient liquidity is to be maintained to meet known or anticipated financial obligations and preserve the value of the surplus, and that cash equivalent investments are to be used to achieve this objective. He said the asset allocation provides for a minimum of 90 percent of assets to be short-term fixed income and Bank of North Dakota CDs, a maximum of 5 percent of assets to be bank loans with floating yield, and a maximum of 5 percent of assets to be absolute return strategies. He said the budget stabilization fund has experienced an average

annualized return of 2.79 percent during the most recent six years and provided the following asset return data by fiscal year ([Appendix D](#)):

Fiscal Yearend	Net Assets End of Period	Net Return
June 30, 2006 (initial funding - September 2005)	\$99,876,516	Not applicable, partial year
June 30, 2007	\$99,876,003	5.12%
June 30, 2008	\$198,837,270	0.01%
June 30, 2009	\$190,101,212	(4.23%)
June 30, 2010	\$325,116,846	7.38%
June 30, 2011 (as of May 31, 2011)	\$336,956,221	3.51%

COMMENTS BY OTHER INTERESTED PERSONS

Mr. Chuck Stroup, Union State Bank, Hazen, commented on the development of an investment policy statement for the budget stabilization fund and the legacy fund. Mr. Stroup recommended the board gather sufficient information, receive expert testimony, and discuss options for investment policy and strategies prior to determining its investment policy recommendations to the State Investment Board. He recommended that the investment policy statements provide a written expectation of investment managers, including an expected rate of return on managed funds. He recommended that as part of the fund's audit procedures, the investments be evaluated against directives in the investment policy statement to ensure adherence.

Mr. Geissinger suggested the board could study investment policies of other states with long-term funds; hear testimony from Callan and Associates--an investment consultant; and receive information from other investment experts.

In response to a question from Mr. Hardmeyer, Representative Weiler said the intent of the legacy fund was to utilize income from a finite resource (oil and gas) to establish savings that could potentially replace the declining revenues from the finite resource in the future. Representative Weiler said the principal balance of the legacy fund is intended to be maintained for future generations.

In response to a question from Tax Commissioner Fong regarding the relationship between the State Investment Board and the Legacy and Budget Stabilization Fund Advisory Board, Chairman Christmann said the Legacy and Budget Stabilization Fund Advisory Board is established to recommend to the State Investment Board the investment policy for the legacy fund and budget stabilization fund. Chairman Christmann said the State Investment Board is responsible for administering the investment policy provisions. Ms. Sharp said the Office of Management and Budget had assumed the role of an advisory board for the budget stabilization fund and assisted the State Investment Board to establish the current investment policy statement for the budget stabilization fund.

Ms. Sophia Preszler, Bismarck, commented on the role of the Legislative Management.

**BOARD DISCUSSION
AND STAFF DIRECTIVES**

Chairman Christmann asked the board members to review and consider if any changes should be made to the current budget stabilization fund investment policy and to consider the investment policy development for the legacy fund during the 2011-12 interim and the long-term investment policy for discussion at the next meeting.

No further business appearing, Chairman Christmann adjourned the meeting subject to the call of the chair at 12:15 p.m.

Sara E. Chamberlin
Fiscal Analyst

Allen H. Knudson
Legislative Budget Analyst and Auditor

ATTACH:4