

NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD

Wednesday, June 26, 2019
Roughrider 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 Jim Dotzenrod; Citizen Members Eric Hardmeyer, Joe Morrisette, Ryan Rauschenberger

Member absent: Senator Jerry Klein

Others present: See [Appendix A](#)

It was moved by Mr. Hardmeyer, seconded by Representative Kreidt, and carried on a voice vote that the minutes of the March 20, 2019, meeting be approved as distributed.

CONSIDERATION OF BOARD CHAIRMAN AND VICE CHAIRMAN

The advisory board discussed the selection of the chairman and vice chairman of the board.

It was moved by Representative Kreidt, seconded by Mr. Morrisette, and carried on a roll call vote that Representative Kempenich continue to serve as chairman of the Legacy and Budget Stabilization Fund Advisory Board. Representatives Kempenich and Kreidt, Senator Dotzenrod, and Citizen Members Hardmeyer, Morrisette, and Rauschenberger voted "aye." No negative votes were cast.

It was moved by Mr. Hardmeyer, seconded by Senator Dotzenrod, and carried on a roll call vote that Senator Klein continue to serve as vice chairman of the Legacy and Budget Stabilization Fund Advisory Board. Representatives Kempenich and Kreidt, Senator Dotzenrod, and Citizen Members Hardmeyer, Morrisette, and Rauschenberger voted "aye." No negative votes were cast.

CONSIDERATION OF STATE INVESTMENT BOARD MEMBER

The advisory board discussed the selection of a member of the advisory board to serve, in a nonvoting capacity, on the State Investment Board (SIB), pursuant to provisions of House Bill No. 1368 (2019).

Chairman Kempenich said SIB meets approximately 20 times during the interim and suggested committee members take turns attending SIB meetings and provide reports to the advisory board.

Mr. Hardmeyer said sending a different member of the advisory board to each meeting of SIB would be too frequent and would not benefit the advisory board.

Representative Kreidt suggested the chairman develop a schedule of members to attend SIB meetings.

Senator Dotzenrod suggested board members rotate responsibility for attending SIB meetings on a quarterly basis.

In response to a question from Mr. Rauschenberger, Chairman Kempenich said one of the citizen members or the chairman could fill in if a legislator is unable to attend one of the SIB meetings.

It was moved by Mr. Hardmeyer, seconded by Senator Dotzenrod, and carried on a roll call vote that advisory board members rotate the responsibility for attending SIB meetings on a quarterly basis and the chairman assign meetings each will attend. Representatives Kempenich and Kreidt, Senator Dotzenrod, and Citizen Members Hardmeyer, Morrisette, and Rauschenberger voted "aye." No negative votes were cast.

STATUS OF THE BUDGET STABILIZATION FUND

At the request of Chairman Kempenich, Mr. David J. Hunter, Executive Director/Chief Investment Officer, Retirement and Investment Office, presented information ([Appendix B](#)) regarding the status of the budget stabilization fund, including fund balance, investment performance, and fund allocation. Mr. Hunter said the budget stabilization fund had a net return of 3.13 percent compared to a policy benchmark return of 3.02 percent for the 1-year period ended March 31, 2019. He said the fund had a net return of 1.64 percent compared to a policy benchmark return of 1.16 percent for the 5-year period ended March 31, 2019. He said as of March 31, 2019, the balance of the fund was \$116.8 million. He said the asset allocation of the budget stabilization fund is 97.7 percent short-term fixed income and 2.3 percent cash and equivalents.

In response to a question from Mr. Hardmeyer, Mr. Morrisette said general fund revenues have been exceeding the March 2019 forecast and the transfer from the general fund to the budget stabilization fund at the end of the biennium is estimated to be \$50 million more than estimated in the March 2019 forecast. In addition, he said, if legacy fund revenues deposited into the general fund at the end of the biennium exceed the \$300 million budgeted, the additional funding would increase the transfer from the general fund to the budget stabilization fund. He said increased revenues and additional funding available from legacy fund earnings could result in an estimated \$500 million transfer from the general fund to the budget stabilization fund at the end of the 2017-19 biennium, which would provide a balance in the budget stabilization fund in excess of \$600 million.

In response to a question from Senator Dotzenrod, Mr. Morrisette said the balance in the budget stabilization fund may not exceed 15 percent of the general fund budget approved by the most recently adjourned Legislative Assembly or approximately \$725 million.

In response to a question from Chairman Kempenich, Mr. Hunter said short-term rates are declining; however, the Retirement and Investment Office (RIO) and SIB will review options to increase budget stabilization fund yields.

STATUS OF THE LEGACY FUND

At the request of Chairman Kempenich, Mr. Hunter presented information ([Appendix C](#)) regarding the status of the legacy fund, including investment allocation, fund balance, investment performance, and investment management fees. Mr. Hunter said the legacy fund had an overall net return of 2.58 percent compared to a policy benchmark return of 3.74 percent for the 1-year period ended March 31, 2019. He said the fund had a net return of 5.58 percent compared to a policy benchmark return of 4.92 percent for the 5-year period ended March 31, 2019. He said the market value of the fund was \$6.21 billion on March 31, 2019. He said, except for a higher cash balance the actual asset allocations of the legacy fund are within the target allocations reflecting the investment policy benchmark of 50 percent equity investments, 35 percent fixed income, and 15 percent real assets. He said new deposits into the legacy fund are being held in cash in preparation for the transfer to the general fund anticipated to occur on or about July 26, 2019.

In response to a question from Chairman Kempenich, Mr. Hunter said legacy fund assets include over \$200 million in cash and cash equivalents.

Mr. Hunter said SIB has placed one equity manager, LSV Asset Management, on a watch list because net investment returns have underperformed.

In response to a question from Chairman Kempenich, Mr. Hunter said LSV Asset Management manages approximately \$1.5 billion over three different strategies, including the insurance trust, legacy fund, and pension trust.

Mr. Hunter said fiscal year 2019 investment management fees for the legacy fund are not yet available, but the trend has been downward. He said investment management fees totaled \$16.6 million in fiscal year 2018, or 0.31 percent of the average market value of the fund's assets compared to 0.34 percent paid during fiscal year 2017.

In response to a question from Mr. Hardmeyer, Mr. Hunter said the goal for legacy fund returns is just under 6 percent over a 10- to 20-year period.

In response to a question from Chairman Kempenich, Mr. Hunter said in May 2018, RIO contracted with Callan Associates to conduct an asset allocation study of the legacy fund. He said it was determined the current target asset allocation and risk profile would best meet the fund's investment goals.

Mr. Hunter said deposits to the legacy fund total approximately \$5 billion from inception through April 30, 2019, and the ending net position is \$6.4 billion. He said through April 2019, the fund generated \$464 million of earnings

pursuant to the definition of earnings in North Dakota Century Code Section 21-10-12, however the estimate of transferable earnings as of May 2019, is slightly less and totals approximately \$454 million.

In response to a question from Chairman Kempenich, Mr. Hunter said total actual transferable earnings for the 2017-19 biennium will not be known until September 2019.

In response to a question from Mr. Hardmeyer, Mr. Morrisette said the transfer of 2017-19 biennium legacy fund earnings from the legacy fund to the general fund will occur in July, but will be charged back to June 2019.

At the request of Chairman Kempenich, Mr. Morrisette provided information regarding the plan for determining and transferring the earnings from the legacy fund to the general fund. Mr. Morrisette said the Office of Management and Budget (OMB) worked with RIO to develop a plan for the transfer. He said RIO indicated it takes at least 30 days to close the month and determine realized earnings, and audited earnings information would take longer. However, he said, the state constitution requires the earnings transfer occur at the end of the biennium. He said because the state must close the biennium by late July, OMB is unable to wait for RIO to determine transferable earnings through June. He said OMB determined an earlier cutoff date will be used to determine the earnings transfer. He said the amount to be transferred in July 2019 will represent 23 months of earnings through May 31, 2019, and is estimated to be approximately \$454 million, pursuant to Section 21-10-12. He said each subsequent transfer will consist of 24 months of earnings from June 1 through May 31.

Chairman Kempenich said he will draft a schedule for advisory board members to attend SIB meetings.

No further business appearing, Chairman Kempenich adjourned the meeting at 9:50 a.m.

Sheila M. Sandness
Senior Fiscal Analyst

ATTACH:3