Legislative Council
600 East Boulevard Avenue, Bismarck, ND 58505

LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD

Wednesday, October 12, 2022
Harvest Room, State Capitol
Bismarck, North Dakota

Senator Jerry Klein, Chairman, called the meeting to order at 8:00 a.m.

Members present: Senators Jerry Klein, Kathy Hogan, Scott Meyer; Representatives Glenn Bosch, Keith Kempenich, Gary Kreidt; Citizen Members Thomas Beadle, Jon Godfread, Brian Kroshus, Todd Steinwand

Members absent: None

Others present: See Appendix A

It was moved by Senator Meyer, seconded by Representative Bosch, and carried on a voice vote that the minutes of the June 30, 2022, meeting be approved as distributed.

LEGACY FUND ASSET ALLOCATION STUDY

Mr. Jim Voytko, President, Director of Research and Senior Consultant, and Mr. Joshua R. Kevan, Senior Consultant, RVK, Inc., presented information (Appendix B) regarding the asset allocation study of the legacy fund and the development of policies and guidelines for an in-state equity investment program under the legacy fund.

Mr. Voytko noted:

- Foundational principles for the in-state investment program include establishing a clear objective to either achieve investment returns or provide economic development.
- An in-state investment program should include reporting requirements to provide transparency and accountability for the investments.

Mr. Kevan noted:

- The structure of North Dakota's in-state investment program is unique compared to other states based on a review of programs in Alaska, Florida, Montana, New Mexico, and Utah.
- Representatives from the programs in other states recommended using a broad approach for the types of allowable investments and focusing on investment returns as the primary objective for the program.
- North Dakota's in-state investment program has the potential to be the largest in-state investment program in the country relative to the size of the state's economy.

Mr. Voytko distributed a draft investment policy for the legacy fund (Appendix C) regarding recommended changes to the investment policy to incorporate the in-state investment program based on the provisions of House Bill No. 1425 (2021). He noted:

- The policy provides a separate structure for the in-state investment program allowing the remaining legacy fund assets to be invested based on an asset allocation policy that provides for the long-term growth while balancing risk consistent with other endowment funds.
- In-state investment ideas should be reviewed and selected by qualified entities rather than the State Investment Board or the Retirement and Investment Office staff.
- The draft policy limits the in-state investments to $10 million per investment because of the scope of investments in North Dakota and based on a review of the structure in other states.

In response to a question from an advisory board member, Mr. Kevan noted the pace of committing capital in the draft policy is based on a 10-year timeline similar to the pace used in private equity markets.

In response to a question from an advisory board member, Mr. Voytko noted the draft policy provides flexibility for the asset allocations to address imbalances that may occur from an expenditure of legacy fund principal or the timing of commitments for in-state investments.

Ms. Janilyn Murtha, Chief Executive Officer, Retirement and Investment Office, noted consideration of the investment policy changes may be impacted by the potential future returns of the funds as analyzed by RVK, Inc.

Mr. Kevan noted:

- RVK, Inc., analyzed four scenarios related to future legacy fund returns based on legacy fund investments without an in-state investment program, with 10 percent invested in fixed income opportunities in the state, with 10 percent invested in equity opportunities in the state, and with 20 percent invested in fixed income and equity opportunities in the state.
- Based on the results of an investment model, the scenario based on legacy fund investments without an in-state investment program produced the highest average return at 5.15 percent per year, whereas the scenario based on legacy fund investments with 20 percent invested in fixed income and equity opportunities in the state produced the lowest average return at 4.03 percent per year, which could amount to a difference of approximately $500 million for the investment returns over 5 years.
- The parameters of the model limit the illiquid assets to 25 percent to allow for a sufficient amount of liquidity in the event the Legislative Assembly approved an expenditure of 15 percent from legacy fund principal, but additional scenarios using a limit of 50 percent for illiquid assets were also included to reflect a situation in which the investments would not need to be structured for a potential expenditure of 15 percent from legacy fund principal.

Mr. Scott Anderson, Chief Investment Officer, Retirement and Investment Office, noted the impact of a potential expenditure of 15 percent from legacy fund principal could be considered as a part of the asset allocation study being conducted by RVK, Inc.

It was moved by Representative Bosch, seconded by Representative Kempenich, and carried on a roll call vote that the Legacy and Budget Stabilization Fund Advisory Board revise the legacy fund investment policy based on the recommendations from RVK, Inc., to incorporate the provisions of House Bill No. 1425 (2021) for the in-state investment program and to provide for a maximum of up to $25 million in any one investment or entity under the in-state investment program rather than the $10 million included in the recommendation. Senators Klein, Hogan, and Meyer; Representatives Bosch, Kempenich, and Kreidt; and Citizen Members Beadle, Godfread, and Steinwand voted "aye." No negative votes were cast.

STATUS OF FUNDS

Mr. Anderson presented information (Appendix D) regarding the status of the budget stabilization fund and the legacy fund. He noted:

- The budget stabilization fund had a balance of $717.4 million as of June 30, 2022, and returned 1.05 percent for the 5-year period ended June 30, 2022, which was less than the benchmark by 0.2 percent.
- The legacy fund had a balance of $7.95 billion as of June 30, 2022, and returned 5.35 percent for the 5-year period ended June 30, 2022, which exceeded the benchmark by 0.38 percent.
- The agency is developing plans to manage some investments within the agency rather than through external managers to reduce investment fees, which could result in a request for additional full-time equivalent positions.
- The Retirement and Investment Office is developing a program for in-state investment managers and financial institutions to manage the investments for some assets in the funds under the control of the State Investment Board.

In response to questions from advisory board members, Mr. Anderson noted:

- The Retirement and Investment Office is not using hedging strategies to rebalance the legacy fund, but external managers were employed to use synthetic investing strategies to rebalance the legacy fund assets when markets were volatile during the COVID-19 pandemic.

- The Retirement and Investment Office plans to use a hybrid work model for any new staff that would manage the investments within the agency allowing the staff to work both in the office and remotely.

No further business appearing, Chairman Klein adjourned the meeting at 11:45 a.m.

Adam Mathiak
Senior Fiscal Analyst

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