

HOUSE BILL NO. 1425 TESTIMONY

Presented by: **Jon Godfread**
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Before: **Finance and Tax Committee**
 Representative Craig Headland, Chairman

Date: **February 2nd, 2021**

Chairman Headland and members of the House Finance and Tax committee. I am Jon Godfread, North Dakota Insurance Commissioner. I am testifying today in my capacity as a statewide elected official and a member of the State Investment Board. However, I am not testifying on behalf of the State Investment Board. At our last meeting, the State Investment Board did not take a position on this legislation.

House Bill 1425 is a simple piece of legislation; its intention is to set a target allocation for the Legacy Fund to direct a portion of the investment to North Dakota. HB 1425 targets 10% of the Legacy Fund Investment to fixed income investments in North Dakota and an additional 10% towards equity investments in North Dakota. It does not change process; it does not change the oversight. It simply directs a portion of the investments, which we make outside North Dakota all the time, towards North Dakota. This bill does not mandate an allocation, this bill does not mandate pulling money out other investments immediately or putting money aside. It simply sets a direction for the Legacy Fund and Budget Stabilization Advisory board, which is responsible for the asset allocation recommendations for the Legacy Fund.

Currently, the Legacy Fund asset allocation stands at 50% equity (30% in domestic equity and 20% in international equity), 35% in fixed income investments, and 15% in real assets.

There are a few points I would like to make and then I will let others speak to the impacts of House Bill 1425. First, when talking about investing the Legacy Fund, it's critically important to note that the Legacy Fund is not a pension fund. Pension funds are generally used to support public employee retirement, teacher's retirement, or injured workers. In accounting terms, those are back-end liabilities that are certainly at play when making investment decisions. However, regarding the Legacy Fund, the people of North Dakota are the true benefactors and I do not believe investing in the people of North Dakota with their own tax revenue is a divisive idea.

Second, this bill would not change the process of how the State Investment Board operates. Currently, the State Investment Board hires and oversees fund managers to invest the dollars based on the allocations set by the client boards, in this case the Legacy and Budget Stabilization Advisory Board. These managers are then charged with investing the dollars and the State Investment Board, along with staff and our manager of managers (consultant) monitors and provides oversight to those fund managers. This bill does not change that process.

Third, since the process called for does not change, is not new nor is it complex for this board, staff, or our consultant to implement and operate. Currently, the State Investment Board has approved up to \$400M of investment to the Bank of North Dakota CD Match Program, however, as of November 2020, we have deployed \$32M of the \$400M. Similar to this bill, the \$400M is a target and those investments are moved into the CD Match Program as investments become available. In the meantime, the money continues in the investments they are in earning a return for the fund. This bill sets targets for investments in the state of North Dakota, it does not mandate the money move by some arbitrary date. It sets a direction.

This has been done before by the State Investment Board, as recently as 5-6 years ago the Legacy Fund went through an asset reallocation. Prior to that change, the fund was heavily invested in bonds and other low risk, low return investments. It took years to move to current asset allocation and it was done in a prudent manner. Nothing in this bill would force any board or manager to operate in an irrational or imprudent manner.

Fourth, by making the changes in Sections 2, 3, and 4 of this bill, we are not only allowing North Dakota Financial Institutions to be at the table when it comes to investing Legacy Fund dollars, but it also sets the goal of investment for the Legacy Fund. By adopting the goal of principle preservation while maximizing total return and providing for a direct benefit to the state by investing a portion of the principle in the state, we recognize the true purpose of the Legacy Fund. This is important because when you consider the prudent investor rule, which primarily applies to pensions funds, you first must look at the mission or goal of the fund. From that point on you apply that mission or goal in a prudent manner.

It is also important to address the language on page 4 at lines 21-22. This would direct the board to essentially set a benchmark target rate of return at 5.5% for the equity investments within the state. This is important because it sets a target rate of return but also recognizes the inherent multiplier effect of investing in our own state and our own community. There is another reason for the importance of this language. It's to prevent our fund managers from charging us a risk premium to do this investing. In the past when discussions have arisen about instate investing, it rightly turns to rates of return. Inevitably, we have been told to do this type of program, you need to expect between 15-20% rate of return, essentially placing a 12%-17% risk premium on North Dakota investments. For your information the prior year benchmark return for the Legacy Fund Domestic Equity investments was 3.65%. This language is critical to ensure we are giving North Dakota companies, fund managers and investors a fair opportunity to invest Legacy Fund dollars, while recognizing the multiplier of jobs, money, and growth, that comes from investing in your own community.

Finally, you will also likely hear that North Dakota does not have the capacity for this level of investment. There are people that will testify after me that will likely address this question better than I can, but in North Dakota, we struggle to attract capital. Prior to my role as Insurance Commissioner, I worked at the Greater North Dakota Chamber. I have seen the capital gap firsthand and I understand the exceptional opportunities that exist in our state.

We are at a unique time in our state. We have seen some tremendous growth in our technology industry, our value-added agriculture industry, and our value-added energy industry. We have most of the tools available for business and entrepreneurs in our state. We have grants, loans, and other supports, but the one area we continually lack is access to capital. House Bill 1425 recognizes this and seeks to address the capital shortfall we have in our state. Outside of the \$32M we currently have invested through CD Match program, not one of the investments done by the State Investment Board is targeted to North Dakota. If there is one fund that should have a portion of the dollars directed to the state and the people of North Dakota, it is the Legacy Fund.

House Bill 1425 recognizes the opportunities we have in our state, it recognizes the expertise we have in our state, and gives our state a chance at expansion, diversification, and growth. As a state we have consistently sold ourselves short, we have consistently assumed we cannot do “that” here, those opportunities are only for the bigger cities, the larger markets. None of that is true, we have the talent, we have the opportunity, and we have the expertise right in our own back yard. I know you see this among your own district constituents. Now is the time to invest in our opportunities and give North Dakota the same shot we give every other community where we invest these dollars.

As always, I am happy to answer any questions your may have, and I would urge your favorable consideration of House Bill 1425.