

July 1997

## **STATE INVESTMENT PROCESS - BACKGROUND MEMORANDUM**

House Concurrent Resolution No. 3002 (attached as an appendix) directs the Legislative Council to study the state's investment process as it relates to the state bonding fund and the fire and tornado fund and to monitor the performance of all investments of the State Investment Board and the Board of University and School Lands. The resolution was recommended by the 1995-96 interim Budget Committee on Government Finance. The committee recommended the study because of the potential to generate larger returns on the state bonding fund and the state fire and tornado fund and to continue monitoring investment processes of the state investment board and the board of university and school lands.

### **PREVIOUS STUDIES**

#### **1995-96 Interim**

The 1995-96 interim Budget Committee on Government Finance, pursuant to Senate Concurrent Resolution No. 4008, studied the state's investment process and the investment of state funds. The committee reviewed the various funds administered by the State Investment Board, Job Service North Dakota, State Treasurer's office, and the Board of University and School Lands including a review of fund balances, the performance of investments, objectives of each fund, and the money managers used by the various state agencies responsible for investing state funds. The committee recommended House Concurrent Resolution No. 3002 providing for this study.

#### **1993-94 Interim**

The 1993-94 interim Employee Benefits Programs Committee, as a result of reviewing a committee bill which would have increased the primary insurance benefits under the old age and survivor insurance system, studied whether investment returns could be enhanced while still maintaining appropriate safety and liquidity requirements in the old age and survivor insurance system fund. As a result of this study, the committee recommended Senate Concurrent Resolution No. 4008 directing the Legislative Council to study the state's investment process in the investment of state funds and House Bill No. 1125 to expand the investment options available to the old age and survivor insurance system. House Bill No. 1125, as approved by the Legislative Assembly, requires the state treasurer to invest any portion of the old age survivor trust funds not needed for current payment of benefits and costs of administration of the fund in bonds, treasury bills, notes, or other securities that are direct obligations of the treasury of the United States; bonds, debentures, or notes issued by a federal farm credit bank, the federal national mortgage association, or the federal home loan mortgage corporation; deposits of the Bank of North Dakota; or deposits of any federally insured bank, federal savings bank, or savings and loan association in an amount not to exceed the maximum insurance available for each deposit and to sell and dispose of the investment when funds are needed for payment of benefits or administration of the fund.

### **1991-92 Interim**

The 1991-92 interim Employee Benefits Programs Committee, pursuant to Senate Concurrent Resolution No. 4005, studied the consolidation of the Retirement and Investment Office, Public Employees Retirement System, and Teachers Fund for Retirement. The study was a result of the passage of Senate Bill No. 2030 by the 1989 Legislative Assembly and the passage of Senate Bill No. 2078 by the 1991 Legislative Assembly. The committee recommended House Bill No. 1035, which was approved by the 1993 Legislative Assembly which repealed the sunset provision contained in 1989 Senate Bill No. 2030 and 1991 Senate Bill No. 2078.

### **1989-90 Interim**

The 1989-90 interim retirement committee, pursuant to Section 14 of Senate Bill No. 2030, studied the feasibility and desirability of the various options relating to the consolidation of various organizational and investment functions of the public employees retirement system, the teachers fund for retirement, and the state investment board. Senate Bill No. 2030 established the state retirement and investment office to coordinate the activities of the state investment board and teachers fund for retirement. The bill also transferred the responsibility for investment of moneys of the public employees retirement system from funding agents under contract with the public employees retirement system to the state investment board. The bill was originally effective through June 30, 1991 (the effective date was later extended to June 30, 1993, and then later the effective date was repealed).

The committee recommended Senate Bill No. 2078 and Senate Concurrent Resolution No. 4005 both of which were adopted by the 1991 Legislative Assembly. Senate Bill No. 2078, as approved by the Legislative Assembly extended the sunset provision to June 30, 1993 of 1989 Senate Bill No. 2030, eliminated the retirement and investment office board, and transferred the administrative responsibilities of that board to the state investment board. The bill also provided that if asset allocations for each fund were not approved by the governing body of that fund and the state investment board by January 1 of each year, the previous asset allocations would remain in effect.

Senate Concurrent Resolution No. 4005 directed the Legislative Council to study the feasibility and desirability of consolidating the retirement and investment office, public employees retirement system, and teachers fund for retirement.

### **1997 LEGISLATION**

House Bill No. 1117, approved by the 1997 Legislative Assembly eliminates the Veterans Home improvement fund and provides that Veterans Home membership contributions be deposited into the Veterans Home operating fund rather than the Veterans Home improvement fund.

House Bill No. 1346, approved by the 1997 Legislative Assembly, provides that the state investment board is also responsible for the investment of the veterans cemetery trust fund.

### State Bonding Fund

The State Bonding Fund was created in 1915 and is maintained for bond coverage of public employees. The State Bonding Fund is managed by the insurance commissioner, and the amount of coverage provided to each state agency, department, industry, and institution is determined by the commissioner based on the amount of money and property handled and the opportunity for default. North Dakota Century Code Section 26.1-21-09 provides that premiums for bond coverage are to be determined by the insurance commissioner but may be waived if the state bonding fund balance is in excess of \$2.5 million. No premiums have been charged possibly since 1953 because the bonding funds balance has exceeded \$2.5 million. The schedule below presents estimated balances, revenues, and expenses of the state bonding fund for the 1997-99 biennium.

<b>ANALYSIS OF THE STATE BONDING FUND FOR THE 1997-99 BIENNIUM</b>		
Estimated balance - July 1, 1997		\$4,166,106
Add estimated revenues:		
Investment income	\$378,690	
State bonding fund claims collections	50,000	
Other income	<u>5,000</u>	
Total estimated revenues		<u>43,690</u>
Total available		\$4,599,796
Less estimated expenditures:		
Insurance Department - Administration (1997 HB 1010)	\$81,743	
State bonding fund losses	<u>450,000</u>	
Total estimated expenditures		<u>531,743</u>
Estimated balance - June 30, 1999		\$4,068,053

The State Investment Board administers the investments of the state bonding fund. As of March 31, 1997, the market value of the fund's investments totaled \$3,793,000. The average return for the period July 1, 1996, through March 31, 1997, was 5.18 percent. The average return for fiscal year 1996 was 6.98 percent.

### State Fire and Tornado Fund

The State Fire and Tornado Fund originated in 1919. The fund is maintained to insure the various political subdivisions and state industries against loss to public buildings and permanent fixtures. North Dakota Century Code Section 26.1-22-14 requires that if the fire and tornado fund balance is less than \$12 million, the insurance commissioner must increase assessments on policies. The schedule below presents estimated balances, income, and expenses of the fire and tornado fund for the 1997-99 biennium.

<b>ANALYSIS OF THE STATE FIRE AND TORNADO FUND THE 1997-99 BIENNIUM</b>		
Estimated balance - July 1, 1997		\$14,149,979
Add estimated revenues:		
Premium collections	\$5,260,000	
Investment income	1,200,000	
Boiler inspection fees	200,000	
Reinsurance recovery	1,000,000 <sup>1</sup>	
Loss claims recovery	15,000	
Total estimated revenues		<u>\$7,675,000</u>
Total available		\$21,824,979
Less estimated expenditures:		
Loss claims payments	6,000,000	

1997 Red River Valley flood loss claims payments Insurance Department	6,000,000 <sup>2</sup>	
Fire and tornado fund administration and boiler inspection program (1997 HB 1010)	646,787	
Anhydrous ammonia storage facility inspections (1997 HB 1010)	150,205	
State Fire Marshal program (1997 HB 1003)	834,973	
Firemen's Association grants (1997 HB 1015)	63,000	
Agriculture Department - Anhydrous ammonia storage facility regulation (1997 HB 1009)	<u>20,444</u>	
Total estimated expenditures		<u>\$13,715,409</u>
Estimated balance - June 30, 1999		<u>\$8,109,570</u>

<sup>1</sup> The loss payment relating to the North Dakota Winter Show building claim is estimated to be \$2 million. The fire and tornado fund has reinsurance that pays for loss claims that exceed \$1 million.

<sup>2</sup> Initial Insurance Department estimates of fire and tornado fund loss payments relating to the 1997 Red River Valley flood range from \$4 to \$8 million. The amount shown is the midpoint of the Insurance Department's estimated range.

The State Investment Board administers the investments of the state fire and tornado fund. As of March 31, 1997, the market value of the fund's investments totaled \$15,865,000. The average return for the period July 1, 1996, through March 31, 1997, was 5.14 percent. The average return for fiscal year 1996 was 6.45 percent.

### State Investment Board

In addition to administering investments of the bonding fund and fire and tornado fund, the State Investment Board administers the following statutory and contracted funds:

Fund Name	As of March 31, 1997		Fiscal 1996 Annual Return
	Market Value \$(000)	Year-to-date Return	
Teachers' Fund for Retirement	897,479	7.91%	15.63%
Public employees' retirement fund	810,572	8.20%	16.09%
Job Service North Dakota pension fund	23,199	10.36%	24.70%
City of Bismarck employee's pension fund	14,898	7.52%	14.50%
City of Bismarck police pension fund	7,198	7.58%	14.45%
Workers' compensation fund	500,361	6.48%	9.50%
Insurance Regulatory trust fund	2,069	6.22%	9.05%
Petroleum tank release compensation fund	5,570	5.87%	8.18%
State risk management fund*	3,218	N/A	N/A
National Guard tuition waiver fund	213	4.66%	5.60%
Veterans Home improvement fund	459	4.63%	5.65%
Public Employees Retirement System retiree health insurance fund	14,608	8.07%	16.45%

\* Began October 1, 1996--will be removed from SIB authority according to HB 1117 on August 1, 1997.

### LAND DEPARTMENT

The Land Department administers the following permanent educational trust funds:

- Common Schools
- North Dakota State University
- School for the Blind
- School for the Deaf
- State Hospital

Ellendale<sup>1</sup>  
 Valley City State University  
 Mayville State University  
 Youth Correctional Center  
 State College of Science  
 School of Mines<sup>2</sup>  
 Veterans Home  
 University of North Dakota

<sup>1</sup> Income earned on the Ellendale trust fund is allocated equally to the School for the Blind, Dickinson State University, Minot State University, Minot State University-Bottineau, Veterans Home, State Hospital, and State College of Science.

<sup>2</sup> Income earned by the School of Mines trust fund is distributed to the University of North Dakota.

The Land Department combines the assets of the educational trust funds for investment purposes. The schedule below presents the investments of the educational trust funds as of March 31, 1997.

Type of Investment	March 31, 1997, Allocation	Percentage of Assets	Fiscal Year-to-date Yield or Total Return
Fixed income	\$249,514,769	61.2%	7.55%
Cash equivalents	10,383,779	2.5%	5.38%
Convertible securities	32,624,084	80.0%	7.34%
U.S. equities	82,384,746	20.2%	12.85%
International equities	32,490,741	8.0%	0.32%
Total/Average	\$407,398,118	100.0%	7.97%

The Land Department also administers investments of the capitol building fund, coal development trust fund, and the lands and minerals trust fund. The March 31, 1997, fund balance and the fiscal year-to-date return on the investments is listed on the schedule below.

	March 31, 1997, Balance	Fiscal Year-to-date Return
Capitol building fund	\$1,067,567	5.07%
Coal development trust fund	\$50,672,244	4.55%
Lands and minerals trust fund	\$5,487,158	5.91%

### PROPOSED STUDY OUTLINE

The committee may wish to proceed with this study as follows:

1. Receive testimony from representatives of the insurance department and state investment board regarding the objectives and purposes of the state bonding fund and fire and tornado fund, the types of investments currently being utilized, current returns on investments of these funds, and investments available but not being utilized.

2. Receive testimony from representatives of the state investment board and the board of university and school lands regarding the objectives and purpose of funds administered by these agencies, the types of investments currently being utilized, current returns on investments being held by the various funds, and investments available but not being utilized.
3. Review possibilities of increasing investment income of the state bonding fund and fire and tornado fund.
4. Receive testimony from interested persons, including investment professionals, regarding possible investment options.
5. Develop recommendations and prepare legislation necessary to implement the recommendations.
6. Prepare the committee's final report for submission to the Legislative Council.