

TO: Legacy and Budget Stabilization Fund Advisory Board (“Advisory Board”)
FROM: Dave Hunter, Executive Director/CIO, Retirement and Investment Office (“RIO”)
DATE: June 15, 2015
SUBJECT: Office of Management and Budget (“OMB”) Update

OMB Update:

On June 10, 2015, RIO was informed the 2015-17 Budget Stabilization Fund (“BSF”) Statutory Cap will be set at **9.5%** of the 2015-17 Legislative Appropriations of **\$6,026,162,678** or **\$572,485,454**. Based on a recent market valuation of the assets in the BSF as of April 30, 2015, RIO will transfer approximately \$23 million from the BSF in late-June.

RIO’s Prior Recommendation:

Based on prior discussion with the Advisory Board and SIB, RIO previously recommended the BSF Investment Policy Statement should be revised to include a specific asset allocation percentage for the BND Match Loan CD program (“BND Program”). RIO recommended a 35% allocation to the BND Program in order to minimize the concentration risk within this “rainy day” fund to no more than approximately one-third of the overall Fund value. **Based on the new BSF Statutory Cap of \$572,485,454, the BND Program limit should not exceed its current limit of \$200 million (e.g. \$572,485,454 x 35% = \$200,369,909).**

Rationale:

Asset allocation recommendations within an investment policy statement are generally stated in percentage terms, rather than absolute dollar limits, in order to accommodate changes in future funding levels. RIO notes that this practice has been consistently followed within the investment policy statements of most other SIB clients in the past.

Review of Century Code Summary Statements:

Century Code 21-10-02 states that “The board (SIB) is charged with the investment of the funds enumerated in section 21-10-06.”

Century Code 21-10-06 specifically lists the “Budget stabilization fund” and the “Legacy fund”.

Century Code 21-10-07 further states that “The state investment board shall apply the prudent investor rule when investing for funds under its supervision.”

Century Code 21-10-11 states that “**The legacy and budget stabilization advisory board is created to develop recommendations for the investment of funds in the legacy fund and the budget stabilization fund to present to the state investment board**”.

Summary Observation:

Based on Century Code 21-10-11, Advisory Board recommendations for the investment of funds in the BSF should be presented to the SIB in the form of an investment policy statement which outlines the permitted investments and stated allocation percentage.

North Dakota Century Code Chapter 21-10 State Investment Board Excerpts

21-10-01. State investment board - Membership - Term - Compensation – Advisory council.

1. The North Dakota state investment board consists of the governor, the state treasurer, the commissioner of university and school lands, the director of workforce safety and insurance, the insurance commissioner, three members of the teachers' fund for retirement board or the board's designees who need not be members of the fund as selected by that board, two of the elected members of the public employees retirement system board as selected by that board, and one member of the public employees retirement system board as selected by that board. The director of workforce safety and insurance may appoint a designee, subject to approval by the workforce safety and insurance board of directors, to attend the meetings, participate, and vote when the director is unable to attend. The teachers' fund for retirement board may appoint an alternate designee with full voting privileges to attend meetings of the state investment board when a selected member is unable to attend. The public employees retirement system board may appoint an alternate designee with full voting privileges from the public employees retirement system board to attend meetings of the state investment board when a selected member is unable to attend. The members of the state investment board, except elected and appointed officials and the director of workforce safety and insurance or the director's designee, are entitled to receive as compensation one hundred forty-eight dollars per day and necessary mileage and travel expenses as provided in sections 44-08-04 and 54-06-09 for attending meetings of the state investment board.

2. The state investment board may establish an advisory council composed of individuals who are experienced and knowledgeable in the field of investments. The state investment board shall determine the responsibilities of the advisory council. Members of the advisory council are entitled to receive the same compensation as provided the members of the advisory board of the Bank of North Dakota and necessary mileage and travel expenses as provided in sections 44-08-04 and 54-06-09.

21-10-02. Board - Powers and duties.

The board is charged with the investment of the funds enumerated in section 21-10-06. It shall approve general types of securities for investment by these funds and set policies and procedures regulating securities transactions on behalf of the various funds. Representatives of the funds enumerated in section 21-10-06 may make recommendations to the board in regard to investments. The board or its designated agents must be custodian of securities purchased on behalf of funds under the management of the board. The board may appoint an investment director or advisory service, or both, who must be experienced in, and hold considerable knowledge of, the field of investments. The investment director or advisory service shall serve at the pleasure of the board. The investment director or advisory service may be an individual, corporation, limited liability company, partnership, or any legal entity which meets the qualifications established herein. The board may authorize the investment director to lend securities held by the funds. These securities must be collateralized as directed by the board. The board may create investment fund pools in which the funds identified in section 21-10-06 may invest.

21-10-02.1. Board - Policies on investment goals and objectives and asset allocation.

1. The governing body of each fund in section 21-10-06 shall establish policies on investment goals and objectives and asset allocation for each respective fund. The policies must provide for:
 - a. The definition and assignment of duties and responsibilities to advisory services and persons employed by the board.
 - b. Acceptable rates of return, liquidity, and levels of risk.
 - c. Long-range asset allocation goals.
 - d. Guidelines for the selection and redemption of investments.
 - e. Investment diversification, investment quality, qualification of advisory services, and amounts to be invested by advisory services.
 - f. The type of reports and procedures to be used in evaluating performance.

2. The asset allocation for each fund, to be effective, must be approved by the governing body of that fund and the state investment board by January first of each year. If the asset allocation is not approved, the previous asset allocation remains effective. The governing body of each fund shall use the staff and consultants of the retirement and investment office in developing asset allocation and investment policies.

21-10-06. Funds under management of board - Accounts.

1. Subject to provisions of section 21-10-01, the board is charged with investment of the following funds:
 - a. State bonding fund.
 - b. Teachers' fund for retirement.
 - c. State fire and tornado fund.
 - d. Workforce safety and insurance fund.
 - e. National guard tuition trust fund.
 - f. Public employees retirement system.
 - g. Insurance regulatory trust fund.
 - h. State risk management fund.
 - i. Budget stabilization fund.
 - j. Health care trust fund.
 - k. Cultural endowment fund.
 - l. Petroleum tank release compensation fund.
 - m. Legacy fund.

21-10-07. Legal investments.

The state investment board shall apply the prudent investor rule in investing for funds under its supervision. The "prudent investor rule" means that in making investments the fiduciaries shall exercise the judgment and care, under the circumstances then prevailing, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income. The retirement funds belonging to the teachers' fund for retirement and the public employees retirement system must be invested exclusively for the benefit of their members and in accordance with the respective funds' investment goals and objectives.

21-10-08. Reserves - Percentage limitations.

In order to meet claims and liabilities, reserves must be established and maintained in each of the funds in accordance with the investment policy and asset allocation established for each fund.

21-10-11. Legacy and budget stabilization fund advisory board.

The legacy and budget stabilization fund advisory board is created to develop recommendations for the investment of funds in the legacy fund and the budget stabilization fund to present to the state investment board. The goal of investment for the legacy fund is principal preservation while maximizing total return. The board consists of two members of the senate appointed by the senate majority leader, two members of the house of representatives appointed by the house majority leader, the director of the office of management and budget or designee, the president of the Bank of North Dakota or designee, and the tax commissioner or designee. The board shall select a chairman and must meet at the call of the chairman. The board shall report at least semiannually to the budget section. Legislative members are entitled to receive compensation and expense reimbursement as provided under section 54-03-20 and reimbursement for mileage as provided by law for state officers. The legislative council shall pay the compensation and expense reimbursement for the legislative members. The legislative council shall provide staff services to the legacy and budget stabilization fund advisory board. The staff and consultants of the state retirement and investment office shall advise the board in developing asset allocation and investment policies.