S.F. 2239
(Pogemiller)

H.F. 2362
(Smith)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s):	MTRFA and Expanded List Plans
Relevant Provisions of Law:	Minnesota Statutes, Section 354A.28, subdivision 5; 356A.06, subdivision 7
General Nature of Proposal:	Adds Explicit Authority to Invest in Index Funds, Mutual Funds, and Commingled Funds
Date of Summary:	February 10, 2006

Specific Proposed Changes

- Note: S.F. 2239 (Pogemiller); H.F. 2362 (Smith) was introduced last year and in large part revises Minnesota Statutes, Section 356A.06, Subdivision 7, a subdivision that was revised last year. Therefore, S2239-A1 is a redraft of S.F. 2239 (Pogemiller); H.F. 2362 (Smith) drawn to the revised subdivision as found in Minnesota Statutes 2005. The amendment also revises the title because the title is incorrect.
- The delete-everything amendment S2239-A1 to S.F. 2239 (Pogemiller); H.F. 2362 (Smith) revises the investment authority for the Minneapolis Teachers Retirement Fund Association (MTRFA) from the same provision as the SBI to the investment authority provision applicable to larger non-SBI plans (Section 356A.06, Subdivision 7), and revises this non-SBI investment authority provision by adding explicit investment authority to invest in index funds and mutual funds; and by adding authority for these non-SBI plans to invest up to five percent of total assets in junk bonds and emerging market debt. Pension funds covered by the revised provision are given until January 1, 2008, to divest of non-conforming assets.

Policy Issues Raised by the Proposed Legislation

1. Need for change.
2. Scope of change.
3. Differences between SBI junk bond language and Section 356a.06 proposed language.
4. Implications of junk bond exposure.
5. Lack of demonstrated need for diversification.
6. Amount of junk bond permissible exposure.
7. Unknown implications of striking "regional and mutual funds" language.
8. Junk bond mutual fund issue.
9. Redrafting needed to reestablish meaningful equity cap.
10. Transition provision issues.

Potential Amendments

S2239-A2 can be used to delete all explicit junk bond and emerging market debt investment authority.

S2239-A3 is an alternative to S2239-A2 and would delete emerging market debt investment authority.

S2239-A4 could be used to restrict authority to a smaller group of plans if some junk bond and/or emerging market investment authority remains in the bill. This would be accomplished by naming the plans to be included, for example, MERF and/or some or all first class city teacher plans.

S2239-A5 could be used, if junk bond authority remains in the bill for some or all plans, to add further restrictions on those holdings, consistent with the additional restrictions on these investments as found in SBI law.

S2239-A6 can be used, if junk bond authority remains in the bill for some or all plans, to change the maximum permitted percentage from five percent of total assets to some other percentage.

S2239-A7 is an alternative to S2239-A6 and can be used to change the maximum permitted percentage from five percent of total assets to a percentage to be specified by the Office of the State Auditor, not to exceed a maximum percentage to be specified by the Commission or the Legislature.

S2239-A8 would reinstate the "regional and mutual fund" language

S2239-A9 If junk bond authority remains in the bill, then the Commission may wish to consider this amendment, which revises the new mutual fund language to include authority to include junk bonds.

S2239-A10 revises the provision ensuring that any equity investments held under the new explicit mutual fund and index fund language is included within the 85 percent equity cap.

S2239-A11 removes the transition language.

S2239-A12 is an alternative to S2239-A11 and revises the transition language by lengthening the period or shortening it, by filling in the blank in the amendment.

S2239-A13 would remove MTRFA from having any junk bond authority.

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director EB

RE: S.F. 2239 (Pogemiller); H.F. 2362 (Smith): Delete Everything Amendment S2239-A1 to Non-SBI Public Pension Plans: Adding Explicit Authority to Invest in Index Funds, Mutual Funds, and Commingled Funds

DATE: February 8, 2006

Note: S.F. 2239 (Pogemiller); H.F. 2362 (Smith) was introduced last year and in large part revises Minnesota Statutes, Section 356A.06, Subdivision 7, a subdivision that was revised last year. Therefore, S2239-A1 is a redraft of S.F. 2239 (Pogemiller); H.F. 2362 (Smith) drawn to the revised subdivision as found in Minnesota Statutes 2005. The amendment also revises the title because the title is incorrect. The title states that the bill excludes below-investment grade bonds, but it does not; rather it explicitly includes them in the investment authority that under the bill would apply to the Minneapolis Teachers Retirement Fund Association (MTRFA) and a few hundred other non-State Board of Investment plans.

Summary of S.F. 2239 (Pogemiller); H.F. 2362 (Smith): Delete Everything Amendment S2239-A1

The delete-everything amendment S2239-A1 to S.F. 2239 (Pogemiller); H.F. 2362 (Smith) revises the investment authority for the Minneapolis Teachers Retirement Fund Association (MTRFA) from the same provision as the State Board of Investment (SBI) to the investment authority provision applicable to larger non-SBI plans (Section 356A.06, Subdivision 7), and revises this non-SBI investment authority provision by adding explicit investment authority to invest in index funds and mutual funds; and by adding authority for these non-SBI plans to invest up to five percent of total assets in junk bonds and emerging market debt. Pension funds covered by the revised provision are given until January 1, 2008, to divest of non-conforming assets.

Background on Permissible Investments Under Section 356A.06, Subdivision 7

The following describes the securities and other investment forms currently permitted under Section 356A.06, Subdivision 7:

a. Types of Permissible Investments. Permissible investments may be owned directly or through commingled trusts and are of the following types:

   1. Government debt obligations, including debt obligations of the United States Government and its agencies, government sponsored organizations of which the United States is a member, state and local governments, and Canada and its provinces. All obligations must be backed by the full faith and credit of the issuing organization or be rated as an investment-grade security by a nationally recognized rating agency, and principal and interest must be payable in United States dollars. (An investment-grade debt security is one rated in the top four quality categories.)

   2. Investment-grade corporate debt of companies organized under the laws of the United States and Canada, including bond notes, debentures, providing the securities are investment-grade and are payable in United States dollars.

   3. Miscellaneous debt and cash equivalent securities, including bankers acceptances, certificates of deposit, commercial paper, mortgage participation securities and asset backed securities, guaranteed investment contracts, providing that securities of a cash equivalent nature are fully backed by insurance, and securities of a longer term debt nature are investment-grade. The SBI may also purchase Minnesota Housing Finance agency mortgage pools providing none of the mortgages are in default.

   4. Stock or convertible securities of any United States or Canadian company, or of any company listed on domestic stock exchanges. The pension fund may not own more than five percent of the outstanding shares of any given company.

   5. International securities, while not further defined or specified in law, presumably refers to foreign stocks and bonds.

6. Puts, calls, futures. A covered pension fund may use puts, calls, and future contracts purchased and sold through regulated markets. Puts and calls are options giving the right to sell (put) or buy (call) a fixed amount of a security at a specified price. Puts can be used if one believes the market price of the security will go down by the contract settlement date; calls could be used if one believes the price may rise. A futures contract is an agreement to exchange securities or currencies at an agreed upon rate.
7. Exchange traded funds. A covered pension fund may choose to invest in any of the various permissible assets authorized under this provision in the form of exchange traded funds.
8. Various miscellaneous investments, including venture capital investments, regional funds, mutual funds, limited partnerships, real estate investment trusts, and resource investments. For any of these investments, there must be at least four other owners in addition to the covered pension fund, and that pension fund may not own more than 20 percent of the investment or act as a general partner or engage in any activity that creates general liability.

b. Asset Mix Restrictions. In addition to specifying legal investments, the section also puts some minimal limits on the proportion of equity investments that a covered pension fund must hold. *The total of all forms of equity investments* [the domestic stock in (4) above, international securities in (5), and miscellaneous equity investments in (8)] *cannot exceed 85 percent of the total portfolio's value. Furthermore, the miscellaneous equity investments in (8) above, considered separately, may not exceed 35 percent of the portfolio's value.*

Background on the Origin of Larger Non-SBI Plan Investment Authority Provision, and Current Law MTRFA Junk Bond Authority

Section 356A.06, Subdivision 7, was created by the Legislature to keep public pension funds other than the SBI out of the junk bond market. Any effort now to provide access by non-SBI funds to the junk bond market is a reversal of legislative policy and should not be undertaken without careful consideration. This section of law is applicable to many pension funds, including the Minneapolis Employees Retirement Fund (MERF), the Duluth Teachers Retirement Fund Association (DTRFA), the St. Paul Teachers Retirement Fund Association (SPTRFA), Minneapolis police and fire relief associations, any other local police and paid fire funds, the Bloomington Fire Relief Association, and probably a few hundred local volunteer fire relief associations. The bill also makes the Minneapolis Teacher Retirement Fund Association (MTRFA) subject to the same investment authority provision, Section 356A.06, Subdivision 7.

In 1994, the SBI asked for junk bond investment authority and the Legislature granted that authority, adding specific language to the SBI's bond investment authority, Section 11A.24, Subdivision 3, "Corporate Obligations." The language, now found in paragraph (b) of that subdivision, states that the SBI may invest in unrated and below-investment grade debt not to exceed five percent of any portfolio. Until 1994, most other large Minnesota pension fund investment authority was created by crossreference to this section of SBI law. The 1994 Legislature willfully acted to keep the non-SBI funds out of the below-investment-grade market by revising these crossreferences to a new provision, Section 356A.06, Subdivision 7, and removing the references to SBI's provision, Section 11A.24. These changes appeared as Laws 1994, Chapter 604, Article 2, entitled "Limit on Investment Authority for other Public Funds." The new Section 356A.06, Subdivision 7, was created largely by copying the SBI law (Minnesota Statutes, Section 11A.24) as it existed *prior* to adding the junk bond authority.

One pension fund association other than the SBI remained tied to the revised SBI investment authority provision, and that was the MTRFA. It is doubtful that this was intended. What happened is that in that same year, 1994, a new post-retirement provision was enacted for the MTRFA, coded as Section 354A.28. That legislation included language stating that the assets of the MTRFA retirees (which the MTRFA refers to as the annuity reserve fund) are to be invested according to the SBI provision, Section 11A.24. When the Legislature changed all the references in *existing* law for non-SBI plans from Section 11A.24 to the new Section 356A.06, Subdivision 7, it failed to catch this new reference to the SBI provision in the new 1994 bill containing the MTRFA post fund language.

Background on Mutual Fund/Index Fund Authority

Volunteer fire plans and local police and paid fire plans have clear investment authority to invest in mutual funds, including index funds, through other investment authority provisions applicable to them, in particular, Sections 66.77, Subdivision 9, and 69.775. Some of the larger nonpublic safety plans, such as MERF and first class city teacher plans, however, may not. Section 356A.06, Subdivision 7, does not mention mutual funds, except as part of a miscellaneous category, referred to as "Other Investments." Under that provision, mutual funds, plus venture capital, real estate ownership interests, resource investments, and internal securities, may not exceed in total 35 percent of the market value of the total portfolio. International stock has become a common form of investment, and an argument can be made that it should not be part of this miscellaneous category. Similarly, many pension fund associations now invest a considerable portion of their total portfolio in index funds, which are designed to match a particular market benchmark. These are very reasonable investment forms to hold, and are likely to entail less risk than using a pool of active managers in a hope of achieving a comparable result. If index funds are considered to be mutual funds, or some other related form of investment that is subject to the miscellaneous investment cap, that maximum restriction could do considerable harm.

According to the MTRFA, the Office of the State Auditor has questioned whether the MTRFA's index fund holdings, and presumably those of various other pension fund associations, are a permissible investment under the plan's investment authority provisions. The MTRFA, possibly in conjunction with some other fund administrations, has responded with this bill draft which would, in part, revise the MTRFA investment authority to Section 356A.06, Subdivision 7, rather than Section 11A.24, and would explicitly authorize holding mutual funds and index investments, and which are not part of the miscellaneous investments category. The other addition, however, to Section 356A.06, Subdivision 7, is explicit authority to hold junk bonds and emerging market debt.

Discussion and Analysis

In part, this bill draft would add explicit junk bond authority to hundreds of pension funds other than SBI. Although the SBI has junk bond authority and has invested in these assets modestly, I am aware of no compelling argument for adding junk bond authority for any pension fund, including the SBI. Long term, the best possible outcome, assuming that the pension fund makes no serious investment mistakes, is that a marginal allocation to junk bond holdings and emerging market debt (which can be consider as foreign junk bonds) will marginally reduce the return to the total portfolio.

One common argument for adding junk bond authority is that junk bonds are an effective diversification element because they behave neither like stocks nor investment-grade bonds (their returns are not well correlated with stocks or investment-grade bonds). This is a troublesome argument, particularly if it is the sole basis for adding junk bonds. Any new form of investment can be justified under this argument since the new investment type will not be perfectly correlated with the existing asset classes. Furthermore, any investment form which ought to be no more than a small fraction of the total portfolio because holding more would not be prudent cannot add effective diversification. The allocation is too small to have any meaningful diversification impact.

The other argument is that junk bonds will enhance return. Junk bonds tend over time to have higher returns than investment-grade bonds, so the claim is that adding junk bonds to a portfolio will improve diversification while enhancing returns. In practice, however, the additional diversification is trivial, while the junk bonds actually harm return. They harm return because although junk bonds have a higher expected return than investment-grade bonds, they have a lower return than stocks and other equity assets. If assets are not needed in the investment-grade bond portfolio, then it would be better to place these assets in stocks or other equity investments rather than in junk bonds.

The SBI request to revise its investment authority in 1994 was inconsistent with its own policy statements. SBI annual reports include a discussion of its asset mix, and the policy justification for each of the asset classes it uses. For years those reports included a statement that SBI invests in bonds as a deflation hedge. In very weak market conditions where deflation rather than inflation is occurring, the reports noted that bonds would be one of the most secure investments and would more than maintain their real value in purchasing power. In other words, bonds were the bedrock or safety net for the portfolio. When SBI decided to invest in junk bonds, it failed to consider that this move was inconsistent with its safety net. Junk bonds are not a sound investment in deflationary markets because of the weakened ability of these companies to cover their debt payments.

The SBI, the MTRFA, and MERF have invested in junk bonds, and there are others, including various volunteer fire funds. MTRFA had the investment authority due to the crossreference to the SBI provision in the MTRFA 1994 law. MERF, and a few other pension funds, have argued that Section 356A.06, Subdivision 7, paragraph (h), the miscellaneous investments provision in existing law, can be read as permitting limited junk bond authority if done through "collective or mutual funds," because the assets covered in this miscellaneous provision are those not authorized elsewhere. Junk bond investing is not authorized in the bond portion of this statute, therefore, under their interpretation, junk bond investing is permitted as a miscellaneous investment if held in a collective or mutual fund. As stated early, those that crafted the 1994 legislation that created Section 356A.06, Subdivision 7, believed that this subdivision does not authorize junk bond holdings. The subdivision was created with the explicit purpose of not extending to non-SBI plans the junk bond authority added to SBI law in 1994.

Several years ago, the MTRFA invested a considerable portion of its assets in junk bonds, with very harmful results. The MTRFA invested in junk bonds at the start of a period when junk bonds were underperforming investment-grade bonds, and unfortunately, they also selected a manager who underperformed the junk bond market. Due to the large junk bond exposure, the bond portfolio as a whole had returns over a several-year period were well below that of investment-grade bond benchmarks. About two years ago, the MTRFA abandoned using junk bonds. SBI and MERF, in recent years, have not been noticeably impacted, but they invest differently than MTRFA did, and in much lower percentages. MERF did have considerable problems with junk bonds back in the late 1980s and early 1990s.

I am troubled that SBI, MERF, and various other funds have not demonstrated that junk bond investments have added value, even within the limited scope of the bond portfolio. For instance, if one were to review bond portfolio returns for SBI, one will find similar Minnesota pension funds with comparable bond returns, although these other funds contend that they have no junk bond investments.

Many volunteer fire relief associations use mutual funds, and a while ago the Office of the State Auditor indicated that many of these mutual funds include some junk bond exposure. The bills currently under consideration, in the form of the S2239-A1 delete everything amendment, would allow junk bond exposure not to exceed five percent of the total portfolio. While this draft language would legitimize the current holdings of many of these relief associations, I would argue that this would be harmful in the long term. Perhaps there is a need to address situations where a bond mutual fund or bond manager suddenly finds the account holding junk bonds, because investment-grade bonds purchased for the portfolio were downgraded after the purchase. (Recent examples are the downgrading of GM and Ford bonds, or bonds of various airlines.) It may not be in the best interest of the investor to immediately sell this mutual fund, or to insist that an investment manager retained by the fund immediately divest of the security. On the other hand, it would be best if pension funds avoided managers who intentionally invest in junk bonds.

Many mutual fund managers have intentionally added junk bonds to bond portfolios for reasons which are not in the best interest of their investors. In recent years there has been growing awareness on the part of investors in general that their investments ought to be measured against some benchmark or performance standard. Unfortunately, rarely does the investor check to see whether the benchmark proposed by the mutual fund managers makes sense given the nature of the portfolio. The benchmarks contained in many mutual fund reports are chosen to make the fund managers look good, not because they represent appropriate benchmarks given the nature of the actual portfolio. For bond funds, perhaps the most common standard is the Lehman Aggregate, the return offered by the investment-grade domestic bond market. This is an appropriate benchmark for an investment-grade portfolio but it is not appropriate if used as the sole benchmark for a bond fund partially devoted to junk bonds. Mutual fund managers add some junk bonds to a mostly investment-grade bond mutual fund to increase the chances that the fund will have high returns relative to this Lehman benchmark and relative to other bond mutual funds. Some of these managers may keep a steady exposure to junk bonds, while others move the portfolio, shifting into junk bond exposure when the manager believes that opportunities exist in that market. It is also not uncommon for bond fund managers to also add some stock to the bond mutual fund. Again, the intention is to spice-up the reported return. When these tactics are successful, they retain existing uninformed investors and attract new ones. It also helps to hide the impact of high management fees.

While these tactics benefit the fund managers, that benefit is at the expense of the investors and at the expense sound pension fund management practices. The investors incur more risk than is necessary to earn a given net return because of the wedge created by manager fees between the gross return and the net return. These tactics also make it impossible for the pension fund that uses these investments to control its asset mix, and there is no greater determinant for total return than asset mix. A pension fund board may believe it has invested half its assets in the domestic investment-grade bonds, but review of the bond manager portfolios would indicate that some of the portfolio is actually in cash, junk bonds, or stock, and the percentages vary at any point in time.

The delete-everything amendment S2239-A1 to S.F. 2239 (Pogemiller); H.F. 2362 (Smith) raises several pension and related public policy issues for Commission consideration and discussion, as follows:

1. <u>Need for Change</u>. The issue is whether much of this bill is needed. The mutual fund/index fund language (on page 4, lines 5 to 9) is a valuable change by clarifying that these organizations can invest

in mutual funds and index funds. The changes, however, in the "other investments" portion, starting on page 4, line 13, will legitimize the holding of junk bonds, which is a questionable policy change, and one which reverses the efforts of the 1994 Legislature to keep the non-SBI pension plans out of that market.

2. Scope of Change. The junk bond/emerging market debt changes proposed in Section 2 of the bill impact all plans subject to this provision, which include the first class city teacher plans, MERF, local police and paid fire plans, Bloomington Fire, and probably a few hundred volunteer fire plans. The level of investment sophistication varies enormously within this group. Even larger more professional organizations can be seriously harmed by that authority, as recently demonstrated by the MTRFA. If the Commission wishes to make that change, the Commission may wish to consider whether that junk bond authority should extend to all the plans currently covered by the provision, or some subgroup. The MTRFA has indicated that currently it is indexing most of its assets, and even if the junk bond authority remains in the bill, it would not use that authority. Other pension funds, however, undoubtedly would.

3. Differences Between SBI Junk Bond Language and Section 356A.06 Proposed Language. The issue is the differences between the junk bond language in SBI law and the proposed language in Section 356A.06. The new proposed language may be substantively different than the authority given to SBI, which may raise Commission concern. The SBI provision, Section 11A.24, Subdivision 3, paragraph (b), reads that:

    (b) The state board may invest in unrated corporate obligations or in corporate obligations that are not rated among the top four quality categories [i.e. are not investment-grade] . . . . . provided that:
    (1) the aggregate value of these obligations may not exceed five percent of the market or book value, whichever is less, of the fund for which the state board is investing;
    (2) the state board's participation is limited to 50 percent of a single offering subject to this paragraph; and
    (3) the state board's participation is limited to 25 percent of an issuer's obligations subject to this paragraph.

   In contrast, the proposed language to be added to Section 356A.06, Subdivision 7, is that a covered plan may invest in "high yield bonds or emerging market debt, up to no more than five percent of total fund assets."

   Regarding differences, the first is that SBI might interpret its provision as not including foreign debt or more specifically, emerging market debt. The proposed language of the non-SBI plans explicitly includes emerging market debt. Second, the cap in the SBI provision is five percent of assets based on market or book, whichever is less, while the proposed language for the non-SBI plans is "five percent of total assets." There is no mention of whether these assets are to be valued at market, actuarial value, cost, book, or some other measure for purposes of this cap. Third, the SBI is prohibited from purchasing more than 50 percent of a single offering while no limit would be placed on the non-SBI plans. If a non-SBI plan were to invest in a very small company, even a modest size non-SBI plan could purchase more than 50 percent of a single offering. Fourth, the SBI can hold no more than 25 percent of the below-investment grade debt of any given company, while no limit is proposed for the non-SBI plans. Finally, it is unclear whether the non-SBI provision is meant to apply to unrated securities.

   The Commission may wish to determine through testimony whether these differences are appropriate, or whether an amendment or amendments are needed.

4. Implications of Junk Bond Exposure. The Commission may wish to consider that junk bonds and emerging market debt will not provide meaningful diversification at the percentages proposed, because the allocation is too small to have much impact, and will somewhat reduce long-term returns. Allowing a larger allocation sufficient to create a meaningful diversification effect would require junk bond holdings at a level which nearly all investment professionals consider to be imprudent and a breach of fiduciary responsibilities as institutional investors. Over the long term, junk bond holdings, whatever the proportion, will lower the total portfolio rate of return compared to results from devoting those assets to equity investments.

5. Lack of Demonstrated Need for Diversification. Pension plan investment advisors tend to recommend to their clients that they should consider investing in additional forms of assets because of the diversifying effect this can provide. Junk bonds are one of the asset forms typically mentioned. However, often the advisor fails to provide evidence that the recommendation makes sense for that particular investment organization, and the boards fail to require that evidence. The advisor's recommendations are based on using market values and the obvious observation that diversification can add more stability to the growth of these assets over time, and to contribution needs. However, the advisor and the board typically fail to consider that for many of our larger pension funds, contribution rates are set by law and do not change unless the applicable law is amended. Variable returns will not trigger any automatic changes in contribution rates. For other plans, such as local police and paid fire plans, contribution needs are influenced by the actuarial value of assets, not market value. These actuarial value of asset methodologies are intended as smoothing methodologies. Furthermore, many of the investment performance-based post-retirement adjustment mechanisms in place are based on forms of five-year averaging of performance, which again is a smoothing methodology. It is not possible to determine whether additional diversification is appropriate for a pension fund without considering these smoothing elements that are already in place. Some diversification is clearly appropriate for pension funds. However, excessive diversification hurts rather than helps. In nearly all cases, diversification reduces a pension fund return.

6. Amount of Junk Bond Permissible Exposure. The delete-everything amendment S2239-A1 to S.F. 2239 (Pogemiller); H.F. 2362 (Smith) would permit up to five percent of total portfolio assets to be in junk bonds. Most pension funds, at least the larger, more professionally managed ones, have most of their assets in equities. If 70 percent of the assets are in equities, then 30 percent would be in bonds or similar debt investments. The five percent cap on junk bonds means that approximately 17 percent of the bond portfolio (5 divided by 30 = 16.6 percent) could be junk bonds. If 80 percent of a fund's assets are in equities, then 25 percent of the bond portfolio could be junk bonds. If junk bond authority remains in the bill, the Commission may wish to consider whether to lower the permissible percentage, and perhaps to express it as a percentage of the bond holdings, rather than total portfolio holdings.

7. Unknown Implications of Striking "Regional and Mutual Funds" Language. The issue is whether striking the "regional and mutual fund" language on page 4, lines 21 to 23, of the delete everything amendment would have some unintended consequences. That language has been used by those who chose to interpret this provision as permitting junk bond investing if it was done through a "regional or mutual fund." For those who were investing in junk bonds, that language is no longer needed, given the explicit authority being added on page 4, lines 21 to 23. However, that stricken language must have had some other meaning and usage when that language was added many years ago. The question is whether striking that language would cause some unintended harm. The Commission may wish to hear brief testimony from the SBI (the language was first added to SBI's provision decades ago) or other parties on this matter, to determine whether there is a need to retain some of that language.

8. Junk Bond Mutual Fund Issue. My understanding is that some pension funds have some junk bond holdings because mutual funds in which they invest hold some of these assets. However, the newly proposed mutual fund language, on page 4, lines 5 to 9, given the crossreferences included in that proposed language, does not include junk bond authority.

9. Redrafting Needed to Reestablish Meaningful Equity Cap. The SBI investment authority provision, and more recently Section 356A.06, subdivision 7, which was derived from the SBI language, includes an 85 percent cap on the portion of the total portfolio held in equities. This is intended to limit risk and variability by requiring at least some diversification, some assets other than equity investments. In Section 356A.06, Subdivision 7, that cap language appears on page 3, line 34, through page 4, line 1, of the delete everything amendment. However, under this draft, some equity assets are left outside the cap. This current draft proposes to explicitly add mutual fund and index fund authority, much of which involve equity assets, but that is not picked up in the cap language. As drafted, a covered pension fund could hold 100 percent equity assets and conform to this provision. It is highly unlikely that was intended. The Commission may wish to consider an amendment.

10. Transition Provision Issues. The transition provision (Section 3) requires divestment of nonconforming assets by January 1, 2008. As drafted, the only nonconforming assets are likely to be junk bonds and emerging market debt in excess of five percent of total assets. As noted earlier, the Commission may wish to reduce that limit, or remove the explicit junk bond language entirely. If it is removed, the Commission could also remove the transition language of Section 3. If there is a need

for it to remain, the Commission may wish to consider whether pension plans should be given until January 1, 2008, to comply, or whether that deadline should be shortened.

Amendments to Delete-Everything Amendment S2239-A1 to S.F. 2239 (Pogemiller); H.F. 2362 (Smith)

The Commission may wish to consider some of the following amendments.

S2239-A2 can be used to delete all explicit junk bond and emerging market debt investment authority.

S2239-A3 is an alternative to S2239-A2 and would delete emerging market debt investment authority.

S2239-A4 could be used to restrict authority to a smaller group of plans if some junk bond and/or emerging market investment authority remains in the bill. This would be accomplished by naming the plans to be included, for example, MERF and/or some or all first class city teacher plans.

S2239-A5 could be used, if junk bond authority remains in the bill for some or all plans, to add further restrictions on those holdings, consistent with the additional restrictions on these investments as found in SBI law.

S2239-A6 can be used, if junk bond authority remains in the bill for some or all plans, to change the maximum permitted percentage from five percent of total assets to some other percentage.

S2239-A7 is an alternative to S2239-A6 and can be used to change the maximum permitted percentage from five percent of total assets to a percentage to be specified by the Office of the State Auditor, not to exceed a maximum percentage to be specified by the Commission or the Legislature. This amendment could be used, for example, if the Commission feels that some de minimus percentage should be allowed because many mutual funds, including some index funds, may include some minimal percentage of these assets. The State Auditor can decide what percent is needed to cover that contingency, with the maximum cap specified in law.

S2239-A8 would reinstate the "regional and mutual fund" language on page 4, lines 21 to 23. The Commission might wish to do that if it is determined that striking this language has the unintended consequence of prohibiting some form of reasonable investment. However, the Commission should be aware that reinstating that language allows some funds to continue their prior interpretation of that language as permitting junk bond investments. That is not an issue if the explicit junk bond language remains in the draft, but it is an issue if that explicit authority is removed by prior amendments.

S2239-A9. If junk bond authority remains in the bill, then the Commission may wish to consider this amendment, which revises the new mutual fund language to include authority to include junk bonds.

S2239-A10 revises the provision ensuring that any equity investments held under the new explicit mutual fund and index fund language is included within the 85 percent equity cap.

S2239-A11 removes the transition language. The transition language may not be needed if the junk/emerging market debt language is not included.

S2239-A12 is an alternative to S2239-A11 and revises the transition language by lengthening the period or shortening it, by filling in the blank in the amendment.

S2239-A13 would remove MTRFA from having any junk bond authority.

Minnesota Statutes 2005, 11A.24

Minnesota Statutes 2005, Table of Chapters

Table of contents for Chapter 11A

11A.24 Authorized investments.

Subdivision 1. **Securities generally.** The state board shall have the authority to purchase, sell, lend or exchange the following securities for funds or accounts specifically made subject to this section including puts and call options and future contracts traded on a contract market regulated by a governmental agency or by a financial institution regulated by a governmental agency. These securities may be owned as units in commingled trusts that own the securities described in subdivisions 2 to 6. Any agreement to lend securities must be concurrently collateralized with cash or securities with a market value of not less than 100 percent of the market value of the loaned securities at the time of the agreement. Any agreement for put and call options and futures contracts may only be entered into with a fully offsetting amount of cash or securities. Only securities authorized by this section, excluding those under subdivision 6, paragraph (a), clauses (1) to (4), may be accepted as collateral or offsetting securities.

Subd. 2. **Government obligations.** The state board may invest funds in governmental bonds, notes, bills, mortgages, and other evidences of indebtedness provided the issue is backed by the full faith and credit of the issuer or the issue is rated among the top four quality rating categories by a nationally recognized rating agency. The obligations in which the board may invest under this subdivision include guaranteed or insured issues of (a) the United States, its agencies, its instrumentalities, or organizations created and regulated by an act of Congress; (b) Canada and its provinces, provided the principal and interest is payable in United States dollars; (c) the states and their municipalities, political subdivisions, agencies or instrumentalities; (d) the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, or any other United States government sponsored organization of which the United States is a member, provided the principal and interest is payable in United States dollars.

Subd. 3. **Corporate obligations.** (a) The state board may invest funds in bonds, notes, debentures, transportation equipment obligations, or any other longer term evidences of indebtedness issued or guaranteed by a corporation organized under the laws of the United States or any state thereof, or the Dominion of Canada or any province thereof provided that:

(1) the principal and interest of obligations of corporations incorporated or organized under the laws of the Dominion of Canada or any province thereof shall be payable in United States dollars; and

(2) obligations shall be rated among the top four quality categories by a nationally recognized rating agency.

(b) The state board may invest in unrated corporate obligations or in corporate obligations that are not rated among the top four quality categories as provided in paragraph (a), clause (2), provided that:

(1) the aggregate value of these obligations may not exceed five percent of the market or book value, whichever is less, of the fund for which the state board is investing;

(2) the state board's participation is limited to 50 percent of a single offering subject to this paragraph; and

(3) the state board's participation is limited to 25

percent of an issuer's obligations subject to this paragraph.

Subd. 4. **Other obligations.** (a) The state board may invest funds in bankers acceptances, certificates of deposit, deposit notes, commercial paper, mortgage securities and asset backed securities, repurchase agreements and reverse repurchase agreements, guaranteed investment contracts, savings accounts, and guaranty fund certificates, surplus notes, or debentures of domestic mutual insurance companies if they conform to the following provisions:

(1) bankers acceptances and deposit notes of United States banks are limited to those issued by banks rated in the highest four quality categories by a nationally recognized rating agency;

(2) certificates of deposit are limited to those issued by (i) United States banks and savings institutions that are rated in the top four quality categories by a nationally recognized rating agency or whose certificates of deposit are fully insured by federal agencies; or (ii) credit unions in amounts up to the limit of insurance coverage provided by the National Credit Union Administration;

(3) commercial paper is limited to those issued by United States corporations or their Canadian subsidiaries and rated in the highest two quality categories by a nationally recognized rating agency;

(4) mortgage securities shall be rated in the top four quality categories by a nationally recognized rating agency;

(5) collateral for repurchase agreements and reverse repurchase agreements is limited to letters of credit and securities authorized in this section;

(6) guaranteed investment contracts are limited to those issued by insurance companies or banks rated in the top four quality categories by a nationally recognized rating agency or to alternative guaranteed investment contracts where the underlying assets comply with the requirements of this section;

(7) savings accounts are limited to those fully insured by federal agencies; and

(8) asset backed securities shall be rated in the top four quality categories by a nationally recognized rating agency.

(b) Sections 16A.58, 16C.03, subdivision 4, and 16C.05 do not apply to certificates of deposit and collateralization agreements executed by the state board under paragraph (a), clause (2).

(c) In addition to investments authorized by paragraph (a), clause (4), the state board may purchase from the Minnesota Housing Finance Agency all or any part of a pool of residential mortgages, not in default, that has previously been financed by the issuance of bonds or notes of the agency. The state board may also enter into a commitment with the agency, at the time of any issue of bonds or notes, to purchase at a specified future date, not exceeding 12 years from the date of the issue, the amount of mortgage loans then outstanding and not in default that have been made or purchased from the proceeds of the bonds or notes. The state board may charge reasonable fees for any such commitment and may agree to purchase the mortgage loans at a price sufficient to produce a yield to the state board comparable, in its judgment, to the yield available on similar mortgage loans at the date of the bonds or notes. The state board may also enter into agreements with the agency for the investment of any portion of the funds of the agency. The agreement must cover the period of the investment, withdrawal privileges, and any guaranteed rate of return.

Subd. 5. **Corporate stocks.** The state board may invest funds in stocks or convertible issues of any corporation organized under the laws of the United States or the states thereof, the Dominion of Canada or its provinces, or any corporation listed on an exchange regulated by an agency of the United States or Canadian national government, if they conform to the following provisions:

(a) The aggregate value of corporate stock investments, as adjusted for realized profits and losses, shall not exceed 85 percent of the market or book value, whichever is less, of a fund, less the aggregate value of investments according to subdivision 6;

(b) Investments shall not exceed five percent of the total outstanding shares of any one corporation, except that the state board may hold up to 20 percent of the shares of a real estate investment trust and up to 20 percent of the shares of a closed-end mutual fund.

Subd. 6. **Other investments.** (a) In addition to the investments authorized in subdivisions 1 to 5, and subject to the provisions in paragraph (b), the state board may invest funds in:

(1) venture capital investment businesses through participation in limited partnerships, trusts, private placements, limited liability corporations, limited liability companies, limited liability partnerships, and corporations;

(2) real estate ownership interests or loans secured by mortgages or deeds of trust or shares of real estate investment trusts through investment in limited partnerships, bank sponsored collective funds, trusts, mortgage participation agreements, and insurance company commingled accounts, including separate accounts;

(3) regional and mutual funds through bank sponsored collective funds and open-end investment companies registered under the Federal Investment Company Act of 1940, and closed-end mutual funds listed on an exchange regulated by a governmental agency;

(4) resource investments through limited partnerships, trusts, private placements, limited liability corporations, limited liability companies, limited liability partnerships, and corporations; and

(5) international securities.

(b) The investments authorized in paragraph (a) must conform to the following provisions:

(1) the aggregate value of all investments made according to paragraph (a), clauses (1) to (4), may not exceed 35 percent of the market value of the fund for which the state board is investing;

(2) there must be at least four unrelated owners of the investment other than the state board for investments made under paragraph (a), clause (1), (2), (3), or (4);

(3) state board participation in an investment vehicle is limited to 20 percent thereof for investments made under paragraph (a), clause (1), (2), (3), or (4); and

(4) state board participation in a limited partnership does not include a general partnership interest or other interest involving general liability. The state board may not engage in any activity as a limited partner which creates general liability.

(c) All financial, business, or proprietary data collected, created, received, or maintained by the state board in connection with investments authorized by paragraph (a), clause (1), (2), or (4), are nonpublic data under section 13.02, subdivision 9. As used in this paragraph, "financial, business, or proprietary data" means data, as determined by the responsible authority for the state board, that is of a financial, business, or proprietary nature, the release of which could cause competitive harm to the state board, the legal entity in which the state board has invested or has considered an investment, the managing entity of an investment, or a portfolio company in which the legal entity holds an interest. As used in this section, "business data" is data described in section 13.591, subdivision 1. Regardless of whether they could be considered financial, business, or proprietary data, the following data received, prepared, used, or retained by the state board in connection with investments authorized by paragraph (a), clause (1), (2), or (4), are public at all times:

(1) the name and industry group classification of the legal entity in which the state board has invested or in which the state board has considered an investment;

(2) the state board commitment amount, if any;

(3) the funded amount of the state board's commitment to date, if any;

(4) the market value of the investment by the state board;

(5) the state board's internal rate of return for the investment, including expenditures and receipts used in the calculation of the investment's internal rate of return; and

(6) the age of the investment in years.

Subd. 7. **Appropriation.** There is annually appropriated to the state board, from the assets of the funds for which the state board invests pursuant to subdivision 6, clause (a), sums sufficient to pay the costs for the management of these funds by private management firms.

HIST: 1980 c 607 art 14 s 22; 1981 c 208 s 3-6,9; 1982 c 587 s 2; 1983 c 216 art 1 s 5; 1983 c 324 s 7-9; 1984 c 382 s 1; 1984 c 383 s 2,3; 1985 c 224 s 3-5; 1987 c 72 s 1; 1987 c 372 art 8 s 2-6; 1988 c 453 s 7,8; 1991 c 47 s 1; 1991 c 206 s 1; 1992 c 539 s 9; 1992 c 587 art 2 s 2; 1992 c 592 s 2; 1993 c 300 s 6,7; 1994 c 604 art 1 s 7-11; 1995 c 122 s 1; 1998 c 386 art 2 s 8; 2000 c 392 s 1,2; 2005 c 156 art 2 s 7

* NOTE: Subdivision 6 was also amended by Laws 2005, chapter
*163, section 2, to read as follows:

* "Subd. 6. **Other investments.** (a) In addition to the
*investments authorized in subdivisions 1 to 5, and subject to
*the provisions in paragraph (b), the state board may invest
*funds in:

* (1) venture capital investment businesses through
*participation in limited partnerships, trusts, private
*placements, limited liability corporations, limited liability
*companies, limited liability partnerships, and corporations;

* (2) real estate ownership interests or loans secured by
*mortgages or deeds of trust or shares of real estate investment
*trusts through investment in limited partnerships, bank
*sponsored collective funds, trusts, mortgage participation
*agreements, and insurance company commingled accounts, including
*separate accounts;

* (3) regional and mutual funds through bank sponsored
*collective funds and open-end investment companies registered
*under the Federal Investment Company Act of 1940, and closed-end
*mutual funds listed on an exchange regulated by a governmental
*agency;

* (4) resource investments through limited partnerships,
*trusts, private placements, limited liability corporations,
*limited liability companies, limited liability partnerships, and
*corporations; and

* (5) international securities.

* (b) The investments authorized in paragraph (a) must
*conform to the following provisions:

* (1) the aggregate value of all investments made according
*to paragraph (a), clauses (1) to (4), may not exceed 35 percent
*of the market value of the fund for which the state board is
*investing;

* (2) there must be at least four unrelated owners of the
*investment other than the state board for investments made under
*paragraph (a), clause (1), (2), (3), or (4);

* (3) state board participation in an investment vehicle is
*limited to 20 percent thereof for investments made under
*paragraph (a), clause (1), (2), (3), or (4); and

* (4) state board participation in a limited partnership does
*not include a general partnership interest or other interest

*involving general liability. The state board may not engage in
*any activity as a limited partner which creates general
*liability.

* (c) All financial, business, or proprietary data collected,
*created, received, or maintained by the state board in
*connection with investments authorized by paragraph (a), clause
*(1), (2), or (4), are nonpublic data under section 13.02,
*subdivision 9. As used in this section, "financial, business,
*or proprietary data" means data, as determined by the
*responsible authority for the state board: (i) that is of a
*financial, business, or proprietary nature; and (ii) the release
*of which could cause competitive harm to the state board, the
*legal entity in which the state board has invested or has
*considered an investment, the managing entity of an investment,
*or a portfolio company in which the legal entity holds an
*interest. As used in this section, "business data" is data
*described in section 13.591, subdivision 1. Regardless of
*whether they could be considered financial, business, or
*proprietary data, the following data received, prepared, used,
*or retained by the state board in connection with investments
*authorized by paragraph (a), clause (1), (2), or (4), are public
*at all times:

* (1) the name and industry group classification of the legal
*entity in which the state board has invested or in which the
*state board has considered an investment;

* (2) the state board commitment amount, if any;

* (3) the funded amount of the state board's commitment to
*date, if any;

* (4) the market value of the investment by the state board;

* (5) the state board's internal rate of return for the
*investment, including expenditures and receipts used in the
*calculation of the investment's internal rate of return; and

* (6) the age of the investment in years."

.... moves to amend the delete everything amendment (S2239-A1) to S.F. No. 2239 as follows:

Page 4, line 26, delete "; and"

Page 4, delete line 27

Page 4, line 28, delete the new language

Amend the title accordingly

.... moves to amend the delete everything amendment (S2239-A1) to S.F. No. 2239 as follows:

Page 4, line 27, delete "or emerging market debt, up to no more than" and insert " not to exceed"

Amend the title accordingly

.... moves to amend the delete everything amendment (S2239-A1) to S.F. No. 2239 as follows:

Page 4, line 27, before "high" insert "for the .... only,"

Amend the title accordingly

.... moves to amend the delete everything amendment (S2239-A1) to S.F. No. 2239 as follows:

Page 5, line 2, strike "and"

Page 5, line 6, after "liability" insert "; and

(v) for investments under clause (1), item (v), the aggregate value of these investments must not exceed the percentage specified in that clause based on market or book value, whichever is less, the covered pension plan's participation is limited to 50 percent of a single bond or debt offering, and participation is limited to 25 percent of an issuer's obligations under that clause"

.... moves to amend the delete everything amendment (S2239-A1) to S.F. No. 2239 as follows:

Page 4, line 27, delete "up to no more than five" and insert "not to exceed ...."

.... moves to amend the delete everything amendment (S2239-A1) to S.F. No. 2239 as follows:

Page 4, line 27, delete everything after the new comma

Page 4, line 28, delete "of total fund assets" and insert "not to exceed a percentage of total fund assets, based on market or book value, whichever is less, to be specified by the state auditor, and not to exceed .... percent of total fund assets"

.... moves to amend the delete everything amendment (S2239-A1) to S.F. No. 2239 as follows:

Page 4, lines 21 to 24, reinstate the stricken language

Page 4, line 26, reinstate the stricken language and delete "(iv)"

Page 4, line 27, delete "(v)" and insert "(vi)"

.... moves to amend the delete everything amendment (S2239-A1) to S.F. No. 2239 as follows:

Page 4, line 9, before the new period insert "<u>and (v)</u>"

.... moves to amend the delete everything amendment (S2239-A1) to S.F. No. 2239 as follows:

Page 3, line 35, after the new comma insert "<u>and equity forms of investment under paragraphs (g) and (h),</u>"

.... moves to amend the delete everything amendment (S2239-A1) to S.F. No. 2239 as follows:

Page 5, delete Section 3

Page 5, line 12, delete "to 3" and insert "and 2"

Renumber the sections in sequence

.... moves to amend the delete everything amendment (S2239-A1) to S.F. No. 2239 as follows:

Page 5, line 10, delete "2008" and insert "...."

.... moves to amend the delete everything amendment (S2239-A1) to S.F. No. 2239 as follows:

Page 5, line 2, strike "; and"

Page 5, line 6, after "liability" insert "; and

(v) the Minneapolis Teachers Retirement Fund Association is not authorized to invest under clause (1), item (v)"

.... moves to amend S.F. No. 2239; H.F. No. 2362, as follows:

Delete everything after the enacting clause and insert:

"Section 1. Minnesota Statutes 2004, section 354A.28, subdivision 5, is amended to read:

Subd. 5. **Investment.** The assets of the annuity reserve fund must be invested, reinvested, and retained ~~in the discretion of~~by the board of trustees of the Minneapolis Teachers Retirement Fund Association in authorized investments under section ~~11A.24~~356A.06, subdivision 7.

Sec. 2. Minnesota Statutes 2005 Supplement, section 356A.06, subdivision 7, is amended to read:

Subd. 7. **Expanded list of authorized investment securities.** (a)**Authority.**Except to the extent otherwise authorized by law ~~or bylaws~~, a covered pension plan not described by subdivision 6, paragraph (a), ~~may~~shall invest its assets only in accordance with this subdivision.

(b) **Securities generally.**The covered pension plan has the authority to purchase, sell, lend, or exchange the securities specified in paragraphs (c) to ~~(h)~~(i), including puts and call options and future contracts traded on a contract market regulated by a governmental agency or by a financial institution regulated by a governmental agency. These securities may be owned as units in commingled trusts that own the securities described in paragraphs (c) to ~~(h)~~(i).

(c) **Government obligations.**The covered pension plan may invest funds in governmental bonds, notes, bills, mortgages, and other evidences of indebtedness provided the issue is backed by the full faith and credit of the issuer or the issue is rated among the top four quality rating categories by a nationally recognized rating agency. The obligations in which funds may be invested under this paragraph include guaranteed or insured issues of (1) the United States, its agencies, its instrumentalities, or organizations created and regulated by an act of Congress; (2) Canada and its provinces, provided the principal and interest is payable in United States dollars; (3) the states and their municipalities, political subdivisions, agencies, or instrumentalities; (4) the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, or any other United States government sponsored organization of which the United States is a member, provided the principal and interest is payable in United States dollars.

(d) **Corporate obligations.** The covered pension plan may invest funds in bonds, notes, debentures, transportation equipment obligations, or any other longer term evidences of indebtedness issued or guaranteed by a corporation organized under the laws of the United States or any state thereof, or the Dominion of Canada or any province thereof if they conform to the following provisions:

(1) the principal and interest of obligations of corporations incorporated or organized under the laws of the Dominion of Canada or any province thereof must be payable in United States dollars; and

(2) obligations must be rated among the top four quality categories by a nationally recognized rating agency.

(e) **Other obligations.** (1) The covered pension plan may invest funds in bankers acceptances, certificates of deposit, deposit notes, commercial paper, mortgage participation certificates and pools, asset backed securities, repurchase agreements and reverse repurchase agreements, guaranteed investment contracts, savings accounts, and guaranty fund certificates, surplus notes, or debentures of domestic mutual insurance companies if they conform to the following provisions:

(i) bankers acceptances and deposit notes of United States banks are limited to those issued by banks rated in the highest four quality categories by a nationally recognized rating agency;

(ii) certificates of deposit are limited to those issued by (A) United States banks and savings institutions that are rated in the highest four quality categories by a nationally recognized rating agency or whose certificates of deposit are fully insured by federal agencies; or (B) credit unions in amounts up to the limit of insurance coverage provided by the National Credit Union Administration;

(iii) commercial paper is limited to those issued by United States corporations or their Canadian subsidiaries and rated in the highest two quality categories by a nationally recognized rating agency;

(iv) mortgage participation or pass through certificates evidencing interests in pools of first mortgages or trust deeds on improved real estate located in the United States where the loan to value ratio for each loan as calculated in accordance with section 61A.28, subdivision 3, does not exceed 80 percent for fully amortizable residential properties and in all other respects meets the requirements of section 61A.28, subdivision 3;

(v) collateral for repurchase agreements and reverse repurchase agreements is limited to letters of credit and securities authorized in this section;

(vi) guaranteed investment contracts are limited to those issued by insurance companies or banks rated in the top four quality categories by a nationally recognized rating agency or to alternative guaranteed investment contracts where the underlying assets comply with the requirements of this subdivision;

(vii) savings accounts are limited to those fully insured by federal agencies; and

(viii) asset backed securities must be rated in the top four quality categories by a nationally recognized rating agency.

(2) Sections 16A.58, 16C.03, subdivision 4, and 16C.05 do not apply to certificates of deposit and collateralization agreements executed by the covered pension plan under clause (1), item (ii).

(3) In addition to investments authorized by clause (1), item (iv), the covered pension plan may purchase from the Minnesota Housing Finance Agency all or any part of a pool of residential mortgages, not in default, that has previously been financed by the issuance of bonds or notes of the agency. The covered pension plan may also enter into a commitment with the agency, at the time of any issue of bonds or notes, to purchase at a specified future date, not exceeding 12 years from the date of the issue, the amount of mortgage loans then outstanding and not in default that have been made or purchased from the proceeds of the bonds or notes. The covered pension plan may charge reasonable fees for any such commitment and may agree to purchase the mortgage loans at a price sufficient to produce a yield to the covered pension plan comparable, in its judgment, to the yield available on similar mortgage loans at the date of the bonds or notes. The covered pension plan may also enter into agreements with the agency for the investment of any portion of the funds of the agency. The agreement must cover the period of the investment, withdrawal privileges, and any guaranteed rate of return.

(f) **Corporate stocks.**The covered pension plan may invest funds in stocks or convertible issues of any corporation organized under the laws of the United States or the states thereof, any corporation organized under the laws of the Dominion of Canada or its provinces, or any corporation listed on an exchange regulated by an agency of the United States or of the Canadian national government, if they conform to the following provisions:

(1) the aggregate value of corporate stock investments, as adjusted for realized profits and losses, <u>plus the aggregate value of investments under paragraph (i),</u> must not

exceed 85 percent of the market or book value, whichever is less, of a fund~~, less the aggregate value of investments according to paragraph (h)~~; and

(2) investments must not exceed five percent of the total outstanding shares of any one corporation.

(g) **Commingled or mutual investments.** The covered pension plan may invest in index funds or mutual funds, including index mutual funds, through bank-sponsored collective funds and shares of open-end investment companies registered under the Federal Investment Company Act of 1940, if the investments of the index or mutual fund comply with paragraphs (c) to (f), and paragraph (i), clause (1)(iv).

(h) **Exchange traded funds.** The covered pension plan may invest funds in exchange traded funds, subject to the maximums, the requirements, and the limitations set forth in paragraph (d), (e), (f), or (h), whichever applies.

~~(h)~~(i) **Other investments.** (1) In addition to the investments authorized in paragraphs (b) to ~~(g)~~(h), and subject to the provisions in clause (2), the covered pension plan may invest funds in:

(i) venture capital investment businesses through participation in limited partnerships and corporations;

(ii) real estate ownership interests or loans secured by mortgages or deeds of trust through investment in limited partnerships, bank sponsored collective funds, trusts, and insurance company commingled accounts, including separate accounts;

(iii) ~~regional and mutual funds through bank sponsored collective funds and open-end investment companies registered under the Federal Investment Company Act of 1940;~~

~~(iv)~~ resource investments through limited partnerships, private placements, and corporations; ~~and~~

~~(v)~~(iv) international securities; and

(v) high yield bonds or emerging market debt, up to no more than five percent of total fund assets.

(2) The investments authorized in clause (1) must conform to the following provisions:

(i) the aggregate value of all investments made according to clause (1) may not exceed 35 percent of the market value of the fund for which the covered pension plan is investing;

(ii) there must be at least four unrelated owners of the investment other than the covered pension plan for investments made under clause (1), item (i), (ii), or (iii)~~, or (iv)~~;

(iii) covered pension plan participation in an investment vehicle is limited to 20 percent thereof for investments made under clause (1), item (i), (ii), or (iii)~~, or (iv)~~; and

(iv) covered pension plan participation in a limited partnership does not include a general partnership interest or other interest involving general liability. The covered pension plan may not engage in any activity as a limited partner which creates general liability.

Sec. 3. **TRANSITION PROVISION.**

A covered pension plan with investment that on the day prior to the effective date of this section do not comply with section 2 shall divest of any assets not in compliance before January 1, 2008.

Sec. 4. **EFFECTIVE DATE.**

Sections 1 to 3 are effective the day following final enactment."

Delete the title and insert:

" A bill for an act

relating to retirement; Minneapolis Teachers Retirement Fund Association and expanded list plans; making Minneapolis Teachers Retirement Fund Association subject to expanded list investment authority provision; clarifying mutual fund authority; revising expanded list investment authority provision to include below-investment grade bonds; amending Minnesota Statutes 2004, section 354A.28, subdivision 5; Minnesota Statutes 2005 Supplement, section 356A.06, subdivision 7."