**S.F. 2428**

(Pappas)

H.F. xxx

(Thissen)

Executive Summary of Commission Staff Materials

<i>Affected Pension Plan(s):</i>	Large Plans
<i>Relevant Provisions of Law:</i>	Minnesota Statutes, Chapter 356 and 356A
<i>General Nature of Proposal:</i>	Public Pension Plans Reporting Requirements and Authorized Investment Provisions Modifications
<i>Date of Summary:</i>	February 10, 2006

Specific Proposed Changes

Revises large plan (over \$10 million in assets) investment return reporting by having the plans report returns to the Office of the State Auditor rather than submitting data and having the State Auditor compute those returns; revises the expanded list (large non-SBI plan) investment authority provision (Section 356A.06, Subdivision 7) by moving real estate investment trusts (REITs) and insurance company commingled account investments to a general securities provision from the miscellaneous investments category; and repealing the following provisions:

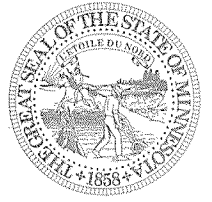
- Section 356A.06, Subdivision 4, Economic Interest Statements, which required the plan executive director and all board members to file annual economic interest statements;
- Section 356A.06, Subdivision 5, Investment Business Recipient Disclosure, which required pension plan chief administrative officers to annually disclose the all investment related organizations and individual which did business with the plan; and
- Section 356A.06, Subdivision 8b, Disclosure of Investment Authority, which required every covered plan to annually provide to its investment managers, advisors, brokers, and similar firm with a copy of the investment authority of the fund, including relevant investment restrictions.

Policy Issues Raised by the Proposed Legislation

1. Investment return self-reporting issues.
2. Appropriate definition of large plan.
3. Implications of striking "regional and mutual funds" language/junk bond authority argument.
4. Proper treatment of real estate investment trusts (REITS) and insurance company commingled accounts.
5. Issues with changing maximum percentage of miscellaneous assets.
6. Scope of change.
7. Repealer issues.

Potential Amendments

- S2428-A1 revises the reporting cap on page 1 to some other figure instead of \$10 million.
- S2428-A2 is an alternative to S2428-A1, and would exclude certain types of plans from reporting.
- S2428-A3 retains the existing reporting without change by deleting Section 1.
- S2428-A4 adds debt and equity REIT and insurance commingled accounts to the applicable debt and equity investment provisions, which also has the effect of including these equity investments within the existing equity cap.
- S2428-A5 restores the existing 35 percent cap on alternative assets.
- S2428-A6, an alternative to S2428-A5, creates a cap at some level other than the proposed 45 percent miscellaneous asset cap.
- S2428-A7 moves developed foreign market stock investing out of the miscellaneous provision and would revise the miscellaneous investment cap to a percentage to be determined by the Commission, presumably a percentage lower than the existing law 35 percent cap.
- S2428-A8 removes the repealer.
- S2428-A9 adds an effective date.



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director *EB*

RE: S.F. 2428 (Pappas); HF xxx (Thissen): Public Pension Plans Reporting Requirements and Authorized Investment Provisions Modifications

DATE: February 10, 2006

Summary of S.F. 2428 (Pappas); HF xxx (Thissen)

S.F. 2428 (Pappas); HF xxx (Thissen) revises large plan (over \$10 million in assets) investment return reporting by having the plans report returns to the Office of the State Auditor rather than submitting data and having the State Auditor compute those returns; revises the expanded list (large non-SBI plan) investment authority provision (Section 356A.06, Subdivision 7) by moving real estate investment trusts (REITs) and insurance company commingled account investments to a general securities provision from the miscellaneous investments category; and repealing the following provisions:

- Section 356A.06, Subdivision 4, Economic Interest Statements, which required the plan executive director and all board members to file annual economic interest statements;
- Section 356A.06, Subdivision 5, Investment Business Recipient Disclosure, which required pension plan chief administrative officers to annually disclose the all investment related organizations and individual which did business with the plan; and
- Section 356A.06, Subdivision 8b, Disclosure of Investment Authority, which required every covered plan to annually provide to its investment managers, advisors, brokers, and similar firm with a copy of the investment authority of the fund, including relevant investment restrictions.

Background Information on Permissible Investments 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 State Board of Investment 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 this is not further defined or specified in law, presumably this 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 Information on the Origin of Larger Non-SBI Plan Investment Authority Provision

In 1994, the State Board of Investment (SBI) asked for junk bond investment authority and the Legislature granted that request, 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 (junk bonds) not to exceed five percent of any portfolio, with some further restrictions regarding the portion of any offering that SBI could purchase, and the percentage of any one company's below-investment-grade debt (junk bonds) that SBI could own. Until 1994, most other large Minnesota pension fund investment authority had the same investment authority as SBI, created by cross-reference 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 cross-references 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 SBI remained tied to the revised SBI investment authority provision, and that was the Minneapolis Teachers Retirement Fund Association (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.

Section 356A.06, Subdivision 7, is applicable to a broad group of plans. The provision is called the "expanded list" investment authority provision. A limited list plan (Section 356A.06, Subdivision 6) is any plan with asset less than \$1 million, unless it uses the services of a registered or licensed investment advisor to invest at least 60 percent of its assets, or uses the State Board of Investment (SBI) to invest at least 60 percent of its assets, or uses an investment advisor and SBI in some combination to invest at least 75 percent of its assets. An expanded list plan is any public pension plan which is not a limited list plan. Therefore, an plan with \$1 million or more is automatically an expanded list plan, and many plans smaller than \$1 million are also expanded list plans because of their use of investment advisors. There are likely to be hundreds of volunteer fire plans that are expanded list plans. The local Minneapolis police and paid fire plan fall into this category, as well as the Minneapolis Employees Retirement Fund (MERF), and various first class city teacher plans.

Junk Bond Issues

In the bill, some language in the miscellaneous investment section is being stricken, language which some plan administrations have contended gave expanded list plans some authority to invest in junk bonds. Although striking that language (page 6, lines 17 to 19) may not have been an effort to undercut that junk bond authority interpretation, it would have that effect.

SBI, the MTRFA, and MERF have invested in junk bonds, and there are others, including various volunteer fire funds. SBI has that authority because it is explicitly stated in the SBI provision. MTRFA has the investment authority due to the cross-reference 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 this interpretation, junk bond investing is permitted as a miscellaneous investment if held in a collective or mutual fund. Those who crafted the 1994 legislation creating 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.

Economic Interest Statements, Investment Business Disclosures, and Disclosure of Investment Authority

The requirements to provide economic interest statements and investment business recipient disclosures were provisions added to law in 1989 when Chapter 356A, Public Pension Fiduciary Responsibility, was enacted. The provisions were intended to provide public disclosure of conflicts of interest, and to provide incentives for plan administrators and board members to avoid future conflicts of interest. These provisions apply to all public pension plans in the state. The disclosure of investment authority may have been added later. The disclosure of investment authority is an effort to ensure that plans invest according to law. For that to happen, the plan administrators must understand their laws, and they must ensure that these requirements are understood by those who invest on the fund's behalf, or who act as investment advisors giving advice on investment matters, including asset mix, to the board. Surveys of the larger fund administrations some years ago indicated that some of these organizations did not fully comprehend their investment authority, and the problem is likely to be worse in the smaller plans. One purpose served by the disclosure of investment authority provision is that it may force plan administrators to better understand their investment authority provisions, in order to convey that information to the investment managers and similar professions hired by the plan.

Rate of Return Reporting to the State Auditor

In the late 1980s or early 1990s the Commission was authorized under law to have large Minnesota public pension plans report time-weighted rates of return to the Commission. The purpose was to provide public disclosure of large plan investment performance, and followed from growing recognition of the importance of investment returns in funding pension plans. With a well invested plan, about 70 percent of the assets to support annuities for retirees come from investment earnings, with the other 30 percent coming from accumulated contributions. A well designed and well executed investment plan can considerably reduce contribution burdens, while a poorly invested plan can add considerably to contribution requirements.

In the early- to mid-1990s, this responsibility to receive and report investment performance was shifted to the State Auditor. The State Auditor investment performance reporting provisions, Section 356.219, represented a considerable potential improvement over the limited reporting by the Commission. The State Auditor investment performance reporting provisions are much broader in scope, requiring all public pension funds to provide data to the State Auditor to enable the auditor to compute and report those returns. This was a considerable expansion over the few dozen pension funds covered in the earlier Commission reviews. Also, by having the State Auditor compute returns from raw data, rather than relying on self-reported returns, the is considerably greater accuracy than in the earlier Commission reports. While Commission staff did not have the raw data to compute returns, the returns submitted to the Commission were reviewed for internal consistency and plausibility. Often returns that were initially reported were not correct (the claimed annual returns were not consistent with the reported quarterly returns) or were clearly not plausible. Considerable time was spent in correspondence and phone calls requesting plan administrators to correct obvious errors. Erroneous reports from the larger volunteer fire plans were common. Some obvious errors were also detected in reports from local paid plans and first class city teacher plans.

Under existing law, Section 356.219, various large pension funds do provide computed total portfolio and asset class returns to the State Auditor, but they must also provide the data to allow the auditor to compute those returns. In the various investment performance reports that the State Auditor has produced, the State Auditor included in its reports both the compute returns provided by the fund and the State Auditor computation of returns given the raw data. For some pension funds, there are some discrepancies. Several years ago, in a preliminary Commission staff report of large fund investment performance, in which we relied in part on the information in the State Auditor reports, we noted these discrepancies. However, the Commission chose not to continue that study, and the source of the discrepancies was never determined.

Policy Issues

S.F. 2428 (Pappas); HF xxx (Thissen) raises the following pension and related public policy issues:

1. Investment Return Self-Reporting Issues. The issue is whether large pension funds, defined in current law (page 1, line 16) as a plan with assets of \$10 million or more, should report computed total portfolio and asset class returns in lieu of sending the raw data to the State Auditor. The Commission may wish to consider whether the State Auditor is providing a valuable check on the accuracy of the reported returns under the current system of having the State Auditor compute the returns from the raw data, at least in many cases. The Commission may wish to hear testimony from the State Auditor and from various pension plan administrator on this issue. As noted previously, in the past there has been differences between the fund-reported returns, and the State Auditor-computed returns that resulted from the pension plans raw data. It is unclear, at least in most cases, which set of returns is the more accurate. As discussed previously, in the early 1990s when returns were reported directly to the Commission, erroneous rate of return reports were common among the larger volunteer fire plans that were reporting, and even with the paid plans and various first class city teacher plans, errors were far from rare.
2. Appropriate Definition of Large Plan. Particularly if the Commission does decide to allow large funds to self-report returns to the State Auditor rather than having the State Auditor compute returns, the Commission may wish to consider how to best define the group that will not provide raw data. On page 1, line 16, the cut off is \$10 million, which may be much too low. Bloomington Fire Department Relief Association, a quasi-volunteer fire plan with approximately \$100 million in assets, is a plan which has had considerable investment performance issues and in the past has had difficulty providing reasonable, accurate investment performance returns. Eden Prairie Fire, another volunteer fire plan, has assets of about \$13 million. The Commission might choose to consider resetting the cutoff to a higher figure, perhaps \$150 million. This would be high enough, at least at the present time, to have all the volunteer fire plans continue to provide raw data to the State Auditor. However, those that exceed this cutoff include the Minneapolis relief associations, the three first class city teacher plans, and MERF. In the recent past, there have been discrepancies between returns those funds self-reported and the returns the State Auditor computed from their data.

Rather than using a dollar cutoff, the Commission might wish to consider a dividing line based on the nature of the organization rather than a dollar cutoff. For instance, relief associations, whether paid or volunteer, could continue to report raw data, while MERF and first class city teacher funds would provide only computed returns.

3. Implications of Striking “Regional and Mutual Funds” Language/Junk bond Authority Argument. The issue is implications of striking the “regional and mutual fund” language on page 6, lines 17 to 19, as this bill draft would do. 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.” Its deletion will undercut that argument, and will have implications for those who hold these investments, unless junk bond investing were explicitly authorized by an amendment or by consideration of another bill on the Commission’s agenda, S.F. 2239 (Pogemiller); H.F. 2362 (Smith).
4. Proper Treatment of Real Estate Investment Trusts (REITs) and Insurance Company Commingled Accounts. The issue is how to best handle REITs and insurance company commingled accounts within the investment authority provision. The proposed changes on page 6, lines 15 to 16, combined with the change on page 3, lines 29 to 30, would move insurance company commingled accounts to the Securities General provision, and would presumably leave some REIT investments in the miscellaneous investment section, while also authorizing REITs under the Securities General provision. The Commission may wish to hear testimony from the Executive Secretary of the St. Paul Teachers Retirement Fund Association (SPTRFA) regarding the nature of insurance company commingled accounts, to enable the Commission to decide if the change related to those investments is reasonable. Regarding REITs, the changes on page 6 and 3 seems an attempt to leave, as a miscellaneous investment form, REIT investments through limited partnerships or bank sponsored collective funds. As drafted, any other REIT investment would fall under “Securities General.”

The placement of the new language presents a problem. In large part, the Securities General provision currently specifies the types of actions that a covered plan can take with the securities that are authorized elsewhere in the provision. While the new language could remain as it is currently proposed, the Commission may wish to add additional language elsewhere. For example, REITs can be of predominantly debt in nature, or they can represent equity real estate assets. It would be reasonable to add language in the Other Obligations paragraph on page 4 to cover debt-related REITs,

and to add language in the Corporate Stock paragraph on page 5 and 6, to cover equity REITs. REITs, including some debt-related REITs, currently trade on stock exchanges. It may therefore be impossible to avoid REITs if the investor is investing in index funds which track various portions of the equity markets, or that tracks the Wilshire 5000, which covers all domestic stock markets. Similar additions might be appropriate for insurance company commingled accounts.

If language is not added to the debt and equity provisions as mentioned above, equity REITs and equity related insurance company commingled accounts would fail to be included in the cap on total equity assets, 85 percent of total assets. The existing cap language is found on page 6, lines 1 to 3.

5. Issues with Changing Maximum Percentage of Miscellaneous Assets. S.F. 2428 (Pappas); HF xxx (Thissen) would change the maximum percentage of miscellaneous assets from 35 percent of a portfolio to 45 percent (page 6, line 26). The existing cap on asset types that are included in this miscellaneous asset provision was set because the asset types included here (including venture capital and resource investments) are believed to be of high risk, and the Legislature chose to allow some exposure to these asset types, but to limit that exposure to control the plan's risk. The draft would increase that percentage from 35 percent to 45 percent, a move that should not be made without careful legislative consideration.

The Commission may also wish to consider that the bill strikes some language in this provision and moves some asset types (various REIT investment and insurance company commingled accounts) to other sections. Therefore, fewer asset types remain in this miscellaneous category, and even without increasing the 35 percent limit, pension plans could increase their exposure to these remaining asset types in the miscellaneous category. This would suggest that the cap should be lowered, rather than raised, to compensate for the asset types that would be moved out of this category by the bill.

The Commission may wish to hear testimony to identify the nature of the problem that the pension plans seeking this change are trying to address. An alternative solution may be more appropriate than the proposed cap change.

The greatest concern is likely to be international securities (which are authorized in existing law language on page 6, line 22). In the decades since this provision was first enacted (for SBI, and later copied into Section 356.A.06, Subdivision 7) foreign stock investing has become a mainstream investment, and is now found in sizable percentage in most institutional portfolios. At the current time, for example, the SBI Post Fund has 15 percent of its total portfolio in foreign stock. Other pension plans may have a comparable percentage, and some higher. That exposure would get a covered pension fund about half way to the existing miscellaneous asset cap. Rather than leaving foreign stock in this provision, the Commission may wish to consider moving at least some portion of it (developed market foreign stock) out of this provision, and revising the cap downward.

6. Scope of Change. The issue is whether to include all covered plans in these investment-related changes, or just some.
7. Repealer Issues. The question is whether it is appropriate to repeal the economic interest statement, investment business recipient and disclosure of investment authority provisions. Those provisions were added to law to foster ethical action by plan administrators and boards, and other plan fiduciaries, and to enhance efforts to have pension plan investment programs operated consistent with law. The Commission may wish to hear testimony from the various parties. Perhaps these provisions are not well tailored to achieve the desired results. One option is the repealer that is contained in the bill. Another is to retain these provisions and study the situation over the next legislative interim to see if the provisions are working well, need to be revised, or should be removed.

Potential Amendments for Commission Consideration

S2428-A1 revises the reporting cap on page 1 to some other figure instead of \$10 million. The Commission might wish to consider \$150 million, or some similar figure.

S2428-A2 is an alternative to S2428-A1, and would exclude certain types of plans from reporting. The Commission may wish to consider including in the blank the first class city teacher plans, MERF, and possibly some others.

S2428-A3 retains the existing reporting without change by deleting Section 1.

S2428-A4 adds debt and equity REIT and insurance commingled accounts to the applicable debt and equity investment provisions, which also has the effect of including these equity investments within the existing equity cap.

S2428-A5 restores the existing 35 percent cap on alternative assets.

S2428-A6, an alternative to S2428-A5, creates a cap at some level other than the proposed 45 percent miscellaneous asset cap.

S2428-A7 moves developed foreign market stock investing out of the miscellaneous provision and would revise the miscellaneous investment cap to a percentage to be determined by the Commission, presumably a percentage lower than the existing law 35 percent cap.

S2428-A8 removes the Repealer.

S2428-A9 adds an effective date.

- 1.1 moves to amend S.F. No. 2428; H.F. No., as follows:
- 1.2 Page 1, line 16, strike "\$10,000,000" and insert "\$......"
- 1.3 Page 2, lines 2 and 13, strike "\$10,000,000" and insert "\$......"

1.1 moves to amend S.F. No. 2428; H.F. No., as follows:

1.2 Page 1, line 16, after "(b)" insert:

1.3 "For the, the report required by subdivision 1 must include the
1.4 market value of the total portfolio and the market value of each investment account,
1.5 investment portfolio, or asset class included in the pension fund as of the beginning of the
1.6 calendar year and the end of the calendar year. In addition, the plan must submit a report
1.7 on a form prescribed by the state auditor that includes the time-weighted return, net of any
1.8 investment-related fees, on a total portfolio and asset class basis.

1.9 (c)"

1.10 Page 1, line 16, after "plan" insert "is not covered under paragraph (b) and"

1.11 Page 1, lines 20 to 24, reinstate the stricken language and delete the new language

1.12 Page 2, line 4, strike "(c)" and insert "(d)" and after "(b)" insert "or (c)"

1.13 Page 2, line 13, strike "(d)" and insert "(e)"

1.14 Page 2, line 18, strike "(e)" and insert "(f)" and after the stricken "(b)" insert "(c)"

1.15 and reinstate the stricken "or" and strike "(d)" and insert "(e)"

1.16 Page 2, line 25, strike "(d)" and insert "(e)"

- 1.1 moves to amend S.F. No. 2428; H.F. No., as follows:
- 1.2 Pages 1 and 2, delete section 1
- 1.3 Amend the title accordingly

1.1 moves to amend S.F. No. 2428; H.F. No., as follows:

1.2 Page 3, line 29, after "estate" insert "investment"

1.3 Page 4, line 19, after "in" insert "real estate investment trusts and insurance company
1.4 commingled accounts of a debt related nature, including separate accounts."

1.5 Page 5. line 32, after "in" insert "real estate investment trusts and insurance company
1.6 commingled accounts of an equity related nature, including separate accounts, and in"

1.7 Page 6, line 1, strike "corporate stock" and after "investments" insert "under this
1.8 paragraph"

1.9 Page 6, line 2, before "must" insert "plus all investments under paragraphs (g) and
1.10 (h)."

1.11 Page 6, line 3, strike ", less the aggregate value of investments according to
1.12 paragraph (h)"

- 1.1 moves to amend S.F. No. 2428; H.F. No., as follows:
- 1.2 Page 6, line 26, delete "45" and reinstate the stricken language

- 1.1 moves to amend S.F. No. 2428; H.F. No., as follows:
- 1.2 Page 6, line 26, delete "45" and insert "..."

1.1 moves to amend S.F. No. 2428; H.F. No., as follows:

1.2 Page 6, line 2, before "must" insert "plus the aggregate value of investment under
1.3 paragraphs (g), (h), and (i),"

1.4 Page 6, line 3, strike ", less the aggregate value of investment according to paragraph
1.5 (h)"

1.6 Page 6, line 6, after "(g)" insert "**Developed market foreign stocks investments.** In
1.7 addition to investments authorized under paragraph (f), the covered pension fund may
1.8 invest in foreign stock sold on exchanges in developed market countries.

1.9 (h)"

1.10 Page 6, line 8, before "or" insert "(g)," and strike "(h)" and insert "(i)"

1.11 Page 6, line 9, strike "(h)" and insert "(i)"

1.12 Page 6, line 22, after "international" insert "debt" and after "securities" insert "and
1.13 emerging market equity investments"

- 1.1 moves to amend S.F. No. 2428; H.F. No., as follows:
- 1.2 Page 7, delete lines 1 to 3
- 1.3 Amend the title accordingly

1.1 moves to amend S.F. No. 2428; H.F. No., as follows:

1.2 Page 7, delete line 3 and insert:

1.3 "Sec. 5. **EFFECTIVE DATE.**

1.4 Sections 1 to 4 are effective the day following final enactment."

Senator Pappas introduced—**S.F. No. 2428:** Referred to the Committee on State and Local Government Operations.

1.1 A bill for an act
 1.2 relating to retirement; modifying allocation requirements; changing reporting
 1.3 mandates; modifying definitions; amending Minnesota Statutes 2004, section
 1.4 356.219, subdivisions 3, 6; Minnesota Statutes 2005 Supplement, section
 1.5 356A.06, subdivision 7; repealing Minnesota Statutes 2004, section 356A.06,
 1.6 subdivisions 4, 5, 8b.

1.7 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

1.8 Section 1. Minnesota Statutes 2004, section 356.219, subdivision 3, is amended to read:

1.9 Subd. 3. **Content of reports.** (a) The report required by subdivision 1 must include
 1.10 a written statement of the investment policy in effect on June 30, 1997, if that statement
 1.11 has not been previously submitted. Following that date, subsequent reports must include
 1.12 investment policy changes and the effective date of each policy change rather than a
 1.13 complete statement of investment policy, unless the state auditor requests submission of
 1.14 a complete current statement. The report must also include the information required by
 1.15 the following paragraphs, as applicable.

1.16 (b) If a public pension plan has a total market value of \$10,000,000 or more as of
 1.17 the beginning of the calendar year, the report required by subdivision 1 must include the
 1.18 market value of the total portfolio and the market value of each investment account,
 1.19 investment portfolio, or asset class included in the pension fund as of the beginning of
 1.20 the calendar year and ~~for each month, and the amount and date of each injection and~~
 1.21 ~~withdrawal to the total portfolio and to each investment account, investment portfolio,~~
 1.22 ~~or asset class~~ the end of the calendar year. In addition, the plan must submit a report on
 1.23 a form prescribed by the state auditor that includes the time-weighted return, net of any
 1.24 investment-related fees, on a total portfolio and asset class basis. If a public pension plan
 1.25 once files a report under this paragraph, it must continue reporting under this paragraph

2.1 for any subsequent year in which the public pension plan is not fully invested as specified
2.2 in subdivision 1, paragraph (b), even if asset values drop below \$10,000,000 in market
2.3 value in that subsequent year.

2.4 (c) For public pension plans to which paragraph (b) applies, the report required by
2.5 subdivision 1 must also include a calculation of the total time-weighted rate of return
2.6 available from index-matching investments assuming the asset class performance targets
2.7 and target asset mix indicated in the written statement of investment policy. The provided
2.8 information must include a description of indices used in the analyses and an explanation
2.9 of why those indices are appropriate. This paragraph does not apply to any fully invested
2.10 plan, as defined by subdivision 1, paragraph (b). Reporting by the State Board of
2.11 Investment under this paragraph is limited to information on the Minnesota public pension
2.12 plans required to be invested by the State Board of Investment under section 11A.23.

2.13 (d) If a public pension plan has a total market value of less than \$10,000,000 as of
2.14 the beginning of the calendar year and was never required to file under paragraph (b), the
2.15 report required by subdivision 1 must include the amount and date of each total portfolio
2.16 injection and withdrawal. In addition, the report must include the market value of the total
2.17 portfolio as of the beginning of the calendar year and for each quarter.

2.18 (e) Any public pension plan reporting under paragraph ~~(b)~~ or (d) may include
2.19 computed time-weighted rates of return with the report, in addition to all other required
2.20 information, as applicable. If these returns are supplied, the individual who computed
2.21 the returns must certify that the returns are net of all costs and fees, including investment
2.22 management fees, and that the procedures used to compute the returns are consistent
2.23 with Bank Administration Institute studies of investment performance measurement and
2.24 Association for Investment Management and Research presentation standards.

2.25 (f) For public pension plans reporting under paragraph (d), the public pension plan
2.26 must retain supporting information specifying the date and amount of each injection and
2.27 withdrawal to each investment account and investment portfolio. The public pension plan
2.28 must also retain the market value of each investment account and investment portfolio at
2.29 the beginning of the calendar year and for each quarter. Information that is required to be
2.30 collected and retained for any given year or years under this paragraph must be submitted
2.31 to the Office of the State Auditor if the Office of the State Auditor requests in writing that
2.32 the information be submitted by a public pension plan or plans, or be submitted by the
2.33 State Board of Investment for any plan or plans for which the State Board of Investment is
2.34 the investment authority under this section. If the state auditor requests information under
2.35 this subdivision, and the public plan fails to comply, the pension plan is subject to penalties
2.36 under subdivision 5, unless penalties are waived by the state auditor under that subdivision.

3.1 Sec. 2. Minnesota Statutes 2004, section 356.219, subdivision 6, is amended to read:

3.2 Subd. 6. **Investment disclosure report.** (a) The state auditor shall prepare an annual
3.3 report to the legislature on the investment performance of the various public pension plans
3.4 subject to this section. The content of the report is specified in paragraphs (b) to (e).

3.5 (b) For each public pension plan reporting under subdivision 3, paragraph (b), the
3.6 state auditor shall ~~compute~~ compile and report total portfolio and asset class time-weighted
3.7 rates of return, net of all investment-related costs and fees as provided by the pension plan.

3.8 (c) For each public pension plan reporting under subdivision 3, paragraph (d), the
3.9 state auditor shall compute and report total portfolio time-weighted rates of return, net of
3.10 all costs and fees. If the state auditor has requested data for a plan under subdivision 3,
3.11 paragraph (f), the state auditor may also compute and report asset class time-weighted
3.12 rates of return, net of all costs and fees.

3.13 (d) The report by the state auditor must include the information submitted by the
3.14 pension plans under subdivision 3, paragraph (c), or a synopsis of that information.

3.15 (e) The report by the state auditor may also include a presentation of multiyear
3.16 performance, information collected under subdivision 4, and any other information or
3.17 analysis deemed appropriate by the state auditor.

3.18 Sec. 3. Minnesota Statutes 2005 Supplement, section 356A.06, subdivision 7, is
3.19 amended to read:

3.20 Subd. 7. **Expanded list of authorized investment securities.** (a) **Authority.**

3.21 Except to the extent otherwise authorized by law or bylaws, a covered pension plan not
3.22 described by subdivision 6, paragraph (a), may invest its assets only in accordance with
3.23 this subdivision.

3.24 (b) **Securities generally.** The covered pension plan has the authority to purchase,
3.25 sell, lend, or exchange the securities specified in paragraphs (c) to (h), including puts and
3.26 call options and future contracts traded on a contract market regulated by a governmental
3.27 agency or by a financial institution regulated by a governmental agency. These securities
3.28 may be owned as units in commingled trusts that own the securities described in
3.29 paragraphs (c) to (h) including real estate trusts and insurance company commingled
3.30 accounts, including separate accounts.

3.31 (c) **Government obligations.** The covered pension plan may invest funds in
3.32 governmental bonds, notes, bills, mortgages, and other evidences of indebtedness
3.33 provided the issue is backed by the full faith and credit of the issuer or the issue is rated
3.34 among the top four quality rating categories by a nationally recognized rating agency. The
3.35 obligations in which funds may be invested under this paragraph include guaranteed or

4.1 insured issues of (1) the United States, its agencies, its instrumentalities, or organizations
4.2 created and regulated by an act of Congress; (2) Canada and its provinces, provided
4.3 the principal and interest is payable in United States dollars; (3) the states and their
4.4 municipalities, political subdivisions, agencies, or instrumentalities; (4) the International
4.5 Bank for Reconstruction and Development, the Inter-American Development Bank, the
4.6 Asian Development Bank, the African Development Bank, or any other United States
4.7 government sponsored organization of which the United States is a member, provided the
4.8 principal and interest is payable in United States dollars.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

6.1 (1) the aggregate value of corporate stock investments, as adjusted for realized
 6.2 profits and losses, must not exceed 85 percent of the market or book value, whichever is
 6.3 less, of a fund, less the aggregate value of investments according to paragraph (h);

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

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

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

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

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

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

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

6.22 ~~(iv)~~ (iv) international securities.

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

6.25 (i) the aggregate value of all investments made according to clause (1) may not
 6.26 exceed ~~35~~ 45 percent of the market value of the fund for which the covered pension
 6.27 plan is investing;

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

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

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

7.1 Sec. 4. **REPEALER.**

7.2 Minnesota Statutes 2004, section 356A.06, subdivisions 4, 5, and 8b, are repealed.

7.3 **EFFECTIVE DATE.** This section is effective the day following final enactment.