

## **State Treasurer’s 2016 Investment Modernization Act**

### **Summary Overview**

#### **1. Without raising legal limit for alternative investments, provide flexibility between alternative investment asset classes.**

[The State Treasurer’s 2016 Investment Modernization Act reflects the 2016 recommendation from the Investment Advisory Committee to obtain additional flexibility within the statutory permitted asset allocation, without requesting a higher aggregate statutory limit on certain private market investments.]

#### Section 1 of Act: Additional Flexibility within Current Statutory Asset Allocation

- With respect to Retirement Systems’ assets, the market value of any of the following categories – (i) non-investment grade fixed income, (ii) real estate, (iii) public equity limited partnerships, (iv) private equity and other alternatives, and (v) inflation protection – shall not exceed fifteen percent (15%) of the market value of all invested assets of the Retirement Systems. The existing statutory limits vary between seven and one-half percent (7.5%) and ten percent (10%) for these asset classes.

#### Act Does Not Change 35% Limit in G.S. 147-69.2(b)(10a)

- The aggregate market value of categories (i) through (v) listed above shall not exceed thirty-five percent (35%) of the market value of all invested assets of the Retirement Systems. The existing statutory limit is thirty-five percent (35%) and DST is not requesting an increase.

In light of expected low investment returns for the next decade, the State Treasurer [and Investment Advisory Committee] believe greater flexibility across the enumerated categories would improve investment returns and risk management of the Retirement Systems’ investments. As a result, employer contributions are expected to be lower and less volatile over the intermediate term.

#### **2. Provide operational flexibility to Department of State Treasurer Banking and Investment Divisions.**

#### Sections 2.1 and 2.2: Provide Employee and IT Resources Needed for More Efficient Investing

The State Treasurer’s public equity index fund portfolio could be internally managed at a lower cost, but in order to make that transition, the Department of State Treasurer must have the flexibility to create positions and ability to fund necessary information technology resources.

- Provides State Treasurer with authority to create investment-related positions, consistent with authority already present for the Supplemental Retirement Plans.

- Removes sunset on 2000 statute, allowing DST (after consultation with legislature and approval of Department of Information Technology) to improve investment and banking operations systems, retirement payroll systems, and other information technology infrastructure needs.

*Sections 2.3 and 2.4: Pay Directly All Investment Program and Banking Division Costs*

Currently, the majority of DST's investment expenses are funded by the investment portfolios, while a small portion of expenses are first appropriated from the General Fund in the budget process, then paid indirectly from the investment portfolios when the investment pools reimburse the General Fund. To improve transparency and simplify a complicated internal budgeting process, DST proposes to have all investment program and banking division costs be paid directly from the investment portfolios. All costs would be the subject of a new report to the General Assembly.

- Requires full-cost reporting by DST on an annual basis to the General Assembly and other parties. The DST report will show all details of previous year's direct and indirect expenditures and will project future expenditures.
- Removes annual appropriation/reimbursement loop for DST investment programs.
- Removes annual appropriation/reimbursement loop for DST banking division.

**WITHOUT RAISING LEGAL LIMIT FOR ALTERNATIVE INVESTMENTS,  
PROVIDE FLEXIBILITY BETWEEN ALTERNATIVE INVESTMENT ASSET  
CLASSES**

**SECTION 1.** G.S. 147-69.2(b) reads as rewritten:

§ 147-69.2. Investments authorized for special funds held by State Treasurer.

(b) *It shall be the duty of the State Treasurer to invest the cash of the funds enumerated in subsection (a) of this section in excess of the amount required to meet the current needs and demands on such funds...*

...

(6c) With respect to Retirement Systems' assets referred to in subdivision (b)(8), they may be invested in obligations, debt securities, and asset-backed securities, whether considered debt or equity, including obligations and securities convertible into other securities, that do not meet the requirements of any of subdivisions (b)(1) through (6) of this section nor subdivision (b)(7) of this section, provided such investments are made through investment companies registered under the Investment Company Act of 1940, individual, common, or collective trust funds of banks and trust companies, group trusts and limited partnerships, limited liability companies or other limited liability investment vehicles that invest primarily in investments authorized by this subdivision and through contractual arrangements in which the investment manager has full and complete discretion and authority to invest assets specified in such arrangements in investments authorized by this subdivision, provided the investment manager for each investment pursuant to this subdivision has assets under management of at least one hundred million dollars (\$100,000,000) ~~and provided that the investments authorized under this subdivision shall not exceed seven and one-half percent (7.5%) of the market value of all invested assets of the Retirement Systems.~~

(7) With respect to Retirement Systems' assets referred to in subdivision (8) of this subsection, (i) insurance contracts that provide for participation in individual or pooled separate accounts of insurance companies, (ii) group trusts, (iii) individual, common, or collective trust funds of banks and trust companies, (iv) real estate investment trusts, (v) investment companies registered under the Investment Company Act of 1940, (vi) limited partnerships, limited liability companies, or other limited liability investment vehicles, and (vii) contractual arrangements in which the investment manager has discretion and authority to invest assets specified in such arrangements in investments authorized by this subsection; provided the investment manager has assets under management of at least one hundred million dollars (\$100,000,000); provided such investment assets are managed primarily for the purpose of investing in or owning real estate or related debt financing, excluding asset-backed financing, located within or outside the United States; ~~and provided that the investments authorized by this subdivision shall not exceed ten percent (10%) of the market value of all invested assets of the Retirement Systems.~~

(8) With respect to assets of the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, the Firefighters' and Rescue Workers' Pension Fund, the Local Governmental Employees' Retirement System, the Legislative Retirement System, the North Carolina National Guard Pension Fund, and the Retiree Health Benefit Fund (hereinafter referred to collectively as the Retirement Systems), and assets invested pursuant to subdivision (b2) of this section, they may be invested in

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equity securities traded on a public securities exchange or market organized and regulated pursuant to the laws of the jurisdiction of such exchange or market and issued by any company incorporated or otherwise created or located within or outside the United States; provided the investments meet the conditions of this subdivision. The investments authorized for the Retirement Systems under this subdivision cannot exceed sixty-five percent (65%) of the market value of all invested assets of the Retirement Systems.

The assets authorized under this subdivision may be invested directly by the State Treasurer in any equity securities authorized by this subdivision for the primary purpose of approximating the movements of a nationally recognized and published market benchmark index. No more than one and one-half percent (1.5%) of the market value of the Retirement Systems' assets that may be invested directly under this subdivision can be invested in the stock of a single corporation, and the total number of shares in that single corporation cannot exceed eight percent (8%) of the issued and outstanding stock of that corporation.

So long as each investment manager has assets under management of at least one hundred million dollars (\$100,000,000), the assets authorized under this subdivision may also be invested through any of the following:

- a. Investment companies registered under the Investment Company Act of 1940; individual, common, or collective trust funds of banks and trust companies; and group trusts that invest primarily in investments authorized by this subdivision.
- b. Limited partnerships, limited liability companies, or other limited liability investment vehicles that are not publicly traded and invest primarily in investments authorized by this subdivision. ~~Investments under this sub-subdivision shall not exceed eight and one-half percent (8.5%) of the market value of all invested assets of the Retirement Systems.~~
- c. Contractual arrangements in which investment managers have full and complete discretion and authority to invest assets specified in such contractual arrangements in investments authorized by this subdivision.

(9) With respect to Retirement Systems' assets, as defined in subdivision (b)(8) of this subsection, they may be invested in interests in limited partnerships, limited liability companies, or other limited liability investment vehicles that are not publicly traded if the primary purpose of the limited partnership, limited liability company, or other limited liability investment vehicle is (i) to invest in private equity, or corporate buyout transactions, within or outside the United States or (ii) to engage in other strategies not expressly authorized by any other subdivision of this subsection. ~~The amount invested under this subdivision shall not exceed eight and three-quarters percent (8.75%) of the market value of all invested assets of the Retirement Systems.~~

(9a) With respect to Retirement Systems' assets, as defined in subdivision (b)(8) of this subsection, they may be invested in inflation-linked bonds, timberlands, commodities, and other investments that are acquired by the Treasurer for the primary purpose of providing protection against risks associated with inflation, provided such investments are made through investment companies registered under the Investment Company Act of 1940, individual, common or collective trust funds of banks and trust companies, group trusts and limited partnerships, limited liability companies or other limited liability investment vehicles that invest primarily in investments authorized by this subdivision and through contractual arrangements in which the investment manager

has full and complete discretion and authority to invest assets specified in such arrangements in investments authorized by this subdivision, provided the investment manager for each investment pursuant to this subdivision has assets under management of at least one hundred million dollars (\$100,000,000) ~~and provided that the investments authorized under this subdivision shall not exceed seven and one-half percent (7.5%) of the market value of all invested assets of the Retirement Systems.~~ Notwithstanding anything in this subsection to the contrary, the investments authorized by this subdivision shall not be included in any subdivision other than this subdivision for purposes of the percentage investment limitations therein or otherwise.

(10) Recodified as part of subdivision (b)(9) by Session Laws 2000-160, s. 2.  
(10a) With respect to Retirement Systems' assets, as defined in subdivision (8) of this subsection, the market value of any of subdivision (6c) or (7), sub-subdivision b. of subdivision (8), or subdivision (9) or (9a) of this subsection shall not exceed ~~ten~~ fifteen percent (~~10%~~ 15%) of the market value of all invested assets of the Retirement Systems; and the aggregate market value of all assets invested pursuant to subdivisions (6c) and (7), sub-subdivision b. of subdivision (8), and subdivisions (9) and (9a) of this subsection shall not exceed thirty-five percent (35%) of the market value of all invested assets of the Retirement Systems. The quarterly report provided by the Treasurer pursuant to G.S. 147-68(d1) shall include a specific listing of all direct and indirect placement fees, asset fees, performance fees, and any other money management fees incurred by the State in the management of subdivisions (6c) and (7), sub-subdivision b. of subdivision (8), and subdivisions (9) and (9a) of this subsection. In the event that the market value of any of subdivision (6c) or (7), sub-subdivision b. of subdivision (8), or subdivision (9) or (9a) of this subsection increases during a fiscal year by an amount greater than three percent (3%) of the market value of all invested assets of the Retirement Systems as of the prior fiscal year end, then the quarterly report provided by the Treasurer pursuant to G.S. 147-68(d1) shall describe how that increase complies with the duties described in G.S. 147-69.7 and the consequent expected impact on the risk profile of the Retirement Systems' assets.

...

**PROVIDE OPERATIONAL FLEXIBILITY TO DEPARTMENT OF STATE  
TREASURER BANKING AND INVESTMENT DIVISIONS.**

**SECTION 2.1.** G.S. 147-69.3(g) reads as rewritten:

**§ 147-69.3. Administration of State Treasurer's investment programs.**

...

(g) The State Treasurer is authorized to appoint those agents, contractors, employees, and committees and retain the services of independent appraisers, auditors, actuaries, attorneys, investment counseling firms, statisticians, custodians, or other persons or firms possessing specialized skills or knowledge necessary for the proper administration of investment programs created pursuant to this section. The State Treasurer may employ a Chief Investment Officer, but shall do so after consultation with the Investment Advisory Committee.

**SECTION 2.2.** G.S. 147-68(d2) reads as rewritten:

**§ 147-68. To receive and disburse moneys; to make reports.**

...

(d2) After consulting with the Joint Legislative Oversight Committee on Information Technology ~~Select Committee on Information Technology~~ and the Joint Legislative Commission on Governmental Operations and after consultation with and approval of the Department of Information Technology ~~Information Resources Management Commission~~, the Department of State Treasurer may spend departmental receipts ~~for the 2000-2001 fiscal year~~ to continue improvement of the Department's investment and banking operations ~~system~~ systems, retirement payroll systems, and other information technology infrastructure needs. The Department of State Treasurer shall report ~~by January 1, 2001 and annually thereafter~~ to the following regarding the amount and use of the departmental receipts: the Joint Legislative Commission on Governmental Operations, the Chairs of the General Government Appropriations Subcommittees of both the House of Representatives and the Senate, and the Joint Legislative Oversight Committee on Information Technology.

...

**SECTION 2.3.** G.S. 147-69.3(f) reads as rewritten:

**§ 147-69.3. Administration of State Treasurer's investment programs.**

...

(f) The cost of administration, management, and operation of investment programs established pursuant to this section shall be apportioned equitably among the programs in such manner as may be prescribed by the State Treasurer, such costs to be charged to and paid from each program, and to the extent not otherwise chargeable directly from to the income or assets of the specific investment program or pooled investment vehicle, shall be deposited with the State Treasurer as a General Fund nontax revenue. The cost of administration, management, and operation of investment programs established pursuant to this section ~~and not directly paid from the income or assets of such program shall be covered by an appropriation to the State Treasurer for this purpose in the Current Operations Appropriations Act~~ shall be reported to the State Auditor, the Joint Legislative Commission on Governmental Operations, the Chairs of the House of Representatives Appropriations Subcommittee and Senate Appropriations Committee, the Chairs of the House of Representatives and Senate Finance Committees, and the Fiscal Research Division by June 15 of each year. Such report shall be developed in consultation with the Investment Advisory Committee and provide the actual costs incurred for the previous fiscal year, the estimated costs for the current fiscal year, and the projected costs for the next fiscal year. Expenditures authorized under this section are hereby appropriated without the need for a specific appropriation for this purpose in the Current Operations Appropriations Act.

**SECTION 2.4.** G.S. 147-68.1 reads as rewritten:

**§ 147-68.1. Banking operations.**

The cost of administration, management, and operations of the banking operations of the Department of State Treasurer shall be apportioned equitably among the funds and programs using these services, ~~and the costs so apportioned shall be deposited with the State Treasurer as a general fund nontax revenue~~ such costs to be charged to and paid

directly from the income or assets of the specific investment program or pooled investment vehicle. The cost of administration, management and operations of the banking operations of the Department of State Treasurer shall be covered by an established pursuant to this section shall be charged to and paid directly from the income or assets of such funds and programs using these services. Expenditures authorized under this section are hereby appropriated without the need for a specific appropriation to the State Treasurer for this purpose in the Current Operations Appropriations Act.

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