



H.F. 1555
(Murphy, M.)

S.F. 927
(Rosen)

Executive Summary of Commission Staff Materials

<u>Affected Pension Plan(s):</u>	All Minnesota Public Pension Plans
<u>Relevant Provisions of Law:</u>	Minnesota Statutes, Sections 11A.24; 69.77, Subd. 9; 69.775; 354A.08; 356A.06, Subds. 6 & 7
<u>General Nature of Proposal:</u>	Revising Investment Authority Provisions
<u>Date of Summary:</u>	January 27, 2012

Specific Proposed Changes

- Creates authority for SBI to invest in exchange-traded funds (ETFs), and permits unlimited use of mutual funds rather than limiting mutual funds to a small portion of the total portfolio.
- Creates new investment authority for volunteer fire plans. Limited list plans may invest in ETFs and in junk bonds if the bond investment is through a mutual fund or ETF. Expanded list plans are given explicit authority to invest in junk bonds with or without the use of a mutual fund or ETF.
- For expanded list plans other than volunteer fire plans, a cap limiting international debt and emerging market equity investments to no more than 20% of the total portfolio is removed, while volunteer fire expanded list plans will be subject to a 15% cap.
- For all plans, any investment in the SBI Supplemental Fund must be included in determining whether portfolio asset mix limits are met. Under current law, no more than 85% of a pension fund's investment can be in equity or equity-like investments.
- Administrative changes: makes technical corrections and removes obsolete language; makes the expanded list investment authority provision more comparable to that of SBI; and moves SBI Supplemental Plan and junk bond investment authority from various first class city teacher plan law and police and paid fire law provisions to the expanded list provision.

Policy Issues Raised by the Proposed Legislation

1. Appropriateness of authorizing SBI to invest in ETFs.
2. Authorizing limited list volunteer fire plans to invest in ETFs.
3. Whether the new authority for volunteer fire plans to use junk bonds is appropriate.
4. Possible quality restrictions on junk bonds.
5. Whether the equity and equity-like investment limit (no more than 85% of the portfolio) is appropriate.
6. Possible need for limit on emerging market securities.
7. Investment authority transition provision issues.

Potential Amendments

Technical Amendment:

H1555-1A clarifies that bond quality determinations must be by recognized agencies and that the proposed limitation on international debt investments by volunteer fire relief associations does not apply to investments in Canadian debt securities (authorized elsewhere in law).

Substantive Amendments:

(see next page)

Substantive Amendments:

Exchange-Traded Funds Authority Amendments

- H1555-2A** removes the proposed authority for SBI to use ETFs if the Commission concludes that the proposed SBI ETF authority is inappropriate or unnecessary.
- H1555-3A** removes the proposed authority for limited list plans (all of which are volunteer fire plans) to use ETFs if the Commission concludes that the proposed ETF authority is inappropriate for these plans due to concerns about potential abuse of this authority.

Junk Bond Authority Amendments

- H1555-4A** removes the proposed junk bond authority for limited and expanded list volunteer fire plans.
- H1555-5A,** an alternative to H1555-4A, removes the proposed volunteer fire junk bond authority for limited list plans but retains the proposed authority for volunteer fire expanded list plans.
- H1555-6A,** which could be used with H1555-4A or H1555-5A, applies to expanded list plans and revises the maximum percentage of the portfolio that can be devoted to junk bonds from 5% to a percentage (presumably lower) to be set by the Commission.
- H1555-7A,** an alternative to H1555-6A, revises the maximum proposed percentage that volunteer fire relief associations can devote to junk bonds from 5% to an unspecified percentage (presumably lower) while leaving the 5% maximum for all other expanded list plans. This amendment should not be used if H1555-4A is adopted.

If amendments -4A to -7A are not used, amendments -8A to -10A are alternatives for permitting better-grade junk bonds (speculative grade) while prohibiting investments in securities that are highly speculative or in default:

- H1555-8A** sets a lower boundary on the quality of permissible junk bonds for volunteer fire plans only, permitting investment in bonds considered speculative (one grade below investment-grade), while prohibiting investments in highly speculative and defaulted securities.
- H1555-9A** is similar to -8A but applies to all limited list plans, all expanded list plans, and SBI.
- H1555-10A** is similar to -8A and -9A but applies to all limited list and expanded list plans.

85% Equity Cap Amendment

- H1555-11A** can be used to reset the maximum permissible percent of assets in equity and equity-like investments from 85% of the total portfolio to a percentage to be determined by the Commission. The revised limit would apply to all plans including SBI.

Emerging Market Securities Cap Amendments

- H1555-12A** revises the 15% cap on emerging market equity and international debt for expanded list volunteer fire plans from 15% to a percent to be specified by the Commission.
- H1555-13A** expands the emerging market equity and international debt 15% cap to include all expanded list plans. This amendment can be used with H1555-12A.
- H1555-14A,** an alternative to -12A and -13A, combines those two amendments by expanding the emerging market equity and international debt cap to include all expanded list plans and revising the percent cap to a percentage specified by the Commission.
- H1555-15A** expands the emerging market equity and international debt 15% cap to include all expanded list plans and SBI.
- H1555-16A,** an alternative to -15A, expands the emerging market equity and international debt cap to include all expanded list plans and SBI, and revises the percent cap to a percentage to be specified by the Commission.


Investment Authority Transition Provision Amendments

- H1555-17A** sets a date other than June 30, 2013, for compliance with the revised investment authority provided under this bill.
- H1555-18A** revises the transition provision by creating an early deadline for compliance (January 1, 2012) if the plan is exceeding 85% equity in its portfolio (or whatever revised limit is specified by the Commission).

Amendment Requested by the State Board of Investment

- H1555-19A** revises an SBI duties and powers provision and an SBI report provision by striking language requiring the inclusion of financial statements in the reports.



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Ed Burek, Deputy Director 
RE: H.F. 1555 (Murphy, M.); S.F. 927 (Rosen): Minnesota Public Pension Funds;
Revising Investment Authority Provisions
DATE: January 27, 2012

General Summary of H.F. 1555 (Murphy, M.); S.F. 927 (Rosen)

H.F. 1555 (Murphy, M.); S.F. 927 (Rosen) revises provisions specifying permitted investments applicable to the State Board of Investment (SBI), first class city teacher plans, any remaining local police or paid fire plan, and volunteer fire plans by making the substantive and administrative changes, as follows:

Substantive Changes:

- For SBI, creating authority to invest in exchange-traded funds (ETFs), and by permitting unlimited use of mutual funds rather than limiting mutual funds to a small portion of the total portfolio;
- New investment authority is created for volunteer fire plans. For those that are limited list plans, the bill provides authority to invest in ETFs and in below-investment-grade bonds (junk bonds) if the bond investment is through a mutual fund or ETF. Expanded list volunteer fire plans are given explicit authority to invest in junk bonds, with or without the use of a mutual fund or ETF;
- For expanded list plans other than volunteer fire plans, a cap limiting international debt and emerging market equity investments to no more than 20% of the total portfolio is removed, while volunteer fire expanded list plans will be subject to a 15% cap; and
- For all plans, any investment the plan has in the SBI Supplemental Fund must be included in determining whether the portfolio equity limits are met (pension portfolios are not permitted to exceed 85% equity).

Administrative Changes:

- Makes technical corrections and removing obsolete language;
- Makes the expanded list investment authority provision more comparable to that of SBI; and
- Moves SBI Supplemental Plan and junk bond investment authority from various first class city teacher plan law and police and paid fire law provisions to the expanded list provision.

Section-by-Section Summary of H.F. 1555 (Murphy, M.); S.F. 927 (Rosen)

A section-by-section summary of H.F. 1555 (Murphy, M.); S.F. 927 (Rosen) is attached.

Background Information on Relevant Topics

The following attachments provide background information on topics relevant to the proposed legislation:

- **Attachment A:** Background information on public pension plan fiduciary responsibility.
- **Attachment B:** Background information on bond credit ratings.
- **Attachment C:** Background information on exchange-traded funds (ETFs).

Discussion and Analysis

- a. Laws 2010 Study Requirement. Minnesota Laws 2010, Chapter 359, Article 1, Section 85, required the State Auditor to convene a group to study Minnesota public pension plan investment-related provisions, particularly those applying to expanded list and limited list plans. The 2010 law charged the study group, composed primarily of representatives from the expanded list and limited list plans, "to study investment related provisions, authorities, and limitations" and to prepare a report with recommended changes by January 15, 2011, to be delivered to the Executive Director of the Legislative Commission on Pensions and Retirement, the chair and ranking minority caucus member of the Senate State and Local Government Operations and Oversight Committee, and the chair and ranking minority member of the House State and Local Government Operations Reform, Technology and Elections Committee. H.F. 1555 (Murphy, M.); S.F. 927 (Rosen) represents the recommendations of the State Auditor's Local Retirement Fund Investment Authorities Study Group.

Under Minnesota Statutes, investment authority provisions divide Minnesota public pension plans into three main groups. In the first group is the State Board of Investment (SBI). The second group is referred to as expanded list plans. An expanded list plan is any Minnesota public retirement plan other than SBI that has more than \$1 million in assets, or uses the services of SBI or a registered investment advisor to invest at least 60% of its assets, or uses SBI and a registered investment advisor in combination to invest at least 75% of its assets. Expanded list plans are the first class city teacher retirement plans, the Bloomington Fire Department Relief Association, any remaining local police or paid fire plan, and some of the more 700 volunteer fire plans. The remaining volunteer fire plans are limited list plans. Limited list plans are small and operate with little or no professional investment input. Therefore, they have the most restricted investment authority.

For SBI, permissible investment provisions are specified in Minnesota Statutes, Chapter 11A. For expanded list and limited list plans, authorized investment provisions currently appear in Minnesota Statutes, Section 356A.06, and in Chapters 69 and 354A. For SBI, permissible investments are stated in Minnesota Statutes, Chapter 11A, as Section 11A.24. All pension plan administrations, including SBI, are required to follow requirements found in various sections of Chapter 356A governing prudent investment activities and fiduciary responsibilities.

- b. Overview of Public Plans Systems. Most Minnesota public pension fund assets are invested by the State Board of Investment (SBI), which is by far the largest Minnesota public plan investment entity. SBI administers and directs the investment of all State of Minnesota financial assets, the majority of which are the pension assets of the plans administered by the Minnesota State Retirement System (MSRS), the Public Employees Retirement Association (PERA), and the Teachers Retirement Association (TRA). TRA's pension assets include those transferred to TRA when the Minneapolis Teachers Retirement Fund Association (MTRFA) was consolidated into TRA in 2007, and the PERA assets include the assets of the recently consolidated Minneapolis Employees Retirement Fund (MERF), as well as the assets of the numerous local police and paid fire plans, port authorities, and other entities that have been consolidated with a PERA plan over the years. In addition, many other Minnesota public pension plan administrations are permitted by law to use SBI to invest all or a portion of their assets, and some have chosen to use that authority.

In comparing the amounts invested by SBI to other Minnesota pension plans, it is useful to note that:

- SBI is one of the largest investors in the country. Its pension assets are considerably in excess of the entire State General Fund biennial budget. As of June 30, 2011, SBI retirement assets totaled \$53.8 billion. In contrast, the entire State General Fund budget for Fiscal 2010-2011 was \$30.7 billion.
- SBI is responsible for investing approximately 96.5% of all Minnesota public pension plan assets, with the other public pension plan administrations combined investing about 3.5%.

The non-SBI plan administrations are:

- 1) The two local police and paid fire relief associations that have not consolidated into the Public Employees Police and Fire Retirement Plan (PERA-P&F), which are the Fairmont Police Relief Association and the Virginia Fire Department Relief Association;
- 2) The Bloomington Fire Department Relief Association, which shares attributes of both paid fire plans and volunteer fire plans;
- 3) The two remaining first class city teacher plans, the Duluth Teachers Retirement Fund Association (DTRFA) and the St. Paul Teachers Retirement Fund Association (SPTRFA); and
- 4) Approximately 700 local volunteer firefighter relief associations.

The percentage of total public retirement plan assets in the various plan funds or systems is indicated in the following table. Calendar-year-end 2009 asset information is used since that was the most recent information readily available for all the plans. The amounts for SBI include all the Combined Fund assets, the Supplemental Fund, and assets of the Minneapolis Employees Retirement Fund (MERF). MERF assets were managed by SBI in 2009 although MERF did not merge into PERA until 2010. The amount for SBI does not include amounts invested in the MSRS Deferred Compensation plan. As a percentage of total assets invested by all plans, the table indicates that 95.4% of all pension assets are invested through SBI. However, the Minneapolis Police Relief Association and the Minneapolis Fire Relief Association have since consolidated into the Public Employees Police and Fire Retirement Plan (PERA-P&F), and their assets are now part of the PERA-P&F fund invested by SBI. If the percentage of the assets shown in the table as managed by those two relief associations are added to SBI's amounts, the percentage of assets invested by SBI increases to about 96.5%. The next largest organization based on assets under management was SPTRFA, with an amount representing less than 2% of total system assets. No other organization approaches 1%. The total combined assets of all the approximately 700

volunteer fire relief associations are less than 1% of total pension assets. The Virginia Fire Department Relief Association's \$2.2 million in assets is so insignificant that as a percentage of total system assets it rounds to 0%.

Minnesota Pension System Assets
as of December 31, 2009*

Plan Investment Administration	Assets (in millions)	Percentage of Total Assets
State Board of Investment	\$43,100.0	95.40%
St. Paul Teachers Retirement Fund Association	\$870.0	1.93%
Minneapolis Police Relief Association	\$281.9	0.62%
700+ volunteer firefighter relief associations	\$402.7	0.89%
Duluth Teachers Retirement Fund Association	\$201.6	0.45%
Minneapolis Firefighters Relief Association	\$212.4	0.47%
Bloomington Fire Department Relief Association	\$99.0	0.22%
Fairmont Police Relief Association	\$7.0	0.02%
Virginia Fire Department Relief Association	\$2.2	0.00%
Total	\$45,176.8 million	100.00%

*most recent data available for all plans

- c. Implication of Assets under Investment. The public pension plan assets these plan administrators are investing are composed of contributions made to these plans by public employers, by employees (except for the volunteer fire plans, to which the employees do not contribute), and the accumulated investment earnings. The importance of good investment performance cannot be overstated. Investment returns are the most important source of revenue to finance public pensions. Howard Bicker, Executive Director of the SBI, and the executive directors of MSRS, PERA, and TRA recently provided materials to legislative committees indicating that:

“Of every dollar paid to retirees, 67 cents comes from investment earnings, 18 cents comes from employer contributions, and 15% comes from employee contributions.”

Because of the public moneys contributed to our public plans and the importance of the investment performance of these assets, past legislatures passed laws to safeguard these assets and to facilitate their prudent investment. The statutes governing the investment of these assets enable the administrators to seek maximum returns subject to prudent risk. At its heart, the statutory regulations contain two parts:

1. general fiduciary standards, including the prudent person standard of care in performing investment duties; and
2. a list of types or categories of authorized (permissible) investments, with certain limitations on asset mix.

Minnesota Statutes, Chapter 356A, Public Pension Fiduciary Responsibility, covers general fiduciary standards and investment issues applicable to all Minnesota public pension plans. A key requirement is that Minnesota public pension plan assets must be prudently invested in good faith, exercising the judgment and care that persons of prudence, discretion, and intelligence would exercise in the management of their own affairs, not for speculation, considering the probable safety of the plan capital as well as the probable investment return to be derived from the assets.

Investments must also be of an approved type, as specified in permissible investment provisions applicable to expanded list plans, limited list plans, or SBI, whichever is applicable. These permissible investment provisions also include an asset mix limit, intended to limit volatility, permitting no more than 85% of the portfolio to be invested in equity or equity-like investments. In the distant past, permissible investment provisions were highly restrictive; but over the decades their nature was transformed through numerous amendments. Currently, very few types of domestic or foreign investments are not permitted. These permissible investment provisions serve to define the outer limit of what can be considered prudent.

H.F. 1555 (Murphy, M.); S.F. 927 (Rosen) revises the statutory provisions dealing with the types or categories of authorized investments for SBI (Sec. 1), expanded list plans (primarily Sec. 7), and limited list plans (primarily Sec. 6). The proposed changes, by improving clarity and by expanding investment authority provided to some plans, might impact investment returns, although the impact will be negligible when viewed from the standpoint of total state public pension assets. The bill makes minor revisions in SBI investment authority, largely by expanding its authority to use mutual funds, but SBI is unlikely to need any of the increased mutual fund authority it would be given. This change is likely to

have no impact, positively or negatively, on SBI's investment results, and SBI invests over 96% of all public pension assets. Revisions which apply to expanded list plans cannot have much positive or negative impact on statewide totals, because these plans have only about 3.5% of total public pension plan assets. Similarly, there are provisions in this bill that might improve limited list plan returns, but limited list plans have less than 1% of total statewide public pension assets.

However, it is important for Commission members to understand that the investment performance of any expanded list or limited list plan can have considerable importance for the applicable local school district, city, or township. These school districts and local units of government receive state aids to assist in funding the local pension plan, but ultimately it is the responsibility of the local jurisdiction to ensure that the plan is properly funded. If anything in the bill leads a pension plan administration to engage in speculation rather than prudent investing, the local jurisdiction will be on the forefront dealing with the financial consequences. If an investment problem occurs in one of the expanded list plans, state aids may be impacted, by redirecting aid to plans with larger unfunded liabilities or by continuing aids for longer periods.

- d. Proposed Technical and Substantive Changes. H.F. 1555 (Murphy, M.); S.F. 927 (Rosen) revises permissible investment provisions, making changes of a technical and substantive nature. Regarding substantive changes, for SBI the bill permits use of exchange-traded funds (ETFs) and permits expanded use of mutual funds. Limited list plans would be permitted to invest using ETFs, and in junk bonds if the investment is through a mutual fund or ETF. Expanded list volunteer fire plans are given explicit authority to invest in junk bonds, with or without the use of a mutual fund or ETF. All expanded list plans other than volunteer fire plans will have authority to place larger percentages of their portfolio in emerging market securities, if deemed prudent. For all plans, the portfolio asset mix limit (no more than 85% in equity or equity-like investments) is clarified by indicating, where applicable, that the limit is based on the total portfolio including any investments the plan fund has in the SBI Supplemental Fund.

The substantive changes in the SBI primary investment authority provision, found in Section 1, are due to a general desire on the part of the members of the investment authority study group to create more consistency between the SBI investment authority provisions and those of the expanded list plans. Extensive mutual fund and ETF authority were already part of the expanded list provision in existing law, and, given the desire for consistency, the study group recommended that similar authority provisions be placed in the SBI provision. While these proposed changes are included in Section 1 (*lines 1.13-1.15 and 5.1-5.3*), it is very unlikely that SBI would need the revised law. Because of SBI's size, it simply is not efficient for it to be engaged in mutual funds, except in special situations, for which its current law authority is probably sufficient.

The bill does contain a few substantive changes (revised authority regarding junk bonds, ETFs, and emerging market securities) for other plans that merit discussion, as follows:

1. Junk Bonds. Before 1994, no plan was authorized to invest in below-investment-grade debt. In 1994, SBI proposed that it be given authority to engage in junk bond investments. The Legislature granted that authority when it passed a revision to the SBI authorized investment provision, Minnesota Statutes, Section 11A.24, to authorized limited use of junk bonds. However, in the statutes of that period the investment authority for larger volunteer fire plans, police and paid fire plans, and first class city teacher plans was created largely by cross-reference to the SBI provision. Revising the SBI provision, if no other changes were made, would create identical junk bond authority in these other plans. The Legislature concluded that was not appropriate, and took action to not extend junk bond investment authority to these plans. The revised SBI provision passed in Laws 1994, Chapter 604, Article 1. Article 2 of the same bill was titled "Limit on Investment Authority for Other Public Funds," and in that article the expanded list provision for the non-SBI plans was totally revised to contain the wording of the SBI investment authority provision before the addition of the junk bond authority. However, 12 years later, in 2006 (Laws 2006, Ch. 216, Art. 8, Secs. 1 & 2), police and paid fire plans and first class city teacher plans were granted explicit authority to invest in junk bonds.

Before 2006, some of the non-SBI plans contended they had authority to invest in junk bonds due to language in the "other investments" paragraph of the then existing version of the expanded list provision, which permitted limited investments in securities not otherwise authorized if the investment is through a "regional or mutual fund." Since junk bonds were not authorized under other paragraphs of the provision, the argument was that limited investments in junk bonds were permitted if held through a mutual fund. In any event, the current bill retains explicit junk bond authority for entities which current have that authority, and extends it to the volunteer fire plans.

Commission staff is aware of no compelling argument for junk bond authority for any pension fund. Long term, the best possible outcome, assuming that the pension fund makes no serious investment mistakes, is that a minimal allocation to junk bond holdings will marginally reduce the return to the total portfolio. Some contend that junk bonds will marginally enhance returns over time, because they have higher returns than investment-grade bonds. However, they have a lower expected 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 domestic and foreign stocks or other equity investments rather than in junk bonds.

The other argument for 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 above arguments assume that the investor is investing in the higher grades of junk bonds, and in limited quantities. Considerable harm can occur if the investor descends below the better quality junk bonds into categories described as highly speculative, extremely speculative, or in default. About a decade ago, the former Minneapolis Teachers Retirement Fund Association (MTRFA) invested a considerable portion of its assets in junk bonds, with very harmful results. The former 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 as a whole. Due to the large junk bond exposure, the bond portfolio as a whole had returns over a several-year period that were well below that of investment-grade bond benchmarks. Several years after entering this market, the MTRFA abandoned using junk bonds. Another former local pension fund, MERF, had considerable problems with junk bonds back in the late 1980s and early 1990s. MTRFA and MERF no longer exist as separate entities; both have been merged into statewide plans in recent years.

There are some highly speculative junk bond mutual funds available to individual investors, and to the small volunteer fire relief associations that might use the proposed junk bond authority in this bill. The Goldman Sachs High Yield Fund, which charges an up-front load as high as 4.5% of invested assets, and with annual operating expenses in excess of 1% of assets, invests in both foreign and domestic "high-yield fixed income securities" (junk bonds), including subordinated and unsecured loans. That mutual fund lost 27.5% of its value in calendar 2008, and then increased in value by 50% in 2009. The ten-year annualized return (ending December 31, 2009) was 5.82% (before any deduction for the load and annual expenses), while for the same ten-year period the domestic investment-grade bond market provided a 6.3% return. Any investor who naively believes that all bond investments are safe and all equities are risky can get into serious trouble.

2. Exchange-Traded Funds. Another issue is the use of exchange-traded funds (ETFs). Expanded list pension funds currently have this authority to use ETFs, but this bill expands that authority to limited list plans. The issue with ETFs is that they can be used to market time, which can be considered to be speculation rather than investing. ETFs are a pool of securities or other assets, often, but not always, designed to match an index. ETFs trade like stocks on a securities exchange, permitting ETFs to be bought or sold during the day through a broker, unlike mutual funds which trade at the end of the day based on closing asset values.

A possible advantage of ETFs is that they can be used like a mutual fund to create long-term exposure to a given asset class, and they may have a cost advantage over a similar mutual fund. Thus, if used prudently, ETFs may be a useful investment tool. On the other hand, ETFs can be used for speculative purposes rather than as long-term investment vehicles. Because ETFs trade like securities on an exchange, they can be used to market time and, can be bought on margin, be used to create leverage (magnifying gains or losses), and they can be sold short. A short sale is a tactic that can be used to make money if an investor believes that a stock will fall in value. The investor borrows a stock from a brokerage account with a requirement that the stock be returned at a specified future date. The investor then sells the borrowed stock, later buying identical stock to return to the brokerage account. If, following the initial sale, the stock falls in value, the investor is able to repurchase the stock at a lower price. The gain is the difference between the prices minus fees. However, if the stock increases in value rather than falls, the investor will lose money on the transaction because the investor must pay a higher price to repurchase the security than he or she obtained when they first sold it.

3. Revised Emerging Markets Securities Authority. Proposed revisions to the expanded list plan emerging markets investment authority are worth noting. To understand the situation, it is useful to first review SBI's investment authority in this area and to provide a little history.

SBI's authority to invest in foreign markets, other than Canadian securities, is covered by SBI's "other investments" provision, Minnesota Statutes, Section 11A.24, Subdivision 6 (that provision appears in the current bill, starting on line 4.25, and particularly lines 5.7-5.12). The provision permits SBI to invest in "international securities" without limit. As the term is used in the provision, international securities means equity and debt securities in developed foreign markets (other than Canada, which is authorized elsewhere in the provision), and also in emerging markets. Before 1994, the maximum that could be invested in these markets, when included with all the other investment forms then permitted under this subdivision (venture capital, resource investments, mutual funds, real estate), was 35% of the total portfolio. This changed in 1994 (Laws 1994, Ch. 604, Art. 1, Sec. 11), when the provision was revised to remove international securities from the 35% of portfolio investment limitation. SBI sought this change, probably because investments in developed foreign markets were becoming a norm in professionally managed pension fund portfolios. As SBI sought to devote a reasonable percentage of its total portfolio to developed foreign markets, not much room was left under the 35% limit for modest investments in emerging markets, plus venture capital and other investment forms included under that cap. SBI could have sought an increase in the cap, but instead it shifted international investments out from the cap. While that seems reasonable for developed market investments, that change also leaves no cap on emerging market investments. Currently, the only restraint regarding emerging market securities is that SBI is required under law to invest prudently, and SBI cannot exceed 85% in equity and equity-like investments, including its emerging market investments.

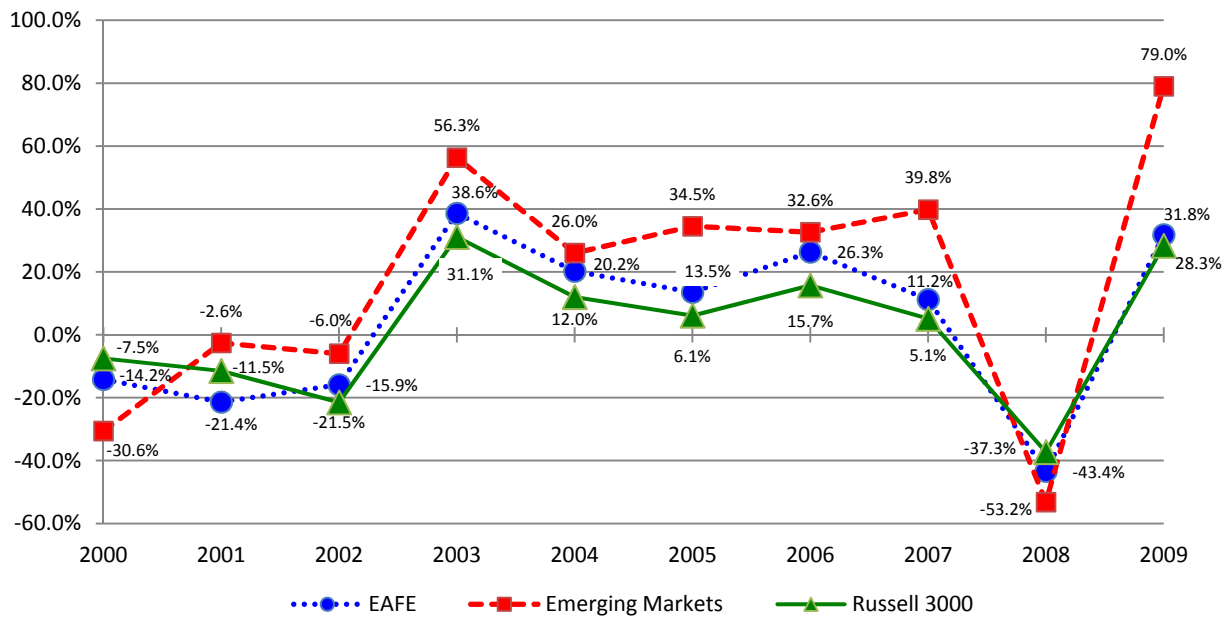
The corresponding expanded list provision in Chapter 356A evolved differently. When the primary investment authority provision for expanded list plans was split from that of SBI in 1994 (see junk bond discussion above) the version of Section 11A.24 used to model the expanded list provision was the version prior to the changes SBI sought in 1994. As a consequence, when the expanded list investment authority provision (Section 356A.06, Subd. 7) was created in 1994, investments in international securities were included under the 35% cap. For many years, apparently this did not cause a problem for the expanded list plans. In 2006 (Laws 2006, Ch. 271, Art. 8, Sec. 6), the expanded list investment authority provision was revised, at the request of plan administrators, by moving certain investments that previously had been in the "other investments" paragraph and subject to the cap, to new separate paragraphs with no cap. A separate paragraph was created covering foreign developed market investments, with no cap, and separate investment paragraphs were also created for mutual fund investments and real estate investment trusts (REITs), again with no cap. Since foreign developed market securities now had its own authority paragraph, the language in the "other investments" paragraph was revised from authorizing "international securities" to authorizing "international debt securities and emerging market equity securities." Also, given all the investment forms that had been moved out of the "other investments" provision, the cap was reset for those that remained, from 35% of the total portfolio to 20%. Thus, due to the 2006 changes, foreign developed market securities had no cap, but emerging market securities did have a cap of 20% of the portfolio for total investments in venture capital, resource investments, emerging market securities, and other miscellaneous investments.

H.F. 1555 (Murphy, M.); S.F. 927 (Rosen) seeks to make the expanded list authority provision more like the current SBI provision, which has no cap on emerging market securities. In the bill the cap on emerging market investments is completely removed if the expanded list plan is not a volunteer fire plan. However, for expanded list volunteer fire plans, there will be a 15% cap on emerging market equity and international debt (lines 15.34-15.36).

In recent years, it is not uncommon for a portfolio to have at least a minimal allocation to emerging markets, but it can be difficult to determine how much Minnesota pension funds hold. SBI reports do not break out emerging market securities from developed foreign market securities. A recent SBI report indicates that as of September 30, 2010, SBI had 15% of the portfolio in international stocks, but the portion of that which was in emerging markets is not specified. Similarly, the Office of the State Auditor annually produces a Large Public Pension Plan Investment Report, providing investment performance and asset mix information about SBI and the larger non-SBI plans, but those reports tend to lump all foreign stocks into a single group, rather than differentiating between developed market and emerging market securities.

The following chart provides an indication of the returns earned in domestic and foreign stocks for the ten-year period 2000 through the end of calendar 2009, and graphically depicts the volatility of

these markets. The Russell 3000, an index covering over 95% of the United States market, depicts the returns offered by domestic stocks. The Europe, Australasia, and Far East index (Australasia is a term for Australia and New Zealand) is the most commonly used index of foreign developed market returns. For emerging markets, the Emerging Markets Free index is used. The return information was obtained from the Russell website and SBI reports.



The decade 2000-2009 was an extremely turbulent period for stocks. Returns in some years were sternly negative, others were strongly positive, with little in between. Domestic stocks produced negative returns in 2000, 2001, 2002, with the worst year being 2008, when the market lost 37.3% of its value. Foreign developed market stock returns, depicted by the EAFE returns, were also highly volatile. The emerging markets were the most volatile, losing nearly 31% of its value in the first year, followed by very high returns for several years in the middle of the decade, then losing 53% of its value in 2008, followed by a lofty 79% return in 2009. The chart also makes it evident that these markets are considerably correlated; the returns move together. In the bad years early in the decade none had positive returns, all did well in the middle of decade, all crashed in 2008, and all had a very good return in 2009.

The returns earned in these markets can also be summarized as ten-year returns. These are not shown in the chart. The ten-year return to the domestic market was -0.2%. In other words, the variable stream of returns for the domestic market shown in the chart is equivalent to losing 0.2% of the portfolio's value in each year of the decade. The EAFE ten-year annualized return was marginally better, positive 1.2%. Emerging markets were the only group providing a high return for the decade as a whole. Its ten-year return was 10.1%, but surviving the ride took considerable nerve.

Pension and Public Policy Issues

H.F. 1555 (Murphy, M.); S.F. 927 (Rosen) raises a number of pension and related public policy issues for consideration by and possible discussion by the Commission, as follows:

1. Authorizing SBI to Invest in ETFs (Exchange-Traded Funds). The issue is whether the new authority for SBI to use exchange-traded funds is appropriate. Further information on ETFs is included in **Attachment C**. The Commission may also wish to hear testimony from SBI and other parties on general properties of ETFs, including potential misuse concerns. Regarding any potential for harm, the Commission may wish to consider that SBI would make very limited use of this tool, if it is used at all, and SBI has an extensive professional staff, outside consultants, and an Investment Advisory Council to provide guidance. SBI's investment operations receive more scrutiny than any other Minnesota public investor.
2. Authorizing Limited List Volunteer Fire Plans to Invest in Exchange-Traded Funds. The issue is whether the new authority to use exchange-traded funds (ETFs) is appropriate for the limited list plans, which are the smallest of our plans and which may have no professional guidance. (Any plan, however small, which uses an investment advisor or SBI to invest a considerable portion of its assets would be classified as an expanded list rather than limited list plan.) The Commission may wish to consider whether possible misuse of ETFs creates an unacceptable financial risk to local communities that are responsible for supporting these plans.

3. Junk Bond Authorization for Volunteer Fire Plans. The issue is whether the new authority for volunteer fire plans to use junk bonds is appropriate. Some concerns are that administrators for some of these plans, particularly the limited list plans, may naively believe that all bonds are safe investments. Another is that, for some of these plans, plan administrators might decide to include nothing in the portfolio but investment-grade bonds and junk bonds, rather than including a reasonable allocation to equities to enhance returns and further stabilize the portfolio returns through diversification. On the other hand, the Commission might conclude that the limitations included in the bill (no more than 5% of the total portfolio's assets can be in junk bonds), provides sufficient safety. Also, some of the securities that already are authorized investments for expanded list plans (such as emerging market equity and debt securities) may pose considerably more risk than domestic junk bonds, although these foreign securities also may have considerably more upside.
4. Possible Quality Restrictions on Junk Bonds. The issue is whether it would be appropriate and feasible to add to the bill, through an amendment, quality restrictions on junk bonds, restricting junk bonds to those that fall just below the investment-grade cutoff, while prohibiting those in the highly speculative and default range. If the Commission concluded such an action has merit, the Commission may wish to consider the scope of the change, whether to restrict such a change to limited list plans, or to extend it to some or all extended list plans and SBI.
5. Appropriate Equity Limit. The issue is whether the equity and equity-like investment limit (no more than 85% of the portfolio) is appropriate. SBI has had an 85% limit for many years, probably decades. The expanded list plans also has an 85% limit stated in its existing law, but the effectiveness of that provision has been eroded in recent years, probably not due to conscience action by the Legislature but due to poor drafting placement. In recent years, the expanded list plans and limited list plans were given authority to invest in the SBI Supplemental Fund, which is a set of investment options very similar to a mutual fund, providing access to money market, bond, and domestic and foreign stock accounts. Due to the placement in statute of that authorizing language, SBI Supplemental Fund investments held by the expanded or limited list plan were not clearly included when determining whether a plan was conforming to the 85% equity limit. A plan could, through the SBI Supplemental Fund alone, or by using the SBI Supplemental Fund stock accounts and other investment authority provisions, be invested 100% in equities. It is very unlikely that outcome was intended by the Legislature.

The bill reflects the study group's conclusion that all of a plan's investments should be used to determine compliance with the 85% limit, and that no further action to revise that upward limit is justified. However, if the Commission were to conclude that the 85% limit should be revised, that could be done through an amendment.

6. Possible Need for Limit on Emerging Market Securities. As discussed previously, nothing in SBI law limits the portion of a portfolio that can be devoted to emerging markets, other than the prudent person standard. Expanded list plans are currently limited, but the draft removes that limit for local police and paid fire plans and first class city teacher plans, while proposing to cap volunteer fire expanded list plan exposure to these markets at 15% of the association's fund market value. This leads to a question of whether it is appropriate to cap some funds but not others. The study group did discuss this issue of potential exposure to emerging markets. The general sentiment of the group was that it would not be prudent for any fund to exceed 15% market value in emerging market securities, but the group was reluctant to impose a hard prohibition, except for the volunteer fire relief associations. The Commission may wish to consider caps on all the funds, or all the non-SBI funds.

In deciding this matter, the Commission may wish to consider that a few of the plans that would have no limit on emerging market securities are plans are in weak condition. In the last few years, Commission staff has raised the question of whether the DTRFA and the SPTRFA, both expanded list plans, are viable as freestanding plans, or whether it would be better to merge those plans into TRA. In 2009, the DTRFA was only 49% funded on market value basis, although in the 2010 valuation that increased to 62% funded based on market value. Based on market value, the SPTRFA was 54% funded in 2009 and 55% funded in 2010. In the package of provisions passed last session to limit the liabilities of our public pension funds (Laws 2010, Ch. 359, Art. 1), the SPTRFA took the least action of all plans included in that law to reign in its liabilities. Also, two other expanded list plans, the Minneapolis police and paid fire relief associations, have had a difficult relationship with their city in recent years and have been urged to consider some form of consolidation into PERA, an action which the relief associations have long resisted. These two relief associations also have provisions in their laws permitting additional distributions of assets to retirees (called a 13th check), if investment returns exceed certain thresholds, and the amount that can be distributed increases at higher funding ratios. Given the pressures these police, fire, and teacher organizations face, an organization might be

tempted to supercharge its returns by significantly boosting its emerging markets allocation. The payoff could be large, but so could the downside if there is a prolonged period of strong negative returns. If that occurs, the city, school district, or state may be called upon to replace the lost assets.

7. Investment Authority Transition Provision Issues. The bill includes an investment authority transition provision (Section 7, page 16.8-16.12), stating that if a plan holds an investment authorized by prior law but prohibited by the current bill, the plan administrators must liquidate the asset or assets by June 30, 2013. This provides roughly two years from the effective date to rid the portfolio of non-conforming assets. The two-year window is consistent with transition provisions in past investment authority bills. However, an issue is whether the deadline should be sooner in cases where the problem is an asset mix exceeding the 85% equity maximum.

Potential Amendments for Commission Consideration

a. Technical Amendment.

- **H1555-1A** clarifies that bond quality determinations must be by recognized agencies and that the proposed limitation on international debt investments by volunteer fire relief associations (page 15.34-15.36 of the bill) does not apply to investments in Canadian debt securities, which are authorized elsewhere in law.

b. Exchange-Traded Funds Authority Amendments.

- **H1555-2A** removes the proposed authority for SBI to use ETFs if the Commission concludes that the proposed SBI ETF authority is inappropriate or is unnecessary because it would not be used even if included in the law.
- **H1555-3A** removes the proposed authority for limited list plans (all of which are volunteer fire plans) to use ETFs if the Commission concludes that the proposed ETF authority is inappropriate for these plans due to concerns about potential abuse of this authority.

c. Junk Bond Authority Amendments.

- **H1555-4A** removes the proposed junk bond authority for limited list and expanded list volunteer fire plans.
- **H1555-5A**, an alternative to -4A, removes the proposed volunteer fire junk bond authority for limited list plans but retains the proposed authority for volunteer fire expanded list plans.
- **H1555-6A**, which could be used with -4A or -5A, applies to expanded list plans and revises the maximum percentage of the portfolio that can be devoted to junk bonds from 5% to a percentage (presumably lower) to be set by the Commission by filling in the blank.
- **H1555-7A**, an alternative to -6A, revises the maximum proposed percentage that volunteer fire relief associations can devote to junk bonds from 5% to a percentage (presumably lower) to be set by the Commission while leaving the 5% maximum for all other expanded list plans. This amendment should not be used if -4A is adopted.

The following amendments are three alternatives for permitting better-grade junk bonds (speculative grade) while prohibiting investments in securities that are highly speculative or in default:

- **H1555-8A** sets a lower boundary on the quality of permissible junk bonds for volunteer fire plans only, permitting investment in bonds which are considered speculative (one grade below investment-grade), while prohibiting investments in highly speculative and defaulted securities.
- **H1555-9A** is similar to -8A but applies to all limited list plans, all expanded list plans, and SBI.
- **H1555-10A** is similar to -8A and -9A but applies to all limited list and all expanded list plans.

d. 85% Equity Cap Amendment.

- **H1555-11A** can be used to reset the maximum permissible percent of assets in equity and equity-like investments from 85% of the total portfolio to a percentage to be determined by the Commission. The revised limit would apply to all plans including SBI.

e. Emerging Market Securities Cap Amendments.

- **H1555-12A** revises the 15% cap on emerging market equity and international debt for expanded list volunteer fire plans from 15% to a percent to be specified by the Commission.
- **H1555-13A** expands the emerging market equity and international debt 15% cap to include all expanded list plans. This amendment can be used with -12A.
- **H1555-14A**, an alternative to -12A and -13A, combines those two amendments by expanding the emerging market equity and international debt cap to include all expanded list plans and revising the percent cap to a percentage specified by the Commission.
- **H1555-15A** expands the emerging market equity and international debt 15% cap to include all expanded list plans and SBI.
- **H1555-16A**, an alternative to -15A, expands the emerging market equity and international debt cap to include all expanded list plans and SBI, and revises the percent cap to a percentage to be specified by the Commission.

f. Investment Authority Transition Provision Amendments.

- **H1555-17A** sets a date other than June 30, 2013, for compliance with the revised investment authority provided under this bill.
- **H1555-18A** revises the transition provision by creating an early deadline for compliance (January 1, 2012) if the plan is exceeding 85% equity in its portfolio (or whatever revised limit is specified by the Commission).

g. Amendment Requested by the State Board of Investment.

- **H1555-19A** revises an SBI duties and powers provision and an SBI report provision by striking language requiring SBI to include financial statements in the reports.

Section-By-Section Summary of H.F. 1555 (Murphy, M.); S.F. 927 (Rosen)

Summary of H.F. 1555 (Murphy, M.); S.F. 927 (Rosen)

Sec.	Pg.Ln	Retirement Plan	Stat. Provision	Summary
1	1.6	SBI	11A.24	<p>The SBI authorized investment provision (M.S., Sec. 11A.24) is revised as follows:</p> <ul style="list-style-type: none"> - Permits SBI to use mutual funds without limit, rather than in limited amounts through "regional and mutual funds," and adds new authority to use exchange-traded funds, without limit; - Permits SBI to use mutual funds without limit, rather than in limited amounts through "regional and mutual funds," and adds new authority to use exchange-traded funds, without limit; - Clarifies the United States and Canadian government debt investment authority subdivision and removes obsolete language; - Clarifies the United States and Canadian corporate bond investment authority subdivision, including revising the limit on below-investment grade bonds to not exceed 5% of the fund based on market value, rather than market or book value, whichever is greater; - Clarifies the miscellaneous debt investments ("other obligations") provision; - Clarifies Subd. 5, the domestic stock provision, and moves the existing limitation on equity and equity-like investments (not to exceed 85% of the portfolio) to new Subd. 5a; - Revises Subd. 6, "Other Investments" by revising the venture capital language to permit "equity and debt" investment businesses through limited partnership, trusts, private placements, and similar arrangements, rather than "venture capital" investment businesses through those arrangements; and - Clarifies the asset manager appropriation language provision.
2	6.9	Local police and paid fire	69.77	<p>A local police and paid fire investment authority provision is revised by reformatting the provision and by removing mutual fund and below-investment grade bond investment authority language (which is being moved to the expanded list investment authority provision in Section 6.</p>
3	7.8	VFRAs	69.775	<p>A volunteer fire investment authority provision is revised by reformatting the provision, and by removing mutual fund investment authority language which is being moved to the expanded list investment authority provision in Section 6.</p>
4	8.1	First class city teachers	354A.08	<p>A first class city teacher investment authority provision (Minnesota Statutes, Section), is revised by removing below-investment grade bond investment authority which is being moved to the expanded list investment authority provision in Section 6.</p>
5	8.20	Limited list plans	356A.06, Subd. 6	<p>The limited list investment authority provision is revised as follows:</p> <ul style="list-style-type: none"> - Basing the criteria for inclusion as a limited list plan on market value rather than book value; - Adds a new paragraph authorizing pension plan governing boards to select and appoint investment authorities to act on their behalf (language is moved here from local police and paid fire, volunteer fire, and first class city teacher plan investment authority provisions); - Expands the authorized debt investments to be more similar to that permitted by expanded list plans, including permitting investments in high-grade guaranteed investment contracts; modernizing criteria defining permitted government-backed securities and permitting investment in similar Canadian securities; eliminating criteria based on multi-year pre-tax earnings for permitted corporate debt obligations and replacing it with a requirement that the securities be rated as investment-grade by a nationally recognized ratings agency; - Authorizes investing in limited list permitted investments through exchange-traded funds; - Moves to this provision authority for limited list plans to invest in assets authorized for expanded list plans (other than miscellaneous "other investments" found in the expanded list provision, Section 6, paragraph (h)), if the investment is through a mutual fund, and expands this to include investments through exchange-traded funds; - Moves to this provision authority to invest in the SBI Supplemental Fund; and - Clarifies that the pension fund's asset mix must not exceeded 85% in equity and equity-like investments, including investments in the SBI Supplemental Fund.
6	11.34	Expanded list plans	356A.06, Subd. 7	<p>The expanded list investment authority provision is revised as follows:</p> <ul style="list-style-type: none"> - Obsolete language is removed; - Permits expanded list volunteer fire plans to invest in below-investment grade bonds (either directly or through mutual funds or exchange-traded funds); - Authorizes investments in closed-end mutual funds (and placing a 20% ownership interest maximum in any closed-end mutual fund and in any real estate investment trust (REIT)); - Revises the "other investments" provision to be identical to the proposed revised SBI provision; - Restricts expanded list volunteer fire plans to have no more than 15% of the portfolio devoted to emerging market equity and foreign debt; - Moves to this provision authority to invest in the SBI Supplemental Fund; and - Clarifies that the pension fund's asset mix must not exceeded 85% in equity and equity-like investments, including investments in the SBI Supplemental Fund.
7	16.8	All Minnesota public plans	Uncoded	<p>Investment Authority Transition Provision. If a previously authorized investment is no longer permitted due to the sections of this act, the investment must be liquidated before June 30, 2013.</p>

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Background Information on Public Pension Plan Fiduciary Responsibility

Minnesota Statutes, Chapter 356A, the Public Pension Fiduciary Responsibility Law, was added to law in 1989, specifying fiduciary standards for Minnesota public pension plans, fostering consistency across all applicable plans.

Minnesota Statutes, Chapter 356A, includes provisions covering the following areas:

1. Fiduciary Status. Fiduciaries are defined as any member of a covered pension plan governing board, the chief administrating officer of the plan, the chief administrating officer of the State Board of Investment, members of the State Board of Investment, and members of the Investment Advisory Council. The Public Employees Retirement Association (PERA) Defined Contribution Plan, the Higher Education Individual Retirement Account Plan, the Higher Education Supplemental Retirement Plan, and the Arts Board, Humanities Commission Individual Retirement Account Plan are explicitly included. Members of the Higher Education Individual Retirement Account Plan Advisory Committee are fiduciaries.
2. Fiduciary Activities. Fiduciary activities include, but are not limited to, investing plan assets, determining the amount and duration of benefits, determining membership eligibility, determining funding requirements, maintenance of membership and financial records, and expenditure of plan assets. No defined contribution plan fiduciary is responsible for any loss due to a participant's self-direction of their account. Fiduciary activities include the reinvestment of plan assets, selection of financial institutions, and investment products.
3. Prohibited Persons. Convicted felons, unless they are constitutional officers, are prohibited from engaging in a fiduciary role. The prohibition lasts five years from the date of conviction if the individual is not incarcerated, or the day following unconditional release if incarcerated.
4. Standards of Fiduciary Care. A fiduciary owes a fiduciary duty to the active, deferred, and retired members of the plan who are its beneficiaries; the taxpayers of the state or political subdivision, who help to finance the plan; and the State of Minnesota, which established the plan. A fiduciary must act in good faith and shall exercise that degree of judgment and care, under the circumstances then prevailing, that persons of prudence, discretion, and intelligence would exercise in the management of their own affairs, not for speculation, considering the probable safety of the plan capital as well as the probable investment return to be derived from the assets.
5. Conduct of Fiduciary Duties Generally. Fiduciary activities must be carried out solely to provide authorized benefits to plan participants and beneficiaries, to incur and pay reasonable and necessary administrative expenses, or to manage the plan in accordance with the purposes and intent of the plan document. These activities must be carried out faithfully, without prejudice, and be consistent with law and the plan document.
6. Legal Title/Asset Holding. Assets of the covered plan can be held only by the plan treasurer, the State Board of Investment, the depository agent of the plan, or the State Board of Investment's depository agent. Legal title to plan assets must be vested in the plan, the State Board of Investment, the governmental entity that sponsors the plan, the nominee of the plan, or the depository agent. The holder of legal title functions as a trustee.
7. Diversification of Investments. Plan assets must be diversified to minimize the risk of substantial investment losses.
8. Absence of Fiduciary Profit. No fiduciary may profit, directly or indirectly, as a result of the investment or management of plan assets.
9. Economic Interest Statements. Each member of the governing board of a covered pension plan and the chief administrative officer of the plan must file annually a statement of economic interest. The statement must be filed with the chief executive officer of the plan and be available to the public. The statement must contain some minimum information and any other information that the fiduciary or the governing board deems necessary to disclose potential or actual conflict of interest.

The chief administrative officer of the covered plan, and the executive director of the State Board of Investment with respect to assets managed by the State Board of Investment, must have an investment business recipient disclosure which discloses the recipients of investment business of the plan and

investment commissions allocated among commercial banks, investment bankers, brokerage organizations, or other investment managers.

10. Authorized Investments. For small pension plans that lack professional investment advice or management or that do not have assets with a book value in excess of \$1,000,000, use the services of a registered investment advisor for the investment of at least 60% of its assets, use the services of the State Board of Investment for the investment of at least 60% of its assets, or use a combination of the services of the State Board of Investment and a registered investment advisor for the investment of at least 75% of its assets, the plan is limited to the restricted list of authorized investments unless other investments are authorized by law. A plan limited to the restricted list can invest in insured or collateralized certificates of deposit, insured savings accounts, government obligations, high quality corporate obligations, and mutual funds which limit their investments to those covered by the restricted list.
- Pension plans not limited to the restricted list can invest in securities generally permitted for the State Board of Investment and other investments authorized by law. Investments in foreign developed markets (countries included in the Europe, Australia, and Far East Index), commingled or mutual fund investments, and real estate investment trusts (REITs) are authorized securities. Asset-backed securities are permitted if those securities are rated in the top four quality categories by a nationally recognized rating agency. Stocks listed on any exchange regulated by the United States or Canadian governments, rather than just those listed on the New York or American stock exchanges, are authorized stock investments and exchange-traded funds are authorized.
11. Broker Disclosure and Acknowledgment. Pension plans must provide its brokers or managers with a complete statement of investment restrictions and requirements annually and the investment broker or manager must acknowledge those restrictions and requirements before doing business with or on behalf of the plan.
12. Minimum Liquidity Requirements. Administrators of pension plans limited to the restricted investment list are required to invest adequate assets in short-term, liquid investments, which can be redeemed without penalty, sufficient to meet the liquidity requirements of the fund.
13. Collateralization. Pension plans must select a depository bank or similar institution and deposits must be covered by insurance or collateral. Loaned securities must be fully collateralized with cash or securities, and any puts, calls, or future contracts can be undertaken only with a fully offsetting amount of cash or securities.
14. Disallows Engagement in Prohibited Transactions. No fiduciary may engage in a prohibited transaction or permit the fund to engage in a prohibited transaction. A prohibited transaction is:
- the sale, exchange, or lease of real estate between the pension plan and a fiduciary of the plan;
 - the lending of money or other extension of credit between the plan and a fiduciary of the plan;
 - providing paid services to the plan by a fiduciary for services other than those performed in the capacity of fiduciary;
 - furnishing goods or services by the plan to a fiduciary other than those required to perform the fiduciary role;
 - the transfer of plan assets to the fiduciary, other than the payment of retirement benefits or reasonable salary and expenses for performing the fiduciary role; or
 - the sale, exchange, loan, or lease of any item of value between the plan and the fiduciary except for fair market value in an arms-length transaction.
15. Provision of Benefit Summary. All active plan participants must be provided with a summary of the benefit provisions of the plan. A copy of the plan document must be provided to members upon request. The plans must also provide members with the financial and actuarial reports of the fund, or summaries of those documents.
16. Benefit Denial Appeals Process. Each plan is required to have a procedure for contested cases involving a determination of eligibility, benefits, or other rights under the plan.
17. Open Meeting Law Applicability. Meetings of the governing board or a committee of a governing board of a pension plan are open to the public and are governed by Section 471.705, the open meeting law.

18. Fiduciary Breach and Liability. A fiduciary breach occurs if the fiduciary violates the fiduciary's duties to plan members, taxpayers, and the state, or engages in a prohibited transaction. Available remedies are those in statute or common law.
19. Co-Fiduciary Responsibility and Liability. Fiduciaries have responsibility to oversee the fiduciary activities of other plan fiduciaries (co-fiduciary responsibility), and has responsibility to correct or alleviate a fiduciary breach by another. A co-fiduciary is liable for a fiduciary breach committed by another fiduciary when the co-fiduciary has a responsibility to oversee the fiduciary activities of the other or a responsibility to correct or alleviate a breach by that fiduciary. A co-fiduciary may eliminate liability through proper delegation and allocation of responsibilities. Otherwise, the liability is joint and several.
20. Permissible Indemnification of Fiduciaries. Fiduciaries may be indemnified at the discretion of the governing board of the plan or of the State Board of Investment. A decision to indemnify must apply to all fiduciaries of similar rank (Laws 1989, Chapter 319, Article 7, Section 11).
21. Continuing Fiduciary Education. Covered pension plans are required to develop a program for the continuing education of fiduciaries who are not reasonably considered to be experts with respect to their fiduciary duties and activities (Laws 1989, Chapter 319, Article 7, Section 13).

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Background Information on Bond Credit Ratings

Sources: Wikipedia and Investopedia

- a. Purpose of Credit Ratings of Securities. Credit ratings are intended provide individual and institutional investors with information that assists them in determining whether or not the issuers of debt obligations and fixed-income securities will be able to meet their obligations with respect to those securities. Credit rating agencies are intended to provide investors with objective analyses and independent assessments of companies and countries that issue such securities.
- b. Primary Security Rating Agencies. There are three major rating agencies of investments in the United States. Those rating agencies are:
1. Fitch. John Knowles Fitch founded the Fitch Publishing Company in 1913 and published financial statistics for use in the investment industry via "The Fitch Stock and Bond Manual" and "The Fitch Bond Book." In 1924, Fitch introduced the letter (AAA through D) rating system that has become the basis for ratings throughout the industry. Following plans to become a full-service global rating agency, in the late 1990s Fitch merged with IBCA of London, a subsidiary of Fimalac, S.A., a French holding company. Fitch also acquired market competitors Thomson BankWatch and Duff & Phelps Credit Ratings Co.
 2. Moody's. John Moody and Company first published "Moody's Manual" in 1900, which published basic statistics and general information about stocks and bonds of various industries. From 1903 until the stock market crash of 1907, "Moody's Manual" was a national publication. In 1909 Moody began publishing "Moody's Analyses of Railroad Investments", which added analytical information about the value of securities. Expanding this idea led to the 1914 creation of Moody's Investors Service which, in the following decade, would provide ratings for nearly all of the government bond markets at the time. By the 1970s, Moody's began rating commercial paper and bank deposits.
 3. Standard & Poor's. Henry Varnum Poor first published the "History of Railroads and Canals in the United States" in 1860 as the forerunner of securities analysis and reporting to be developed over the next century. Standard Statistics formed in 1906, which published corporate bond, sovereign debt and municipal bond ratings. Standard Statistics merged with Poor's Publishing in 1941 to form the Standard and Poor's Corporation. It was acquired by The McGraw-Hill Companies, Inc. in 1966. Standard and Poor's has become best known by virtue of its assembled indexes such as the S&P 500.
- c. Bond Credit Ratings. In investment, the bond credit rating is intended to assess the credit worthiness of corporate or government debt issues. It is analogous in purpose to credit ratings for individuals. The credit rating is a financial indicator to potential investors of debt securities such as bonds. These are assigned by credit rating agencies such as Moody's, Standard & Poor's, and Fitch Ratings to have letter designations (such as AAA, B, CC) which represent the quality of a bond. Bond ratings below BBB/Baa are considered to be not investment grade and are colloquially called "junk bonds."

Moody's		S&P		Fitch		
Long-term	Short-term	Long-term	Short-term	Long-term	Short-term	
Aaa	P-1	AAA	A-1+	AAA	F1+	Prime
Aa1		AA+		AA+		High grade
Aa2		AA		AA		
Aa3		AA-		AA-		
A1	P-2	A+	A-1	A+	F1	Upper medium grade
A2		A		A		
A3		A-		A-		
Baa1	P-3	BBB+	A-2	BBB+	F2	Lower medium grade
Baa2		BBB		BBB		
Baa3		BBB-		BBB-		
Ba1	Not prime	BB+	B	BB+	B	Non-investment grade speculative
Ba2		BB		BB		
Ba3		BB-		BB-		

Moody's		S&P		Fitch		
Long-term	Short-term	Long-term	Short-term	Long-term	Short-term	
B1		B+		B+		Highly speculative
B2		B		B		
B3		B-		B-		
Caa1		CCC+	C	CCC	C	Substantial risks
Caa2		CCC				Extremely speculative
Caa3		CCC-				In default with little prospect for recovery
Ca		CC				
		C				
C				DDD		In default
/		D	/	DD	/	
/				D		

- d. Recent Debate Over the Debt Rating System. The effectiveness of the debt rating system is a hotly debated subject recently because of the subprime crisis of 2007, which revealed the system's flaws when highly-rated structured securities were suddenly revealed to be of very questionable value. The loans supporting these structured securities were made to marginally qualified borrowers and the loans were often backed by very inadequate collateral, but these circumstances did not result in significant downgrades from ratings agencies. Questions have been raised as to whether this could have been a result of a potential conflict of interest and/or a lack of competition in the industry.

When an individual invests in a fixed-income security, the individual is essentially loaning money for a promise of scheduled, fixed-interest payments and for the eventual return of principal when the loan matures. An investment in this type of security involves a risk that the company might not do well enough to pay the agreed-upon interest on the scheduled dates. There is an even greater risk that the company will not be able to return the principal borrowed when the security matures. To help investors assess these risks, the ratings agencies analyze and rate companies and the fixed-income securities they issue, to determine the likelihood that companies will default on their loans.

According to a report published by the Basel Committee on Banking Supervision in 2000, there are about 150 credit rating agencies worldwide, but only a handful of these companies are nationally recognized as major players, called Nationally Recognized Statistical Rating Organizations (NRSRO).

So much is riding on the rating bestowed on the security that it may be possible for rating agencies to become involved in or threatened by conflicts of interest. Another concern is that the debt rating industry is dominated by only three companies: Standard & Poor's (S&P), Moody's, and Fitch.

Because the rating companies receive their compensation from the companies whose structured securities they rate, ratings company critics suggest that the fact that the ratings companies obtain fees from the companies that issue structured securities may make the ratings agencies susceptible to issuing artificially high ratings. In addition, critics suggest that the rating agencies may become reluctant to downgrade the securities of firms they were involved with for fear of losing future business. Some ratings agencies also advise issuers on structured debt securities and then rate the securities they helped structure, which many critics believe to be a questionable business practice leading to inflated ratings.

Background Information on Exchange-Traded Funds (ETFs)

- a. **Definition.** Exchange-traded funds (ETFs) are investment companies that are registered under the Investment Company Act of 1940 as open-end funds or unit investment trusts (UITs). Unlike typical open-end funds or UITs, however, ETFs do not sell or redeem their individual shares ("ETF shares") at net asset value. Instead, ETFs sell and redeem ETF shares at net asset value only in large blocks (such as 50,000 ETF shares). In addition, national securities exchanges list ETF shares for trading, which allow investors to purchase and sell individual ETF shares among themselves at market prices throughout the day. ETFs therefore possess characteristics of traditional open-end funds and UITs, which issue redeemable shares, and of closed-end funds, which generally issue shares that trade at negotiated prices on national securities exchanges and are not redeemable. A fundamental characteristic of all existing ETFs traded in the United States is that they are based on specific domestic and foreign market indices. An "index-based ETF" seeks to track the performance of an index by holding in its portfolio either the contents of the index or a representative sample of the securities in the index.
- b. **Structure.** ETFs offer public investors an undivided interest in a pool of securities and other assets and thus are similar in many ways to traditional mutual funds, except that shares in an ETF can be bought and sold throughout the day like stocks on a securities exchange through a broker-dealer. Unlike traditional mutual funds, ETFs do not sell or redeem their individual shares at net asset value, or NAV. Instead, financial institutions purchase and redeem ETF shares directly from the ETF, but only in large blocks, varying in size by ETF from 25,000 to 200,000 shares, called "creation units". Purchases and redemptions of the creation units generally are in kind, with the institutional investor contributing or receiving a basket of securities of the same type and proportion held by the ETF, although some ETFs may require or permit a purchasing or redeeming shareholder to substitute cash for some or all of the securities in the basket of assets.¹

The ability to purchase and redeem creation units gives ETFs an arbitrage mechanism intended to minimize the potential deviation between the market price and the net asset value of ETF shares. Existing ETFs have transparent portfolios, so institutional investors will know exactly what portfolio assets they must assemble if they wish to purchase a creation unit, and the exchange disseminates the updated net asset value of the shares throughout the trading day, typically at 15-second intervals.¹

If there is strong investor demand for an ETF, its share price will (temporarily) rise above its net asset value per share, giving arbitrageurs an incentive to purchase additional creation units from the ETF and sell the component ETF shares in the open market. The additional supply of ETF shares increases the ETF's market capitalization and reduces the market price per share, generally eliminating the premium over net asset value. A similar process applies when there is weak demand for an ETF and its shares trade at a discount from net asset value.

In the United States, most ETFs are structured as open-end management investment companies (the same structure used by mutual funds and money market funds), although a few ETFs, including some of the largest ones, are structured as unit investment trusts. ETFs structured as open-end funds have greater flexibility in constructing a portfolio and are not prohibited from participating in securities lending programs or from using futures and options in achieving their investment objectives.²

Under existing regulations, a new ETF must receive an order from the Securities and Exchange Commission, or SEC, giving it relief from provisions of the Investment Company Act of 1940 that would not otherwise allow the ETF structure. In 2008, however, the SEC proposed rules that would allow the creation of ETFs without the need for exemptive orders. Under the SEC proposal, an ETF would be defined as a registered open-end management investment company that:

- Issues (or redeems) creation units in exchange for the deposit (or delivery) of basket assets the current value of which is disseminated on a per share basis by a national securities exchange at regular intervals during the trading day;
- Identifies itself as an ETF in any sales literature;
- Issues shares that are approved for listing and trading on a securities exchange;
- Discloses each business day on its publicly available web site the prior business day's net asset value and closing market price of the fund's shares, and the premium or discount of the closing market price against the net asset value of the fund's shares as a percentage of net asset value; and
- Either is an index fund, or discloses each business day on its publicly available web site the identities and weighting of the component securities and other assets held by the fund.¹

The SEC rule proposal would allow ETFs either to be index funds or to be fully transparent actively managed funds. Historically, all ETFs in the United States have been index funds. In 2008, however, the SEC began issuing exemptive orders to fully transparent actively managed ETFs. The first such order was to PowerShares Actively Managed Exchange-Traded Fund Trust,³ and the first actively managed ETF in the United States was the Bear Stearns Current Yield Fund, a short-term income fund that began trading on the American Stock Exchange under the symbol YYY on 25 March 2008.⁴ The SEC rule proposal indicates that the SEC may still consider future applications for exemptive orders for actively managed ETFs that do not satisfy the proposed rule's transparency requirements.¹

Some ETFs invest primarily in commodities or commodity-based instruments, such as crude oil and precious metals. Although these commodity ETFs are similar in practice to ETFs that invest in securities, they are not "investment companies" under the Investment Company Act of 1940.¹

Publicly traded grantor trusts, such as Merrill Lynch's HOLDRs securities, are sometimes considered to be ETFs, although they lack many of the characteristics of other ETFs. Investors in a grantor trust have a direct interest in the underlying basket of securities, which does not change except to reflect corporate actions such as stock splits and mergers. Funds of this type are not "investment companies" under the Investment Company Act of 1940.⁵

As of 2009, there were approximately 1,500 exchange-traded funds traded on US exchanges.⁶ This count uses the wider definition of ETF, including HOLDRs and closed-end funds.

- c. Development. During the year 2000, the number of ETFs increased from 30 to 80, and the amount of assets held by ETFs nearly doubled from \$34 billion to \$66 billion. While the total amount of ETF assets at the end of 2000 was still relatively small when compared to the approximately \$4 trillion of assets in equity open-end investment companies ("open-end funds" or "mutual funds"), ETF assets were much closer to the \$89 billion of total assets invested in unit investment trusts and the \$135 billion of total assets invested in closed-end investment companies ("closed-end funds"). The following provides information on the assets and the number of exchange-traded index funds over an 11-year period, by type of fund:

Year	Total	Domestic Equity	Global/ International Equity	Bond
<i>Assets (millions of dollars, end of year)</i>				
1993	\$464	\$464	--	--
1994	424	424	--	--
1995	1,052	1,052	--	--
1996	2,411	2,159	\$252	--
1997	6,707	6,200	506	--
1998	15,568	14,542	1,026	--
1999	33,873	31,881	1,992	--
2000	65,585	63,544	2,041	--
2001	82,993	79,977	3,016	--
2002	102,143	92,904	5,324	\$3,915
2003	150,983	132,332	13,984	4,667
<i>Number of Funds (end of year)</i>				
1993	1	1	--	--
1994	1	1	--	--
1995	2	2	--	--
1996	19	2	17	--
1997	19	2	17	--
1998	29	12	17	--
1999	30	13	17	--
2000	80	55	25	--
2001	102	68	34	--
2002	113	66	39	8
2003	119	72	41	6

Note: Components may not add to the total because of rounding

Sources: Strategic Insight and Investment Company Institute

In 1993, a subsidiary of the AMEX introduced the first ETF – the SPDR Trust, organized as a unit investment trust. The SPDR Trust, which issues ETF shares referred to as SPDRs (pronounced "spiders"), is a UIT that tracks the Standard & Poor's 500 Composite Stock Price Index ("S&P 500 Index") by holding substantially all of the securities in the S&P 500 Index in substantially the same weightings as in the S&P 500 Index. The trustee adjusts the portfolio of the SPDR Trust only to reflect changes in the composition of the S&P 500 Index. In order to offer SPDRs, the SPDR Trust obtained exemptions from various provisions of the Investment Company Act of 1940. Among other things, the exemptions allow the SPDR Trust to redeem SPDRs in large aggregations only, SPDRs to trade at negotiated prices in the secondary market, dealers to sell SPDRs to purchasers in the

secondary market unaccompanied by a prospectus (when prospectus delivery is not required by the Securities Act of 1933), and certain affiliated persons of the SPDR Trust to deposit securities into, and receive securities from, the SPDR Trust in connection with the purchase and redemption of large aggregations of SPDRs.

In 1996, ETF sponsors introduced the first two ETFs organized as open-end funds. The CountryBaskets Index Fund, Inc., consisted of different portfolios that tracked various country indices of the Financial Times/S&P Actuaries World Indices. The Foreign Fund, Inc., offers series that track various Morgan Stanley Capital International (“MSCI”) country indices. These ETFs obtained exemptions from various provisions of the Act that were generally analogous to the exemptions obtained by the ETFs organized as UITs. Many ETFs organized as open-end funds replicate the holdings of their corresponding indices to track the performance of the indices. However, because ETFs organized as open-end funds employ investment advisers, some of these ETFs instead may use “sampling strategies” to track the performance of an index. Using a sampling strategy, an investment adviser can construct a portfolio that is a subset of the component securities in the corresponding index, rather than a replication of the index. The investment adviser also may acquire securities for the ETF portfolio that are not included in the corresponding index. While these ETFs still seek to track the performance of their respective indices, they have greater flexibility in accomplishing that goal. In addition, ETFs that are open-end funds are not prohibited from participating in securities lending programs or from using futures and options in achieving their investment objectives.

ETFs issue shares only in large aggregations or blocks (such as 50,000 ETF shares) called “Creation Units.” An investor, usually a brokerage house or large institutional investor, may purchase a Creation Unit with a “Portfolio Deposit” equal in value to the aggregate net asset value of the ETF Shares in the Creation Unit. The investment adviser or sponsor of the ETF announces the contents of the Portfolio Deposit at the beginning of each business day. The Portfolio Deposit generally consists of a basket of securities that mirrors the composition of the ETF’s portfolio. Because the purchase price of the Creation Unit must equal the net asset value of the underlying ETF shares, the required Portfolio Deposit generally also includes a small amount of cash to account for the difference between the value of the basket of securities and the net asset value of the ETF shares. The value of a Creation Unit typically exceeds several million dollars. After purchasing a Creation Unit, the investor may hold the ETF shares, or sell some or all of the ETF shares to investors in the secondary market.

ETFs register offers and sales of shares under the Securities Act of 1933 and list their ETF shares for trading on a national securities exchange under the Securities Exchange Act of 1934. As with any listed security, investors also may trade ETF shares in off-exchange transactions. In either case, ETF shares trade at negotiated prices. The development of the secondary market in ETF shares depends upon the activities of the exchange specialist assigned to make a market in the ETF shares and upon the willingness of Creation Unit purchasers to sell ETF shares in the secondary market.

ETF shares purchased in the secondary market are not redeemable from the ETF except in Creation Unit aggregations. If an investor purchases a Creation Unit to the ETF for redemption, the redeeming investor receives a “Redemption Basket,” the contents of which are identified by the ETF investment adviser or sponsor at the beginning of the day. The Redemption Basket (usually the same as the Portfolio Deposit) consists of securities and a small amount of cash. An investor holding fewer ETF shares than the amount needed to constitute a Creation Unit may dispose of those ETF shares only by selling them in the secondary market. The investor receives market price for the ETF shares, which may be higher or lower than the net asset value of the ETF shares. The investor also pays customary brokerage commissions on the sale.

- d. Investment Uses. ETFs generally provide the easy diversification, low expense ratios, and tax efficiency of index funds, while still maintaining all the features of ordinary stock, such as limit orders, short selling, and options. Because ETFs can be economically acquired, held, and disposed of, some investors invest in ETF shares as a long-term investment for asset allocation purposes, while other investors trade ETF shares frequently to implement market timing investment strategies.² Among the advantages of ETFs are the following:^{5/7}

- Lower costs – ETFs generally have lower costs than other investment products because most ETFs are not actively managed and because ETFs are insulated from the costs of having to buy and sell securities to accommodate shareholder purchases and redemptions. ETFs typically have lower marketing, distribution and accounting expenses, and most ETFs do not have 12b-1 fees.
- Buying and selling flexibility – ETFs can be bought and sold at current market prices at any time during the trading day, unlike mutual funds and unit investment trusts, which can only be traded at the end of the trading day. As publicly traded securities, their shares can be purchased on margin

and sold short, enabling the use of hedging strategies, and traded using stop orders and limit orders, which allow investors to specify the price points at which they are willing to trade.

- Tax efficiency – ETFs generally generate relatively low capital gains, because they typically have low turnover of their portfolio securities. While this is an advantage they share with other index funds, their tax efficiency is further enhanced because they do not have to sell securities to meet investor redemptions.
- Market exposure and diversification – ETFs provide an economical way to rebalance portfolio allocations and to "equitize" cash by investing it quickly. An index ETF inherently provides diversification across an entire index. ETFs offer exposure to a diverse variety of markets, including broad-based indexes, broad-based international and country-specific indexes, industry sector-specific indexes, bond indexes, and commodities.
- Transparency – ETFs, whether index funds or actively managed, have transparent portfolios and are priced at frequent intervals throughout the trading day.

Some of these advantages derive from the status of most ETFs as index funds.

¹ Exchange-Traded Funds, SEC Release Nos. 33-8901, IC-28193, 73 Fed. Reg. 14618 (March 11, 2008).

² Actively Managed Exchange-Traded Funds, SEC Release No. IC-25258, 66 Fed. Reg. 57614 (November 8, 2001).

³ PowerShares Capital Management LLC, et al.; Notice of Application, Release No. IC-28140 (February 1, 2008), 73 Fed. Reg. 7328 (February 7, 2008) (notice);
PowerShares Capital Management LLC, Release No. IC-28171 (February 27, 2008) (order). The SEC issued orders to Bear Stearns Asset Management, Inc., Barclays Global Fund Advisors, and WisdomTree Trust on the same day.

⁴ American Stock Exchange Lists First Actively-Managed Exchange Traded Fund (March 25, 2008).

⁵ ETFConnect, "Index ETFs – Know Your Funds" (visited April 7, 2008).

⁶ Peaceful Gains. "A List of exchange-traded funds". <http://etf.peacefulgains.com/A-List-of-exchange-traded-funds/>. Retrieved October 23, 2009.

⁷ American Stock Exchange, ETFs – Individual Investor (visited April 7, 2008).

- 1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:
- 1.2 Page 12, line 17, after "categories" insert "by a nationally recognized rating agency"
- 1.3 Page 15, line 35, after "investments" insert "authorized under clause (1), item (iv)."

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 1, line 13, delete "exchange-traded or"

- 1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:
- 1.2 Page 10, line 27, delete "exchange-traded"
- 1.3 Page 10, line 28, delete "funds, or through"
- 1.4 Page 10, line 31, delete "exchange-traded funds and"
- 1.5 Page 10, line 35, delete "or exchange-traded"

- 1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:
- 1.2 Page 10, line 33, delete "to" and insert " (d), (f), or"
- 1.3 Page 12, line 15, after "plan" insert " other than a volunteer firefighter relief
- 1.4 association governed by sections 69.771 to 69.776."

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 10, line 33, delete "to" and insert ", (d), (f), or"

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 12, line 18, delete "five" and insert "...."

- 1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:
- 1.2 Page 12, line 18, delete "five" and insert "...."
- 1.3 Page 12, line 19, after "value" insert "if the covered plan is a volunteer firefighter
- 1.4 relief association governed by sections 69.771 to 69.776, or five percent of the covered
- 1.5 plan's market value for any other expanded list plan"

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 12, line 15, before "An" insert "(1)"

1.3 Page 12, line 18, delete "(1)" and insert "(i)"

1.4 Page 12, line 20, delete "(2)" and insert "(ii)"

1.5 Page 12, line 22, delete "(3)" and insert "(iii)"

1.6 Page 12, after line 23, insert:

1.7 "(2) For volunteer firefighter relief associations governed by sections 69.771 to
1.8 69.776, clause (1) applies, except that investing in corporate obligations below the top
1.9 five quality categories as rated by a nationally recognized rating agency, or in comparable
1.10 unrated corporate obligations, is prohibited."

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 2, line 25, strike "in unrated corporate obligations or"

1.3 Page 2, line 26, strike everything after "are"

1.4 Page 2, line 27, strike "paragraph (a), clause (2)," and before "if" insert "rated in
1.5 the fifth quality category from the top by a nationally recognized rating agency, or in
1.6 comparable unrated securities."

1.7 Page 12, line 16, delete "in unrated corporate obligations or"

1.8 Page 12, line 17, delete everything before "if" and insert "rated in the fifth quality
1.9 category from the top by a nationally recognized rating agency, or in comparable unrated
1.10 securities."

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 12, line 16, delete "in unrated corporate obligations or"

1.3 Page 12, line 17, delete everything before "if" and insert "rated in the fifth quality
1.4 category from the top by a nationally recognized rating agency, or in comparable unrated
1.5 securities."

- 1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:
- 1.2 Page 4, line 24, delete "85" and insert " .."
- 1.3 Page 16, line 5, delete "85" and insert " .."

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 15, line 35, delete "15" and insert "15."

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 15, line 34, delete "volunteer firefighter relief associations" and insert "an
1.3 expanded list plan"

1.4 Page 15, line 35, delete "association's" and insert "expanded list plan's"

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 15, line 34, delete "volunteer firefighter relief associations" and insert "an
1.3 expanded list plan"

1.4 Page 15, line 35, delete "15" and insert ":", and delete "association's" and insert "
1.5 expanded list plan's"

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 5, line 16, strike "and"

1.3 Page 5, line 19, strike the period and insert "; and"

1.4 Page 5, after line 19, insert:

1.5 "(5) emerging market equity and international debt investments authorized under
1.6 paragraph (a), clause (4), must not exceed 15 percent of the market value of the fund for
1.7 which the state board is investing."

1.8 Page 15, line 34, delete "volunteer firefighter relief associations" and insert "an
1.9 expanded list plan"

1.10 Page 15, line 35, delete "association's" and insert "expanded list plan's"

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 5, line 16, strike "and"

1.3 Page 5, line 19, strike the period and insert "; and"

1.4 Page 5, after line 19, insert:

1.5 "(5) emerging market equity and international debt investments authorized under
1.6 paragraph (a), clause (4), must not exceed .. percent of the market value of the fund for
1.7 which the state board is investing."

1.8 Page 15, line 34, delete "volunteer firefighter relief associations" and insert "an
1.9 expanded list plan"

1.10 Page 15, line 35, delete "15" and insert ".." and delete "association's" and insert ""
1.11 expanded list plan's"

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 16, line 12, delete "June 30, 2013" and insert "....."

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 16, line 9, before "If" insert "(a)"

1.3 Page 16, after line 12, insert:

1.4 "(b) Notwithstanding the liquidation date specified in paragraph (a), if a fund
1.5 invested by the State Board of Investment or any covered pension plan fund exceeds the
1.6 maximum permissible asset mix limit on equities and similar investments under section
1.7 1 or 6, whichever is applicable, the noncompliance must be corrected before January
1.8 1, 2012."

1.1 moves to amend H.F. No. 1555; S.F. No. 927, as follows:

1.2 Page 1, after line 5, insert:

1.3 "Section 1. Minnesota Statutes 2010, section 11A.07, subdivision 4, is amended to read:

1.4 Subd. 4. **Duties and powers.** The director, at the direction of the state board, shall:

1.5 (1) plan, direct, coordinate, and execute administrative and investment functions
1.6 in conformity with the policies and directives of the state board and the requirements of
1.7 this chapter and of chapter 356A;

1.8 (2) prepare and submit biennial and annual budgets to the board and with the
1.9 approval of the board submit the budgets to the Department of Management and Budget;

1.10 (3) employ professional and clerical staff as necessary. Employees whose primary
1.11 responsibility is to invest or manage money or employees who hold positions designated
1.12 as unclassified under section 43A.08, subdivision 1a, are in the unclassified service of the
1.13 state. Other employees are in the classified service. Unclassified employees who are
1.14 not covered by a collective bargaining agreement are employed under the terms and
1.15 conditions of the compensation plan approved under section 43A.18, subdivision 3b;

1.16 (4) report to the state board on all operations under the director's control and
1.17 supervision;

1.18 (5) maintain accurate and complete records of securities transactions and official
1.19 activities;

1.20 (6) establish a policy relating to the purchase and sale of securities on the basis of
1.21 competitive offerings or bids. The policy is subject to board approval;

1.22 (7) cause securities acquired to be kept in the custody of the commissioner of
1.23 management and budget or other depositories consistent with chapter 356A, as the state
1.24 board deems appropriate;

1.25 (8) prepare and file with the director of the Legislative Reference Library, by
1.26 December 31 of each year, a report summarizing the activities of the state board, the
1.27 council, and the director during the preceding fiscal year. The report must be prepared

2.1 so as to provide the legislature and the people of the state with a clear, comprehensive
 2.2 summary of the portfolio composition, the transactions, the total annual rate of return,
 2.3 and the yield to the state treasury and to each of the funds whose assets are invested by
 2.4 the state board, and the recipients of business placed or commissions allocated among
 2.5 the various commercial banks, investment bankers, money managers, and brokerage
 2.6 organizations and the amount of these commissions or other fees. ~~The report must contain~~
 2.7 ~~financial statements for funds managed by the board prepared in accordance with generally~~
 2.8 ~~accepted accounting principles.~~ The report must include an executive summary;

2.9 (9) include on the state board's Web site its annual report and an executive summary
 2.10 of its quarterly reports;

2.11 (10) require state officials from any department or agency to produce and provide
 2.12 access to any financial documents the state board deems necessary in the conduct of
 2.13 its investment activities;

2.14 (11) receive and expend legislative appropriations; and

2.15 (12) undertake any other activities necessary to implement the duties and powers
 2.16 set forth in this subdivision consistent with chapter 356A.

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

2.18 Sec. 2. Minnesota Statutes 2010, section 11A.14, subdivision 14, is amended to read:

2.19 Subd. 14. **Reports required.** As of each valuation date, or as often as the state
 2.20 board determines, each participant shall be informed of the number of units owned and the
 2.21 current value of the units. ~~Annually, the state board shall provide each participant financial~~
 2.22 ~~statements prepared in accordance with generally accepted accounting principles.~~

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

2.24 Renumber the sections in sequence and correct the internal references

2.25 Amend the title accordingly

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State of Minnesota
HOUSE OF REPRESENTATIVES

EIGHTY-SEVENTH
SESSION

HOUSE FILE No. **1555**

April 26, 2011

Authored by Murphy, M.

The bill was read for the first time and referred to the Committee on Government Operations and Elections

A bill for an act

relating to retirement; all Minnesota public pension plans; revising investment authority provisions; amending Minnesota Statutes 2010, sections 11A.24; 69.77, subdivision 9; 69.775; 354A.08; 356A.06, subdivisions 6, 7.

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

Section 1. Minnesota Statutes 2010, section 11A.24, is amended to read:

11A.24 AUTHORIZED INVESTMENTS.

Subdivision 1. **Securities generally.** (a) The state board shall have the authority is authorized to purchase, sell, lend or and exchange the following securities specified in this section, 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 directly or through shares in exchange-traded or mutual funds, or as units in commingled trusts that own the securities described in subdivisions 2 to 6, subject to any limitations as specified in this section.

(b) 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)~~ (3), may be accepted as collateral or offsetting securities.

Subd. 2. **Government obligations.** The state board ~~may~~ is authorized to invest funds in governmental bonds, notes, bills, mortgages, and other evidences of indebtedness provided if the issue is backed by the full faith and credit of the issuer or if the issue

2.1 is rated among the top four quality rating categories by a nationally recognized rating
 2.2 agency. The obligations in which the board may invest under this subdivision ~~include~~ are
 2.3 guaranteed or insured issues of ~~(a)~~:

2.4 (1) the United States, its agencies, its instrumentalities, or organizations created
 2.5 and regulated by an act of Congress; ~~(b)~~

2.6 (2) the Dominion of Canada and or any of its provinces, provided the principal and
 2.7 interest is are payable in United States dollars; ~~(c)~~

2.8 (3) any of the states and or any of their municipalities, political subdivisions,
 2.9 agencies or instrumentalities; ~~(d) the International Bank for Reconstruction and~~
 2.10 ~~Development, the Inter-American Development Bank, the Asian Development Bank, the~~
 2.11 ~~African Development Bank, or and~~

2.12 (4) any other United States government sponsored organization of which the United
 2.13 States is a member, provided if the principal and interest is are payable in United States
 2.14 dollars.

2.15 Subd. 3. **Corporate obligations.** (a) The state board ~~may~~ is authorized to invest
 2.16 funds in bonds, notes, debentures, transportation equipment obligations, ~~or and~~ any other
 2.17 longer term evidences of indebtedness issued or guaranteed by a corporation organized
 2.18 under the laws of the United States or any state ~~thereof~~ of the United States, or the
 2.19 Dominion of Canada or any Canadian province thereof ~~thereof provided that if~~:

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

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

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

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

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

2.32 (3) the state board's participation is limited to 25 percent of an issuer's obligations
 2.33 subject to this paragraph.

2.34 Subd. 4. **Other obligations.** (a) The state board ~~may~~ is authorized to invest funds in
 2.35 ~~bankers acceptances, certificates of deposit, deposit notes, commercial paper, mortgage~~
 2.36 ~~securities and asset backed securities, repurchase agreements and reverse repurchase~~

3.1 ~~agreements, guaranteed investment contracts, savings accounts, and guaranty fund~~
 3.2 ~~certificates, surplus notes, or debentures of domestic mutual insurance companies if they~~
 3.3 ~~conform to the following provisions:~~

3.4 (1) ~~bankers acceptances and deposit notes of United States banks are limited to those~~
 3.5 ~~if issued by banks~~ a United States bank that is rated in the highest four quality categories
 3.6 by a nationally recognized rating agency;

3.7 (2) ~~certificates of deposit are limited to those if issued by (i) a United States banks~~
 3.8 ~~and savings institutions that are~~ bank or savings institution that is rated in the top four
 3.9 quality categories by a nationally recognized rating agency or whose certificates of deposit
 3.10 are fully insured by federal agencies; ~~or (ii) certificates of deposits issued by a credit~~
 3.11 ~~unions union in amounts up to an amount within the limit of the insurance coverage~~
 3.12 provided by the National Credit Union Administration;

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

3.16 (4) mortgage securities ~~shall be~~ and asset-backed securities if rated in the top four
 3.17 quality categories by a nationally recognized rating agency;

3.18 (5) ~~collateral for~~ repurchase agreements and reverse repurchase agreements ~~is~~
 3.19 ~~limited to if collateralized with~~ letters of credit ~~and or~~ securities authorized in this section;

3.20 (6) guaranteed investment contracts ~~are limited to those if issued by an insurance~~
 3.21 ~~companies company or banks a bank that is~~ rated in the top four quality categories by a
 3.22 nationally recognized rating agency or ~~to~~ alternative guaranteed investment contracts
 3.23 ~~where if~~ the underlying assets comply with the requirements of this section;

3.24 (7) savings accounts ~~are limited to those if~~ fully insured by a federal agencies
 3.25 agency; and

3.26 (8) ~~asset backed securities shall be rated in the top four quality categories by a~~
 3.27 ~~nationally recognized rating agency~~ guaranty fund certificates, surplus notes, or debentures
 3.28 if issued by a domestic mutual insurance company.

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

3.32 (c) In addition to investments authorized by paragraph (a), clause (4), the state board
 3.33 ~~may~~ is authorized to purchase from the Minnesota Housing Finance Agency all or any
 3.34 part of a pool of residential mortgages, not in default, that has previously been financed
 3.35 by the issuance of bonds or notes of the agency. The state board may also enter into a
 3.36 commitment with the agency, at the time of any issue of bonds or notes, to purchase at

4.1 a specified future date, not exceeding 12 years from the date of the issue, the amount of
 4.2 mortgage loans then outstanding and not in default that have been made or purchased from
 4.3 the proceeds of the bonds or notes. The state board may charge reasonable fees for any
 4.4 such commitment and may agree to purchase the mortgage loans at a price sufficient to
 4.5 produce a yield to the state board comparable, in its judgment, to the yield available on
 4.6 similar mortgage loans at the date of the bonds or notes. The state board may also enter
 4.7 into agreements with the agency for the investment of any portion of the funds of the
 4.8 agency. The agreement must cover the period of the investment, withdrawal privileges,
 4.9 and any guaranteed rate of return.

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

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

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

4.22 Subd. 5a. **Asset mix limitations.** The aggregate value of investments under
 4.23 subdivision 5, plus the aggregate value of all investments under subdivision 6, must not
 4.24 exceed 85 percent of the market value of a fund.

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

4.28 (1) ~~venture capital~~ equity and debt investment businesses through participation in
 4.29 limited partnerships, trusts, private placements, limited liability corporations, limited
 4.30 liability companies, limited liability partnerships, and corporations;

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

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

5.4 ~~(4)~~ (3) resource investments through limited partnerships, trusts, private placements,
 5.5 limited liability corporations, limited liability companies, limited liability partnerships,
 5.6 and corporations; and

5.7 ~~(5)~~ (4) international securities.

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

5.10 (1) the aggregate value of all investments made ~~according to~~ under paragraph (a),
 5.11 clauses (1) to ~~(4)~~ (3), may not exceed 35 percent of the market value of the fund for
 5.12 which the state board is investing;

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

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

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

5.20 (c) All financial, business, or proprietary data collected, created, received, or
 5.21 maintained by the state board in connection with investments authorized by paragraph (a),
 5.22 clause (1), (2), or ~~(4)~~ (3), are nonpublic data under section 13.02, subdivision 9. As used
 5.23 in this paragraph, "financial, business, or proprietary data" means data, as determined by
 5.24 the responsible authority for the state board, that is of a financial, business, or proprietary
 5.25 nature, the release of which could cause competitive harm to the state board, the legal
 5.26 entity in which the state board has invested or has considered an investment, the managing
 5.27 entity of an investment, or a portfolio company in which the legal entity holds an interest.
 5.28 As used in this section, "business data" is data described in section 13.591, subdivision 1.
 5.29 Regardless of whether they could be considered financial, business, or proprietary data, the
 5.30 following data received, prepared, used, or retained by the state board in connection with
 5.31 investments authorized by paragraph (a), clause (1), (2), or ~~(4)~~ (3), are public at all times:

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

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

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

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

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

6.3 (6) the age of the investment in years.

6.4 Subd. 7. **Appropriation.** There is annually appropriated to the state board, from
6.5 the assets of the funds for which the state board invests ~~pursuant~~ relating to authorized
6.6 investments under subdivision 6, clause paragraph (a), sums sufficient to pay the costs for
6.7 the management of these ~~funds~~ assets by private management firms.

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

6.9 Sec. 2. Minnesota Statutes 2010, section 69.77, subdivision 9, is amended to read:

6.10 Subd. 9. **Local police and paid fire relief association investment authority.**

6.11 (a) The ~~funds~~ special fund of the association must be invested in securities that are
6.12 authorized investments under section 356A.06, subdivision 6 or 7, whichever applies.

6.13 ~~Notwithstanding any provision of section 356A.06, subdivision 6 or 7 to the contrary, the~~
6.14 ~~special fund of the relief association may be additionally invested in:~~

6.15 ~~(1) open-end investment companies registered under the federal Investment~~
6.16 ~~Company Act of 1940, if the portfolio investments of the investment companies comply~~
6.17 ~~with the type of securities authorized for investment under section 356A.06, subdivision 7,~~
6.18 ~~up to 75 percent of the market value of the assets of the fund; and~~

6.19 ~~(2) domestic government and corporate debt obligations that are not rated in the top~~
6.20 ~~four quality categories by a nationally recognized rating agency, and comparable unrated~~
6.21 ~~securities if the percentage of these assets does not exceed five percent of the total assets~~
6.22 ~~of the special fund or 15 percent of the special fund's nonequity assets, whichever is less;~~
6.23 ~~the special fund's participation is limited to 50 percent of a single offering of the debt~~
6.24 ~~obligations, and the special fund's participation is limited to 25 percent of an issuer's debt~~
6.25 ~~obligations that are not rated in the top four quality categories. Securities held by the~~
6.26 ~~association before June 2, 1989, that do not meet the requirements of this subdivision may~~
6.27 ~~be retained after that date if they were proper investments for the association on that date.~~

6.28 ~~(b) The governing board of the association may select and appoint investment~~
6.29 ~~agencies to act for and in its behalf or may certify special fund assets for investment by the~~
6.30 ~~State Board of Investment under section 11A.17. The governing board of the association~~
6.31 ~~may certify general fund assets of the relief association for investment by the State Board~~
6.32 ~~of Investment in fixed income pools or in a separately managed account at the discretion~~
6.33 ~~of the State Board of Investment as provided in section 11A.14. The governing board of~~
6.34 ~~the association may select and appoint a qualified private firm to measure management~~

7.1 performance and return on investment, and the firm ~~shall~~ must use the formula or formulas
7.2 developed by the state board under section 11A.04, clause (11).

7.3 (c) The governing board of the association may certify general fund assets of the
7.4 relief association for investment by the State Board of Investment in fixed income pools
7.5 or in a separately managed account at the discretion of the State Board of Investment
7.6 as provided in section 11A.14.

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

7.8 Sec. 3. Minnesota Statutes 2010, section 69.775, is amended to read:

7.9 **69.775 INVESTMENTS.**

7.10 (a) The special fund assets of a relief association governed by sections 69.771 to
7.11 69.776 must be invested in securities that are authorized investments under section
7.12 356A.06, subdivision 6 or 7, whichever applies.

7.13 ~~(b) Notwithstanding the foregoing, up to 75 percent of the market value of the assets~~
7.14 ~~of the special fund, not including any money market mutual funds, may be invested in~~
7.15 ~~open-end investment companies registered under the federal Investment Company Act of~~
7.16 ~~1940, if the portfolio investments of the investment companies comply with the type of~~
7.17 ~~securities authorized for investment under section 356A.06, subdivision 7.~~

7.18 ~~(c) Securities held by the associations before June 2, 1989, that do not meet the~~
7.19 ~~requirements of this section may be retained after that date if they were proper investments~~
7.20 ~~for the association on that date.~~

7.21 ~~(d) The governing board of the association may select and appoint investment~~
7.22 ~~agencies to act for and in its behalf or may certify special fund assets for investment by the~~
7.23 ~~State Board of Investment under section 11A.17.~~

7.24 ~~(e) The governing board of the association may certify general fund assets of the~~
7.25 ~~relief association for investment by the State Board of Investment in fixed income pools~~
7.26 ~~or in a separately managed account at the discretion of the State Board of Investment~~
7.27 ~~as provided in section 11A.14.~~

7.28 ~~(f)~~ (b) The governing board of the association may select and appoint a qualified
7.29 private firm to measure management performance and return on investment, and the
7.30 firm ~~shall~~ must use the formula or formulas developed by the state board under section
7.31 11A.04, clause (11).

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

8.1 Sec. 4. Minnesota Statutes 2010, section 354A.08, is amended to read:

8.2 **354A.08 AUTHORIZED INVESTMENTS.**

8.3 ~~(a) In addition to investments authorized under section 356A.06, subdivision 7, a~~
 8.4 ~~teachers retirement fund association may receive, hold, and dispose of:~~

8.5 ~~(1) real estate or personal property acquired by it, whether the acquisition was by~~
 8.6 ~~purchase, or any other lawful means, as provided in this chapter or in the association's~~
 8.7 ~~articles of incorporation, and.~~

8.8 ~~(2) domestic government and corporate debt obligations that are not rated in the top~~
 8.9 ~~four quality categories by a nationally recognized rating agency, and comparable unrated~~
 8.10 ~~securities if the percentage of these assets does not exceed five percent of the total assets~~
 8.11 ~~of the pension plan or 15 percent of the pension plan's nonequity assets, whichever is less,~~
 8.12 ~~if the pension plan's participation is limited to 50 percent of a single offering of the debt~~
 8.13 ~~obligations, and if the pension plan's participation is limited to 25 percent of an issuer's~~
 8.14 ~~debt obligations that are not rated in the top four quality categories.~~

8.15 ~~(b) In addition to other authorized real estate investments, an association may also~~
 8.16 ~~invest funds in Minnesota situs nonfarm real estate ownership interests or loans secured~~
 8.17 ~~by mortgages or deeds of trust. The board may also certify assets for investment by the~~
 8.18 ~~State Board of Investment as provided under section 11A.17.~~

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

8.20 Sec. 5. Minnesota Statutes 2010, section 356A.06, subdivision 6, is amended to read:

8.21 Subd. 6. **Limited list of authorized investment securities.** ~~(a) Except to the~~
 8.22 ~~extent otherwise authorized by law, Authority. This subdivision specifies the investment~~
 8.23 ~~authority for a limited list plan. A limited list plan is a covered pension plan may invest its~~
 8.24 ~~assets only in investment securities authorized by this subdivision if the plan that does not:~~

8.25 (1) have assets with a book market value in excess of \$1,000,000;

8.26 (2) use the services of an investment advisor registered with the Securities and
 8.27 Exchange Commission in accordance with the Investment Advisers Act of 1940, or
 8.28 registered as an investment advisor in accordance with sections 80A.58, and 80A.60, for
 8.29 the investment of at least 60 percent of its assets, calculated on book market value;

8.30 (3) use the services of the State Board of Investment for the investment of at least 60
 8.31 percent of its assets, calculated on book market value; or

8.32 (4) use a combination of the services of an investment advisor meeting the
 8.33 requirements of clause (2) and the services of the State Board of Investment for the
 8.34 investment of at least 75 percent of its assets, calculated on book market value.

9.1 (b) **Investment agency appointment authority.** ~~securities authorized for The~~
 9.2 ~~governing board of a covered pension plan covered by this subdivision are;~~ may select
 9.3 and appoint investment agencies to act for or on its behalf.

9.4 (c) **Savings accounts; similar vehicles.** A limited list plan is authorized to invest in:

9.5 (1) certificates of deposit issued, to the extent of available insurance or
 9.6 collateralization, by a financial institution that is a member of the Federal Deposit
 9.7 Insurance Corporation or the Federal Savings and Loan Insurance Corporation, that is
 9.8 insured by the National Credit Union Administration, or that is authorized to do business
 9.9 in this state and has deposited with the chief administrative officer of the plan a sufficient
 9.10 amount of marketable securities as collateral in accordance with section 118A.03;

9.11 (2) guaranteed investment contracts, limited to those issued by insurance companies
 9.12 or banks rated in the top four quality categories by a nationally-recognized rating agency
 9.13 or to alternative guaranteed investment contracts where the underlying assets comply
 9.14 with the requirements of this paragraph; and

9.15 (3) ~~savings accounts, to the extent of available insurance, with a financial institution~~
 9.16 ~~that is a member of the Federal Deposit Insurance Corporation or the Federal Savings and~~
 9.17 ~~Loan Insurance Corporation;~~ limited to those fully insured by federal agencies.

9.18 (3) (d) **Government-backed obligations.** A limited list plan is authorized to invest
 9.19 in governmental obligations as further specified in this paragraph, including bonds, notes,
 9.20 bills, or other fixed obligations, issued by the United States, an agency or instrumentality
 9.21 of the United States, an organization established and regulated by an act of Congress or by
 9.22 a state, state agency or instrumentality, municipality, or other governmental or political
 9.23 subdivision that mortgages, and other evidences of indebtedness, if the issue is backed
 9.24 by the full faith and credit of the issuer or if the issue is rated among the top four quality
 9.25 rating categories by a nationally-recognized rating agency. The obligations in which plans
 9.26 are authorized to invest under this paragraph are guaranteed or insured issues of:

9.27 (i) ~~for the obligation in question, issues an obligation that equals or exceeds the~~
 9.28 ~~stated investment yield of debt securities not exempt from federal income taxation and of~~
 9.29 ~~comparable quality;~~

9.30 (ii) ~~for an obligation that is a revenue bond, has been completely self-supporting~~
 9.31 ~~for the last five years; and~~

9.32 (iii) ~~for an obligation other than a revenue bond, has issued an obligation backed by~~
 9.33 ~~the full faith and credit of the applicable taxing jurisdiction and has not been in default on~~
 9.34 ~~the payment of principal or interest on the obligation in question or any other nonrevenue~~
 9.35 ~~bond obligation during the preceding ten years;~~

10.1 (1) the United States, one of its agencies, one of its instrumentalities, or an
 10.2 organization created and regulated by an act of Congress;

10.3 (2) the Dominion of Canada or one of its provinces if the principal and interest are
 10.4 payable in United States dollars;

10.5 (3) a state or one of its municipalities, political subdivisions, agencies, or
 10.6 instrumentalities; or

10.7 (4) any United States government-sponsored organization of which the United States
 10.8 is a member if the principal and interest are payable in United States dollars.

10.9 ~~(4) (e) **Corporate obligations.** A limited list plan is authorized to invest in corporate~~
 10.10 ~~obligations, including bonds, notes, debentures, or other regularly issued and readily~~
 10.11 ~~marketable evidences of indebtedness issued by a corporation organized under the laws~~
 10.12 ~~of any state that during the preceding five years has had on average annual net pretax~~
 10.13 ~~earnings at least 50 percent greater than the annual interest charges and principal payments~~
 10.14 ~~on the total issued debt of the corporation during that period and that, for the obligation~~
 10.15 ~~in question, has issued an obligation rated in one of the top three quality categories by~~
 10.16 ~~Moody's Investors Service, Incorporated, or Standard and Poor's Corporation; and~~

10.17 ~~(5) shares in an open-end investment company registered under the federal~~
 10.18 ~~Investment Company Act of 1940, if the portfolio investments of the company are limited~~
 10.19 ~~to investments that meet the requirements of clauses (1) to (4); transportation equipment~~
 10.20 ~~obligations, or any other longer-term evidences of indebtedness issued or guaranteed by~~
 10.21 ~~a corporation organized under the laws of the United States or any of its states, or the~~
 10.22 ~~Dominion of Canada or any of its provinces if:~~

10.23 ~~(1) the principal and interest are payable in United States dollars; and~~

10.24 ~~(2) the obligations are rated among the top four quality categories by a~~
 10.25 ~~nationally-recognized rating agency.~~

10.26 ~~(f) **Mutual fund authority, limited list authorized assets.** Securities authorized~~
 10.27 ~~under paragraphs (c) to (e) may be owned directly or through shares in exchange-traded~~
 10.28 ~~funds, or through open-end mutual funds, or as units of commingled trusts.~~

10.29 ~~(g) **Extended mutual fund authority.** Notwithstanding restrictions in other~~
 10.30 ~~paragraphs of this subdivision, a limited list plan is authorized to invest the assets of~~
 10.31 ~~the special fund in exchange-traded funds and open-end mutual funds, if their portfolio~~
 10.32 ~~investments comply with the type of securities authorized for investment under section~~
 10.33 ~~356A.06, subdivision 7, paragraphs (c) to (g). Investments under this paragraph must not~~
 10.34 ~~exceed 75 percent of the assets of the special fund, not including any money market~~
 10.35 ~~investments through mutual or exchange-traded funds.~~

11.1 (h) Supplemental fund authority. The governing body of a limited list plan may
 11.2 certify special fund assets to the State Board of Investment for investment under section
 11.3 11A.17.

11.4 (i) Assets mix restrictions. A limited list plan must conform to the asset mix
 11.5 limitations specified in section 356A.06, subdivision 7.

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

11.7 Sec. 6. Minnesota Statutes 2010, section 356A.06, subdivision 7, is amended to read:

11.8 Subd. 7. **Expanded list of authorized investment securities.** (a) **Authority.**
 11.9 ~~Except to the extent otherwise authorized by law,~~ A covered pension plan not described by
 11.10 subdivision 6, paragraph (a), is an expanded list plan and shall invest its assets only in
 11.11 accordance with as specified in this subdivision. The governing board of an expanded list
 11.12 plan may select and appoint investment agencies to act for or on its behalf.

11.13 (b) **Securities generally; investment forms.** ~~The covered pension~~ An expanded list
 11.14 plan has the authority is authorized to purchase, sell, lend, or and exchange the investment
 11.15 securities specified in paragraphs (c) to (i) authorized under this subdivision, including
 11.16 puts and call options and future contracts traded on a contract market regulated by a
 11.17 governmental agency or by a financial institution regulated by a governmental agency.
 11.18 These securities may be owned directly or through shares in exchange-traded or mutual
 11.19 funds, or as units in commingled trusts that own the securities described in paragraphs (c)
 11.20 to (i), including real estate investment trusts and insurance company commingled accounts,
 11.21 including separate accounts, subject to any limitations specified in this subdivision.

11.22 (c) **Government obligations.** ~~The covered pension~~ An expanded list plan may
 11.23 is authorized to invest funds in governmental bonds, notes, bills, mortgages, and other
 11.24 evidences of indebtedness if the issue is backed by the full faith and credit of the issuer or
 11.25 the issue is rated among the top four quality rating categories by a nationally recognized
 11.26 rating agency. The obligations in which funds may be invested under this paragraph
 11.27 include are guaranteed or insured issues of:

11.28 (1) the United States, one of its agencies, one of its instrumentalities, or organizations
 11.29 an organization created and regulated by an act of Congress;

11.30 (2) the Dominion of Canada and or one of its provinces, provided if the principal
 11.31 and interest is are payable in United States dollars;

11.32 (3) ~~the states and their~~ a state or one of its municipalities, political subdivisions,
 11.33 agencies, or instrumentalities; and

11.34 (4) ~~the International Bank for Reconstruction and Development, the Inter-American~~
 11.35 ~~Development Bank, the Asian Development Bank, the African Development Bank, or~~

12.1 ~~any other a~~ United States ~~government sponsored~~ government-sponsored organization of
 12.2 which the United States is a member, ~~provided if~~ the principal and interest ~~is~~ are payable
 12.3 in United States dollars.

12.4 (d) Investment-grade corporate obligations. ~~The covered pension~~ An expanded
 12.5 list plan may is authorized to invest funds in bonds, notes, debentures, transportation
 12.6 equipment obligations, or any other longer term evidences of indebtedness issued or
 12.7 guaranteed by a corporation organized under the laws of the United States or any state
 12.8 ~~thereof of its states,~~ or the Dominion of Canada or any ~~province thereof~~ of its provinces if
 12.9 ~~they conform to the following provisions:~~

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

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

12.15 (e) Below-investment-grade corporate obligations. An expanded list plan is
 12.16 authorized to invest in unrated corporate obligations or in corporate obligations that are
 12.17 not rated among the top four quality categories if:

12.18 (1) the aggregate value of these obligations does not exceed five percent of the
 12.19 covered pension plan's market value;

12.20 (2) the covered pension plan's participation is limited to 50 percent of a single
 12.21 offering subject to this paragraph; and

12.22 (3) the covered pension plan's participation is limited to 25 percent of an issuer's
 12.23 obligations subject to this paragraph.

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

12.30 (i) ~~bankers acceptances and deposit notes of United States banks are limited to those~~
 12.31 if issued by banks a United States bank that is rated in the highest four quality categories
 12.32 by a nationally recognized rating agency;

12.33 (ii) ~~certificates of deposit are limited to those~~ if issued by (A) a United States
 12.34 ~~banks and bank or savings institutions that are~~ institution rated in the highest four quality
 12.35 categories by a nationally recognized rating agency or whose certificates of deposit are
 12.36 fully insured by federal agencies; ~~or (B) if issued by a credit unions union in amounts~~

13.1 ~~up to~~ an amount within the limit of the insurance coverage provided by the National
 13.2 Credit Union Administration;

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

13.6 (iv) mortgage ~~participation or pass through certificates evidencing interests in pools~~
 13.7 ~~of first mortgages or trust deeds on improved real estate located in the United States where~~
 13.8 ~~the loan to value ratio for each loan as calculated in accordance with section 61A.28,~~
 13.9 ~~subdivision 3, does not exceed 80 percent for fully amortizable residential properties and~~
 13.10 ~~in all other respects meets the requirements of section 61A.28, subdivision 3~~ securities
 13.11 and asset-backed securities if rated in the top four quality categories by a nationally
 13.12 recognized rating agency;

13.13 (v) ~~collateral for~~ repurchase agreements and reverse repurchase agreements ~~is~~
 13.14 ~~limited to~~ if collateralized with letters of credit ~~and~~ or securities authorized in this section;

13.15 (vi) guaranteed investment contracts ~~are limited to those~~ if issued by an insurance
 13.16 ~~companies~~ company or banks a bank that is rated in the top four quality categories by a
 13.17 nationally recognized rating agency or ~~to~~ alternative guaranteed investment contracts
 13.18 ~~where~~ if the underlying assets comply with the requirements of this subdivision;

13.19 (vii) savings accounts ~~are limited to those~~ if fully insured by a ~~federal agencies~~
 13.20 agency; and

13.21 (viii) ~~asset-backed securities must be rated in the top four quality categories by a~~
 13.22 ~~nationally recognized rating agency~~ guaranty fund certificates, surplus notes, or debentures
 13.23 if issued by a domestic mutual insurance company.

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

13.27 (3) In addition to investments authorized by clause (1), item (iv), ~~the covered pension~~
 13.28 an expanded list plan may is authorized to purchase from the Minnesota Housing Finance
 13.29 Agency all or any part of a pool of residential mortgages, not in default, that has previously
 13.30 been financed by the issuance of bonds or notes of the agency. The covered pension plan
 13.31 may also enter into a commitment with the agency, at the time of any issue of bonds or
 13.32 notes, to purchase at a specified future date, not exceeding 12 years from the date of the
 13.33 issue, the amount of mortgage loans then outstanding and not in default that have been
 13.34 made or purchased from the proceeds of the bonds or notes. The covered pension plan may
 13.35 charge reasonable fees for any such commitment and may agree to purchase the mortgage
 13.36 loans at a price sufficient to produce a yield to the covered pension plan comparable, in

14.1 its judgment, to the yield available on similar mortgage loans at the date of the bonds or
 14.2 notes. The covered pension plan may also enter into agreements with the agency for the
 14.3 investment of any portion of the funds of the agency. The agreement must cover the period
 14.4 of the investment, withdrawal privileges, and any guaranteed rate of return.

14.5 ~~(f)~~ (g) Corporate stocks. ~~The covered pension~~ An expanded list plan may is
 14.6 authorized to invest funds in stocks or convertible issues of any corporation organized
 14.7 under the laws of the United States or the any of its states thereof, any corporation
 14.8 organized under the laws of the Dominion of Canada or any of its provinces, or any
 14.9 corporation listed on an exchange that is regulated by an agency of the United States or of
 14.10 the Canadian national government; ~~if they conform to the following provisions:~~

14.11 ~~(1) the aggregate value of investments under this paragraph, plus paragraphs (g) and~~
 14.12 ~~(k), plus equity investments under paragraphs (h), (i), and (j), as adjusted for realized~~
 14.13 ~~gains and losses, must not exceed 85 percent of the market or book value, whichever is~~
 14.14 ~~less, of a fund; and~~

14.15 ~~(2) investments~~ An investment in any corporation must not exceed five percent of
 14.16 the total outstanding shares of ~~any one~~ that corporation, except that an expanded list plan
 14.17 may hold up to 20 percent of the shares of a real estate investment trust and up to 20
 14.18 percent of the shares of a closed mutual fund.

14.19 ~~(g) Developed market foreign stocks investments.~~ ~~In addition to investments~~
 14.20 ~~authorized under paragraph (f), the covered pension fund may invest in foreign stock sold~~
 14.21 ~~on an exchange in any developed market country that is included in the Europe, Australia,~~
 14.22 ~~and Far East Index.~~

14.23 ~~(h) Commingled or mutual investments.~~ ~~The covered pension plan may invest~~
 14.24 ~~in index funds or mutual funds, including index mutual funds, through bank-sponsored~~
 14.25 ~~collective funds and shares of open-end investment companies registered under the~~
 14.26 ~~Federal Investment Company Act of 1940, to the extent that these funds comply with~~
 14.27 ~~paragraphs (c) to (j).~~

14.28 ~~(i) Real estate investment trust, related investments.~~ ~~The covered pension plan~~
 14.29 ~~may invest in real estate investment trusts secured by mortgages or deeds of trust and~~
 14.30 ~~sold on an exchange, and insurance company commingled accounts, including separate~~
 14.31 ~~accounts, of a debt or equity nature.~~

14.32 ~~(j) Exchange traded funds.~~ ~~The covered pension plan may invest funds in exchange~~
 14.33 ~~traded funds, subject to the maximums, the requirements, and the limitations set forth in~~
 14.34 ~~paragraphs (c) to (i), as applicable.~~

15.1 ~~(k)~~ (h) Other investments. (1) In addition to the investments authorized in
 15.2 paragraphs (b) to ~~(j)~~ (g), and subject to the provisions in clause (2), ~~the covered pension~~
 15.3 an expanded list plan may is authorized to invest funds in:

15.4 (i) ~~venture capital~~ equity and debt investment businesses through participation in
 15.5 limited partnerships, trusts, private placements, limited liability corporations, limited
 15.6 liability companies, limited liability partnerships, and corporations;

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

15.11 ~~(iii) regional and mutual funds through bank sponsored collective funds and~~
 15.12 ~~open-end investment companies registered under the Federal Investment Company Act of~~
 15.13 ~~1940 to the extent that a fund or a portion of a fund does not qualify under paragraph (h);~~

15.14 ~~(iv)~~ (iii) resource investments through limited partnerships, trusts, private
 15.15 placements, limited liability corporations, limited liability companies, limited liability
 15.16 partnerships, and corporations; and

15.17 ~~(v)~~ (iv) international debt securities and emerging market equity securities.

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

15.20 (i) the aggregate value of all investments made ~~according to~~ under clause (1),
 15.21 ~~including allocated amounts of index and mutual funds items (i), (ii), and (iii),~~ may not
 15.22 exceed ~~20~~ 35 percent of the market value of the fund for which the ~~covered pension~~
 15.23 expanded list plan is investing;

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

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

15.30 ~~(iv) covered pension plan~~ the expanded list plan's participation in a limited
 15.31 partnership does not include a general partnership interest or other interest involving
 15.32 general liability. The ~~covered pension~~ expanded list plan may not engage in any activity
 15.33 as a limited partner which creates general liability; and

15.34 (v) for volunteer firefighter relief associations, emerging market equity and
 15.35 international debt investments must not exceed 15 percent of the association's special
 15.36 fund market value.

16.1 (i) Supplemental plan investments. The governing body of an expanded list plan
16.2 may certify assets to the State Board of Investment for investment under section 11A.17.

16.3 (j) Asset mix limitations. The aggregate value of an expanded list plan's
16.4 investments under paragraphs (g) and (h) and equity investments under paragraph (i),
16.5 regardless of the form in which these investments are held, must not exceed 85 percent of
16.6 the covered plan's market value.

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

16.8 Sec. 7. INVESTMENT AUTHORITY TRANSITION PROVISION.

16.9 If any investment by the State Board of Investment or any covered pension plan fund
16.10 was an authorized investment under law in effect immediately before the effective date
16.11 of applicable sections of this act, but is not authorized by this act, the applicable assets
16.12 must be liquidated before June 30, 2013.

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