

Legislative Analysis



PUBLIC EMPLOYEE RETIREMENT SYSTEMS: AUTHORIZED INVESTMENTS, ETC.

Mitchell Bean, Director
Phone: (517) 373-8080
<http://www.house.mi.gov/hfa>

House Bill 5323

Sponsor: Rep. Richard Hammel

Committee: Banking and Financial Services

Complete to 2-2-10

A SUMMARY OF HOUSE BILL 5323 AS INTRODUCED 9-9-09

The bill would update the Public Employee Retirement System Investment Act to allow investment earnings to be used to train and educate fund trustees, require written disclosures of service fees, specifically authorize investments in private equities, and increase the maximum amounts allowed to be invested in real estate, among other things.

The Public Employee Retirement System Investment Act authorizes the investment of assets of public employee retirement systems in Michigan, and places limitations on the ways in which those funds can be invested. The act applies to all retirement systems operated by the state or by local units of government in Michigan. The bill would amend the Public Employee Retirement System Investment Act to make the following changes:

Investment fiduciaries. Current law allows an investment fiduciary to use a portion of the income of the system for certain things, such as defraying the costs of investing, managing, and protecting the assets of the system. The bill would modify that provision by specifying that the costs of investing, managing, and protecting the assets would include providing training and education (i.e., for plan trustees).

An investment fiduciary is also currently allowed to use a portion of the system's income to retain investment and all other services necessary for the conduct of the affairs of the system. The bill would add that these services would include investment advisors, consultants, custodians, auditors, attorneys, actuaries, administrators, and physicians.

The bill would also require all investment service providers to provide to the investment fiduciary of the system complete written disclosure of all fees associated with providing services before services were provided and on an annual basis after services were provided.

Investment companies. The act allows an investment fiduciary to invest in investment companies registered under the federal Investment Company Act, with some restrictions. The bill would add that an investment company could be established as a limited partnership, corporation, limited liability company, trust, or other organizational entity for which the liability of an investor did not exceed the amount of the investment under the laws of the U.S. or the applicable laws of the jurisdiction under which the investment company had been established.

Debt instruments. The act currently authorizes an investment fiduciary to invest in domestic debt instruments and lists several examples of acceptable obligations. The bill would add that an investment could also be made in obligations described in the examples which are not rated or of investment grade. The aggregate investments made under this provision could not exceed 10 percent of the investments of the system.

Real estate investment trusts. Current law allows investment in publicly or privately issued "real estate investment trusts" (REITs) or in certain other real or personal property. An investment cannot exceed 5 percent of a system's assets. The bill would increase the maximum investment to 10 percent.

Currently, in addition to the limit cited above, an investment fiduciary of a system with assets of more than \$100 million can form or invest in one or more limited partnerships, corporations, limited liability companies, trusts, or other entities to hold title to, improve, lease, manage, develop, maintain, or operate real or personal property. The liability of the investor cannot exceed the amount of an investment under federal law or the laws of any U.S. state, district, or territory or of a foreign country. The limit on these kinds of investments currently cannot exceed 5 percent of assets; the bill would increase that to 10 percent.

Currently, if the investment fiduciary of a system is the State Treasurer then the investments described in the above paragraphs can exceed 5 percent of the assets of the system. The bill would allow investments by the State Treasurer to exceed the new limits of 10 percent of the assets of the system.

Private Equity. The term "private equity" means an asset class consisting of equity or debt securities in entities that are not publicly traded. These may include, but are not limited to, investments in leveraged buyouts, venture capital, growth capital, distressed or special situations, mezzanine capital, and secondary investments in equity or debt interests.

Currently, if the investment fiduciary is the state treasurer, investments in private equity cannot exceed 30 percent of the total assets of the system. The bill would not alter this provision.

The act authorizes other systems to invest in private equities under what is known as the "basket clause," namely, investments not specifically authorized by the act. The bill would specifically authorize an investment fiduciary to invest in private equities as follows:

- A system having assets of less than \$500 million could invest not more than 10 percent of the system's assets in private equity. The investments would have to be made through a fund of funds vehicle. "Fund of funds" would mean an investment fund that uses an investment strategy of holding a portfolio of other investment funds rather than investing directly in shares, bonds, or other securities.

- A system having assets of \$500 million but less than \$1 billion could invest up to 15 percent of the system's assets in private equity.
- A system having assets of \$1 billion or more could invest not more than 20 percent of its assets in private equity.

Pooled funds. Current law allows a financial institution, a trust company, or a management company retained as an investment fiduciary to invest the assets of a system in a collective investment fund, common trust fund, or pooled fund that is established and maintained for investment of those assets by the financial institution or management company. The bill would revise the provision to instead specify that an investment fiduciary, retained to act as an investment fiduciary, could invest the assets of a system in any collective investment fund, common trust fund, or pooled fund established and maintained for investment of those assets under state or federal laws, rules, or regulations.

The bill would add that the investment fiduciary of the collective fund, common trust fund, or pooled fund would have to be a financial institution, a trust company, a management company qualified under Section 15 of the act, or an affiliate of one of these entities (if a registered investment advisor under the federal Investors Advisors Act or state Uniform Securities Act). The pooled fund could be established as a limited partnership, corporation, limited liability company, trust, or other organizational entity for which liability of any investor did not exceed the amount of the investment under U.S. law or the laws of the state, district, territory, or foreign country that applied to the organization of the pooled fund.

Basket clause. The act allows an investment fiduciary to invest a percentage of the system's assets in investments not specifically authorized by the act. The bill would change the asset classes and investment percentages as follows:

- A system with less than \$250 million currently is allowed to invest up to 5 percent of its assets. Under the bill, a system with less than \$500 million would be allowed to invest not more than 10 percent of its assets.
- A system having assets of \$250 million currently is allowed to invest up to 10 percent of those assets. Under the bill, a system having \$500 million but less than \$1 billion in assets would be allowed to invest not more than 15 percent.
- A system having more than \$1 billion in assets could, under the bill, invest up to 20 percent of its assets – increased from the current 15 percent.
- The "basket clause" limit for the state treasurer would be increased to 25 percent from 20 percent.

Derivatives. Under current law, an investment fiduciary can invest in various types of derivatives to enhance portfolio performances. The aggregate market value of the underlying security, future, or other instrument or index made under this provision cannot exceed 15 percent of the assets of the system (although some kinds of investment are

outside of the limit). Under the bill, the aggregate market value could not exceed 30 percent of the assets of the system.

MCL 38.1133 et al.

FISCAL IMPACT:

House Bill 5323 would have an indeterminate, but likely negligible, fiscal impact on the Department of Treasury and local pension boards administratively. Any fiscal impact to the State or locals would derive from a change in an investment fiduciary's investment portfolio breakdown. This bill would allow pension plans to diversify their investments in an effort to protect them in certain financial markets. A change in the investment portfolio will likely result in a change in the portfolio's return on investments, which is dependent upon the market performance of each asset held by the pension plan.

Legislative Analyst: Susan Stutzky
Fiscal Analyst: Ben Gielczyk

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.