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BILL ANALYSIS



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House Bill 5925 (Substitute S-1 as reported)
Sponsor: Representative Kim Rhead
House Committee: Appropriations
Senate Committee: Appropriations

CONTENT

The bill would amend Public Act 314 of 1965, which provides for the authorization of and limitations on the investment of assets of public employee retirement systems in Michigan. The bill proposes to name Public Act 314 of 1965 the "Public Employee Retirement System Investment Act". The amendments contained in House Bill 5925 (S-1) are generally designed to update the provisions of the Act to conform to the investment options currently available to large institutional investors.

The provisions of Public Act 314 of 1965 apply to all retirement systems operated by State or local governmental organizations in Michigan. There are currently more than 500 retirement systems subject to the provisions of the Act. The largest systems that must conform with the Act are the Public School Employees Retirement System and the State Employees Retirement System with combined assets valued in excess of \$25.0 billion.

House Bill 5925 (S-1) proposes to make the following changes to Public Act 314:

- Amend the definitions section of the Act to include new definitions of "derivative", "foreign security", "investment grade" and "investment fiduciary", among others.
- Amend the definition of how pension funds value assets from a cost basis to a market basis. This change is in conformance with new governmental accounting requirements.
- Require that an investment fiduciary be either a registered security advisor, a bank, or an insurance company.
- Clarify that the limits placed on an investment fiduciary do not apply to pension funds in a defined contribution plan in which the participant directs the investment of the assets in his or her account.
- Place general limits on the actions of an investment fiduciary in terms of acceptable ethical behavior. The fiduciary also would have to monitor the investment of the system's assets to ensure that the limitations on those investments were in accordance with the Act.
- Increase the maximum amount of a retirement system asset that may be invested in equity stocks from 60% to 65%.
- Remove the limitation that excludes investments in the stock of a company that has not paid a dividend to shareholders in at least three of the past five years.
- Increase the minimum size asset holding that a mutual fund trading company must manage from \$100 million to \$500 million before that mutual fund company is eligible to receive pension fund investments. The same asset level also would apply to investments in insurance companies.
- Provide for the authorization to invest in obligations issued in the United States by foreign governments, banks, or corporations.
- Prohibit foreign investments in countries that are identified by the United States State Department as engaging in or sponsoring terrorism.

- Place limits on investments to ensure that no more than 5% of a pension system's assets were invested in one company and ensure that the total investment of a pension system did not exceed 5% of the valuation of an individual company.
- Provide for the authorization to invest up to 5% of a pension system's assets in indirect real estate investment trusts.
- Amend the existing requirement that limits direct investments in real estate from systems greater than \$250 million in total assets to \$100 million in total assets. These real estate investments are limited to 5% of the pension system's total assets.
- Amend the provisions that currently allow pension systems with an asset valuation of between \$10 million and \$250 million to invest up to 5% of the system's assets in investments not specified in the Act. The amendment would allow all systems with assets under \$250 million to utilize this 5% exclusion rule.
- Provide that a system could invest up to 15% of the system assets in derivative type investments. The language on derivative investments would prohibit the investment of any pension funds in derivative investments that had the purpose of leveraging as a means of investments. (Derivative type investments are sophisticated financial instruments that derive their value from an underlying asset or index. Derivatives come in many forms such as futures, options, swaps, collateralized mortgage obligations and forwards.)
- Provide that a pension system could not invest greater than 20% of the system's assets in foreign securities.
- Provide that a record, material or other data received and used by an investment fiduciary in connection with the investment of assets that dealt with proprietary information pertaining to the company in which the investment was being made would be excluded from provisions of the Freedom of Information Act. This provision would apply to information that had not been publicly disseminated by the company and whose dissemination would cause the company a competitive disadvantage.

MCL 38.1132 et al.

FISCAL IMPACT

House Bill 5925 (S-1) provides for a general rewrite and update in the pension investment act to conform to the current investment options currently available to large investors. The fiscal impact of the bill on the valuation of pension assets is unknown. This would depend on the quality of the investment decisions made on behalf of each pension fund.

Date Completed: 12-5-96

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.