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BILL



ANALYSIS

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Senate Bill 797 (Substitute S-3 as reported)
Sponsor: Senator Mark C. Jansen
Committee: Appropriations

CONTENT

Senate Bill 797 (S-3) would amend the Public Employee Retirement System Investment Act in numerous areas, as follows:

- Replace the term "foreign security" with "global security".
- Replace the term "foreign stock" with "global equity".
- Add the State Treasurer and his or her investment personnel to the definition of "investment fiduciary" for the State Employees', School Employees', Judges', and State Police retirement systems.
- Revise the definition of "investment", which currently includes a guarantee by an investment fiduciary, to add: "but does not include, as a sole investment, a pledge of the system's assets as collateral to guarantee the repayment of obligations made by a third party to a borrower".
- Add a requirement for an investment fiduciary to prepare and maintain written policies regarding ethics and professional training and education, including travel; and to publish a summary annual report that would include several informational components.
- Broaden the uses of a retirement system's income to include the retention of investment advisors, consultants, custodians, accountants, auditors, attorneys, actuaries, and others.
- Authorize the use of a system's income for defraying the costs of professional training and education, including travel costs, of system board members; require the board to adopt an annual budget for professional training and education, including travel; and cap the budget at the lesser of \$150,000 or an amount equal to \$12,000 multiplied by the number of board members, with professional training, education, and travel costs not to exceed \$30,000 for any one board member.
- Require an investment service provider to give the investment fiduciary a complete written disclosure of all fees or other compensation associated with its relationship with the retirement system, before providing any investment services and on an annual ongoing basis.
- Prohibit an investment fiduciary from making a payment to its service provider(s) if the service provider or a covered associate of the provider had made a contribution to an official of a governmental entity, including a contribution to a legal defense fund, during the previous 24 months, under various circumstances.
- Require the reimbursement of all costs paid to an investment fiduciary or service provider who was convicted of or entered a no contest plea for a felony or misdemeanor arising out of his or her service to a retirement system.
- Broaden the current domestic equity section, which allows up to 70% of a system's assets to be invested in stock, to include global equities, as long as the global equities met certain standards, including being on an industry-recognized exchange outside of the United States.
- Change the cap on investments in certain obligations and investment-grade investments to not more than 15% of the retirement system's total assets.
- Double the cap on investment in real estate (to 10% of a system's assets).

- Cap investments in private equity for systems not overseen by the State Treasurer, and with assets totaling more than \$1.0 billion, at 10%, but allow an additional 5% to be invested in Michigan private equity.
- Add a cap of 5% for investments in Michigan private equity for systems with assets between \$250.0 million and \$1.0 billion.
- Require an investment fiduciary of a collective investment fund, common trust fund, or pooled fund to be a financial institution, trust company, or qualified management company, or an eligible affiliate of one of those entities.
- Require the retention of financial records for at least six years.
- Exempt from disclosure information regarding the calculation of the actual or estimated retirement benefits for members; but, upon a majority vote of the governing body of the political subdivision sponsoring the system, require the system to make disclosure to a designated representative, and allow the system to require a promise of confidentiality.
- Require the system to make its summary annual report available to plan participants and citizens via posting to a website if the system has a website; or require the political subdivision sponsoring the system to post the summary annual report if the system does not have a website.
- Allow the State Treasurer or an investment fiduciary of a system with assets exceeding \$2.0 billion to invest up to 30% in global securities, up from the 20% investment allowed in foreign securities under current law.
- Allow the governing board of a retirement system to remove a member of the board either by a unanimous vote or by an order of a circuit court, as specified in the legislation.

As summarized above, the bill addresses various areas of the Act, beginning with changing the term "foreign security" to "global security". The bill also would allow for the State Treasurer or investment fiduciary of large retirement systems (with assets in excess of \$2.0 billion) to increase their investment in global securities, from the current 20% to 30% of the assets.

The bill would add new requirements for rules regarding professional education, training, and travel, for board members overseeing retirement systems, and cap the amounts that may be spent on any single board member (\$30,000) and also for the entire board, at the lesser of \$12,000 multiplied by the number of board members, or \$150,000. These amounts would be adjusted by inflation on an annual basis.

Also, the legislation would require the publication of a summary annual report that would be more detailed than what is currently required under law. The summary annual report would include these new items: investment service providers, the system's itemized budget (including professional training, education, and travel), the system's investment returns, and numerous pieces of information from the system's most recent annual actuarial valuation report.

The bill contains language that mirrors the recent Securities and Exchange Commission's "Pay-to-Play" restrictions applicable to registered investment managers. An investment fiduciary may not make a payment from the assets of a system to a service provider if the service provider or a covered associate of the service provider has made a contribution to an official of a governmental entity during the previous 24-month period. However, this prohibition does not apply in the following cases: 1) the service provider or covered associate was entitled to vote for the official at the time of the contribution and it did not exceed \$350 per election; 2) the service provider or covered associate was not entitled to vote for the official but the contribution did not exceed \$150 per election; 3) the contribution was made to an official by an individual more than six months before he or she became a covered associate of the service provider; or, 4) the contribution was made to an official and was discovered within four months, did not exceed \$350, and the contribution is returned.

Regarding the removal of a member of a retirement system's board or governing body, the bill would provide for the removal to occur in one of two ways: 1) unanimous vote of all members of the board or body, other than the member in question; or 2) a majority vote of the board and an order of a circuit court with jurisdiction. The board would be required to hold a public hearing on the question of removal, and could remove a member for the following reasons: a) for an elected member, the board received an eligible petition; b) the member was legally incapacitated from executing his or her duties; c) the member had committed a material breach of the system's provisions or policies; or d) the member was convicted of a violation of law, and the removal was in the best interests of the system. An individual removed from office could appeal the removal to the circuit court with jurisdiction.

It should be noted that, in many instances, where the analysis refers to "investment fiduciary", the "investment fiduciary" of a retirement system that is ultimately responsible for the noted responsibilities is the retirement board. Therefore, the legislation ultimately would add the responsibilities noted above, while stated as responsibilities of the investment fiduciary, to the boards of retirement systems, and to the State Treasurer, as appropriate.

MCL 38.1132b et al.

FISCAL IMPACT

The fiscal impact of the bill is indeterminate. The bill would limit the amount of spending on professional training, education, and travel, and add transparency reporting requirements for retirement systems, investment fiduciaries, and investment service providers.

The bill also would change the maximums that may be invested in real estate and in global equities, in some cases doubling the allowable percentages. Investment performance and investment decisions would determine the fiscal impact resulting from the changes proposed in this legislation.

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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.