

INVESTMENT BOARD

Agency Overview

Dollars in Thousands

	Current		Governor Recomm.		Biennium
	FY2004	FY2005	FY2006	FY2007	2006-07
<u>Direct Appropriations by Fund</u>					
General					
Current Appropriation	2,167	2,167	2,167	2,167	4,334
Recommended	2,167	2,167	217	217	434
Change		0	(1,950)	(1,950)	(3,900)
% Biennial Change from 2004-05					-90%
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	2,097	2,305	217	217	434
Open Appropriations					
Supplmntl Invest Invest Index	11	25	25	25	50
Supplemental Invest Suppl Bond	5	15	15	15	30
Supplemental Invest Invest Gic	84	150	150	150	300
Supplmntl Invest Moneymarket	0	10	10	10	20
Supplemental Investment Income	22	50	50	50	100
Supplemental Investment Growth	8	50	50	50	100
Post Retirement Investment	651	1,100	1,100	1,100	2,200
Invest Ext Money Managers #2	611	1,000	1,000	1,000	2,000
Supplemental Intl Equity	2	10	10	10	20
Statutory Appropriations					
Invest Ext Money Managers #2	0	0	1,950	1,950	3,900
Total	3,491	4,715	4,577	4,577	9,154
<u>Expenditures by Category</u>					
Total Compensation	1,786	1,893	1,840	1,840	3,680
Other Operating Expenses	1,705	2,822	2,737	2,737	5,474
Total	3,491	4,715	4,577	4,577	9,154
<u>Expenditures by Program</u>					
Investment Of Funds	2,097	2,305	2,167	2,167	4,334
Refunds/Retire Funds	1,394	2,410	2,410	2,410	4,820
Total	3,491	4,715	4,577	4,577	9,154
Full-Time Equivalentents (FTE)	20.1	20.1	20.1	20.1	

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Change Summary

<i>Dollars in Thousands</i>				
	FY2005	Governor's Recomm.		Biennium
		FY2006	FY2007	2006-07
Fund: GENERAL				
FY 2005 Appropriations	2,167	2,167	2,167	4,334
Subtotal - Forecast Base	2,167	2,167	2,167	4,334
Change Items				
Funding Source Restructuring	0	(1,950)	(1,950)	(3,900)
Total Governor's Recommendations	2,167	217	217	434
Fund: SUPPLMNTL INVEST INVEST INDEX				
Planned Open Spending	25	25	25	50
Total Governor's Recommendations	25	25	25	50
Fund: SUPPLEMENTAL INVEST SUPPL BOND				
Planned Open Spending	15	15	15	30
Total Governor's Recommendations	15	15	15	30
Fund: SUPPLEMENTAL INVEST INVEST GIC				
Planned Open Spending	150	150	150	300
Total Governor's Recommendations	150	150	150	300
Fund: SUPPLMNTL INVEST MONEYMARKET				
Planned Open Spending	10	10	10	20
Total Governor's Recommendations	10	10	10	20
Fund: SUPPLEMENTAL INVESTMENT INCOME				
Planned Open Spending	50	50	50	100
Total Governor's Recommendations	50	50	50	100
Fund: SUPPLEMENTAL INVESTMENT GROWTH				
Planned Open Spending	50	50	50	100
Total Governor's Recommendations	50	50	50	100
Fund: POST RETIREMENT INVESTMENT				
Planned Open Spending	1,100	1,100	1,100	2,200
Total Governor's Recommendations	1,100	1,100	1,100	2,200
Fund: INVEST EXT MONEY MANAGERS #2				
Planned Open Spending	1,000	1,000	1,000	2,000
Total Governor's Recommendations	1,000	1,000	1,000	2,000
Fund: SUPPLEMENTAL INTL EQUITY				
Planned Open Spending	10	10	10	20
Total Governor's Recommendations	10	10	10	20
Fund: INVEST EXT MONEY MANAGERS #2				
Planned Statutory Spending	0	0	0	0
Change Items				
Funding Source Restructuring	0	1,950	1,950	3,900
Total Governor's Recommendations	0	1,950	1,950	3,900

<i>Dollars in Thousands</i>				
	FY2005	Governor's Recomm.		Biennium
		FY2006	FY2007	2006-07
<u>Revenue Change Items</u>				
<i>Fund: GENERAL</i>				
Change Items				
Funding Source Restructuring	0	(1,950)	(1,950)	(3,900)
<i>Fund: INVEST EXT MONEY MANAGERS #2</i>				
Change Items				
Funding Source Restructuring	0	1,950	1,950	3,900

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Change Item: Funding Source Restructuring

Fiscal Impact (\$000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	(\$1,950)	(\$1,950)	(\$1,950)	(\$1,950)
Revenues	(1,950)	(1,950)	(1,950)	(1,950)
Other Fund				
Expenditures	1,950	1,950	1,950	1,950
Revenues	1,950	1,950	1,950	1,950
Net Fiscal Impact	\$0	\$0	\$0	\$0

Recommendation

The Governor recommends a change in the State Board of Investment's (SBI) budget process and funding sources.

This will allow the SBI to directly bill operating costs to the retirement systems and other funds for which assets are invested. This change will reduce both expenditures and non-dedicated receipts in the General Fund. Approximately 90% of the SBI's operating costs will be paid directly from the retirement systems and state funds other than the General Fund.

Background

- ⇒ The SBI and its Administrative Committee recommend that the portion of the SBI's budget related to the investment of the General Fund should be predetermined at the start of each biennium. This amount is \$217,000 annually in FY 2006 and 2007 and will require a direct General Fund appropriation.
- ⇒ The SBI's annual budget will continue to be reviewed by the legislature and the SBI Administrative Committee, and must be approved by the SBI Board.
- ⇒ The SBI will continue to charge entities that use its investment management services, but the proposed change will allow billing receipts to be deposited directly into the SBI's operating fund as dedicated receipts available for its use. This amount is anticipated to be approximately \$1.95 million annually in FY 2006 and 2007.
- ⇒ The three state retirement systems (Public Employees Retirement Association, Teachers Retirement Association, and Minnesota State Retirement System) support this change.

Relationship to Base Budget

This change will reduce the direct General Fund appropriation to the SBI from \$2.167 million per year to \$217,000. Dedicated receipts to the General Fund will be reduced accordingly. The net fiscal impact to the General Fund will be zero.

Key Measures

- ⇒ The cost to the state General Fund will be clearly defined at the beginning of each biennium.
- ⇒ The level of investment services offered by the SBI and associated costs must be generally acceptable to the three state retirement systems.
- ⇒ The investment performance of state-managed funds will be maintained at current levels or improved.

Alternatives Considered

Continuation of the status quo was considered as an option. However, this would result in lack of flexibility when managing state investments and may result in diminished investment performance.

Statutory Change: M.S. 11A.04, M.S. 11A.07

Agency Purpose

The State Board of Investment (SBI) develops and implements investment policies and strategies for the state's retirement funds, trust funds, and cash accounts. The statutory mission of the SBI is "to establish standards which will insure that state and pension assets will be responsibly invested to maximize the total rate of return without incurring undue risk" (M.S. Section 11A.01).

Core Functions

All activities of the board are governed by M.S. Chapter 11A and Chapter 356A. To meet the goals established therein, the SBI must:

- ⇒ Establish and periodically update the investment objectives, asset allocation and investment management structure for each of the funds.
- ⇒ Seek and retain superior money managers to manage the assets of each fund.
- ⇒ Monitor and evaluate investment performance to insure investment objectives are met.
- ⇒ Assess developments in the broad financial markets and evaluate their potential impact on SBI operations and policies.
- ⇒ Communicate its investment policies to clients and constituents.

At A Glance

- ◆ The State Board of Investment is composed of the state's four constitutional officers.
- ◆ SBI provides investment management for the Basic Retirement Funds, Post Retirement Fund, Permanent School Fund, Environmental Trust Fund, Assigned Risk Plan, Supplemental Investment Fund, Closed Landfill Investment Fund, Invested Treasurer's Cash, and approximately 50 other state cash accounts.
- ◆ On 6-30-04, assets managed by the board totaled \$47.1 billion.
- ◆ The majority of the board's activity relates to investment of retirement funds (82%). Clients are the current and retired members of the three statewide retirement systems (PERA, TRA, MSRS).
- ◆ For cash accounts, the board's largest clients are the State Treasurer and the Department of Finance.

The board retains an executive director, an internal investment management staff, and external investment managers to execute its policies. In performing its duties, the board is assisted by the Investment Advisory Council (IAC) which is composed of 17 persons with investment and retirement fund expertise. SBI staff

- ◆ recommend (with assistance from the IAC) strategic planning alternatives to the board and council and executes board decisions;
- ◆ provide internal management for the Permanent School Fund, Environmental Trust Fund, and state cash accounts;
- ◆ monitor the performance of all external managers retained by the board; and
- ◆ review prospective investment vehicles for legislative consideration.

Operations

Investment activity is divided into two major areas; externally managed and internally managed funds. Each concentration requires different strategies and investment vehicles.

Externally managed funds. Assets of the Basic Retirement, Post Retirement, Supplemental Investment Funds, and Assigned Risk Plan are external management.

The Basic Retirement Funds invest the contributions of public employees and employers during the employees' years of public service. Approximately 256,000 employees in eight statewide retirement funds are in the Basic Funds. The goal is to act as a fiduciary, investing contributions to provide sufficient funds to finance promised benefits at retirement.

The Post Retirement Fund contains the assets of over 82,000 retired employees covered by the eight statewide retirement plans. Upon retirement, assets sufficient to finance fixed monthly annuities for the life of the retiree are transferred from the Basic Funds to the Post Fund. The SBI invests these assets to generate returns to maintain promised benefits and to generate additional returns that will provide benefit increases to retired public employees.

The Supplemental Investment Fund is a multi-purpose investment program that offers a range of investment options to state and local employees. It serves a wide range of participants and investment goals, and is, therefore, structured much like a family of mutual funds.

The Assigned Risk Plan is administered by the Department of Commerce to provide workers compensation insurance to companies unable to obtain private insurance. The goal is to match the projected liability stream while also maintaining adequate liquidity.

Internally managed funds. The SBI directly invests about 16% of the assets with which it is entrusted. This includes the assets of the Permanent School Fund, Environmental Trust Fund, and all money in state cash accounts.

The Permanent School Fund is created by the Minnesota State Constitution and designated as a source of revenue for public schools. Income from the fund's assets is used to offset state school aid payments. The Permanent School Fund is invested in a balanced portfolio of common stocks and bonds

The Environmental Trust Fund is created by the Minnesota State Constitution and designed as a source of revenue for funding environmental projects. Currently the fund is invested in a portfolio with 70% common stocks and 30% fixed income.

The Closed Landfill Investment Fund was created to provide the Pollution Control Agency with funds to pay the long-term costs of maintaining the integrity of landfills in Minnesota once they have been closed. The assets of the fund are unavailable for expenditure until after FY 2020. The Closed Landfill Investment Fund is invested entirely in common stock

State Cash Accounts represent the cash balances in more than 400 individual accounts that flow through the Minnesota State Treasury. These accounts range in size from \$5,000 to over \$400 million, and are invested by SBI staff through two commingled short-term investment pools. The objectives of these pooled funds are to preserve capital, to provide a high level of current income and to meet the cash needs of state government without the forced sale of securities at a loss.

Budget

The SBI receives its operational budget from a General Fund appropriation. By statute, the SBI charges the statewide retirement funds and non-General Fund cash accounts recovering approximately 90% of its General Fund appropriation. These receipts are deposited in the General Fund as non-dedicated revenue. The General Fund appropriation not recovered by the bill-back provision (approximately 10%) represents the portion of the SBI's budget that is associated with the investment of the General Fund portion of the Invested Treasurer's Cash Fund

Performance Indicators

Statutes establish investment goals for the Basic and Post Retirement funds. In addition, the board has set more exacting standards for investment returns. Performance has generally exceeded both statutory requirements and the board's investment performance targets at the total fund level. Returns are presented net of management fees and investment expenses.

Summary Of Investment Results

Period Ending 6/30/04	<u>Millions</u>	<u>1Year (%)</u>	<u>Annualized 3Years (%)</u>	<u>Annualized 5Years (%)</u>
Basic Funds:	\$18,824	16.6	3.0	2.3
Market composite		16.3	3.0	2.1
Post Fund:	\$18,415	16.3	3.3	2.2
Market composite		15.7	3.4	2.0
Benefit increase		2.5	1.9	3.9
Supplemental Fund:	\$1,041			
Income Share	\$ 467	12.7	2.4	1.8
Market composite		12.2	2.8	2.0
Growth Share	\$ 134	20.2	-0.6	-2.2
Market composite		20.6	0.2	-1.7
Stock index	\$ 192	20.5	0.1	-1.4
Market composite		20.6	0.2	-1.5
International	\$ 59	31.0	4.7	0.9
Market composite		32.1	4.5	0.2
Bond market	\$ 93	1.5	6.8	7.4
Market composite		0.3	6.4	6.9
Fixed Interest	\$ 52	4.4	5.3	5.7
Market composite		2.9	3.1	4.2
Money Market	\$ 44	1.3	1.9	3.5
3 month t bills		1.0	1.5	3.1
Assigned Risk Plan	\$264	3.8	4.3	4.8
Market composite		3.8	4.4	4.8
State Cash Accounts				
Treasurer's Pool	\$4,150	1.1	2.1	3.8
Trust Pool	\$94	1.1	1.7	3.5
91 day T-bill		1.0	1.5	3.1
Permanent School	\$ 578	10.2	3.2	2.6
Market composite		9.5	3.1	2.6
Closed Landfill	\$ 20	19.2	-0.6	-2.2
Market composite		19.1	-0.7	-2.3
Environmental				
Trust Fund	\$ 342	13.7	1.8	0.8
Composite		13.3	1.6	0.7

Contact

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