

SUMMARY *of* PROCEEDINGS



SELECT COMMITTEE ON CAPITAL FINANCING & INVESTMENTS

COMMITTEE MEETING INFORMATION

Monday, June 27, 2016
UW at Casper College, Room UU322
Casper, Wyoming

COMMITTEE MEMBERS PRESENT

Senator Drew Perkins, Chairman
Representative Michael Madden, Vice Chairman
Senator Bruce Burns
Senator Fred Emerich
Senator Floyd Esquibel
Senator Dave Kinskey
Senator Ray Peterson
Representative Jim Byrd
Representative Steve Harshman
Representative Dan Kirkbride
Representative Jerry Paxton
Representative Sue Wilson

OTHER LEGISLATORS PRESENT

Senator Eli Bebout
Representative Lloyd Larsen

LEGISLATIVE SERVICE OFFICE STAFF

Don Richards, Budget/Fiscal Administrator
Matt Obrecht, Legislative Counsel

OTHERS PRESENT AT MEETING

Please refer to [Appendix 1](#) to review the Committee Sign-in Sheet
for a list of other individuals who attended the meeting.

The Committee Meeting Summary of Proceedings (meeting minutes) is prepared by the Legislative Service Office (LSO) and is the official record of the proceedings of a legislative committee meeting. This document does not represent a transcript of the meeting; it is a digest of the meeting and provides a record of official actions taken by the Committee. All meeting materials and handouts provided to the Committee by the Legislative Service Office, public officials, lobbyists, and the public are on file at the Legislative Service Office and are part of the official record of the meeting. An index of these materials is provided at the end of this document and these materials are on file at the Legislative Service Office. For more information or to review meeting materials, please contact the Legislative Service Office at (307) 777-7881 or by e-mail at lso@wyoleg.gov. The Summary of Proceedings for each legislative committee meeting can be found on the Wyoming Legislature's website at www.wyoleg.gov.

EXECUTIVE SUMMARY

The Select Committee on Capital Financing and Investments met for one day on Monday, June 27th. The primary purpose of the meeting was to receive background from the State Treasurer's Office and contract consultants on the state's investment performance, asset allocation, investment management fees, the state's spending policy, and state constitutional and statutory provisions governing state investments. The Select Committee requested and received approval for two (2) additional meeting dates during the 2016 interim in order to more fully explore these topics. The first meeting of the Committee was primarily dedicated to education and issue identification.

CALL TO ORDER

Chairman Perkins called the meeting to order at 9:00 a.m. The following sections summarize the Committee proceedings by topic. Please refer to [Appendix 2](#) to review the Committee Meeting Agenda.

State Treasurer Mark Gordon provided the Committee with opening remarks, articulating three (3) categories of work the Committee could consider this interim: (1) the history, context, overview and constraints facing Wyoming's investment portfolio; (2) portfolio construction and expectations; and (3) statutory changes and a review of materials provided from prior meetings. He provided each member of the Committee with a copy of *Pioneering Portfolio Management* by David F. Swensen, 2009. Treasurer Gordon pointed out four (4) areas of the book worth considering for the Committee's work: (1) spending policies (beginning on page 29); (2) asset allocation (beginning on page 51); (3) quantitative and qualitative analysis (beginning on page 103); and (4) investment staff (beginning on page 301). Treasurer Gordon indicated the Committee could consider whether the statutory caps on equities are appropriate, whether the spending policy amounts are appropriate, and ways to improve return on investments.

Senator Perkins outlined general goals for the Select Committee during the interim and added that potential bill drafts may be considered by the Legislature should the electorate adopt Constitutional Amendment A in November 2016. Responding to Committee questions, Treasurer Gordon explained his speaking efforts and the efforts of others to education the electorate on Amendment A over the summer.

OVERVIEW OF STATE INVESTMENT PORTFOLIO

Becky Gratsinger, of RVK the investment consultant for the state of Wyoming, provided the Committee with a handout describing the structure, performance, and limits on investments for major invested funds of the State. ([Appendix 3](#)) Ms. Gratsinger discussed the investments of the Permanent Wyoming Mineral Trust Fund (PWMTF) in detail. She indicated that, for PWMTF, the investment goal is capital appreciation, total return, and protection against inflation. The long-term return expectation is defined as the consumer price index plus four percent (4%). In the current investment environment Ms. Gratsinger noted that the current statutory spending policy amount of five percent of the five-year average market value will be very difficult to meet.

Treasurer Gordon provided the Committee an experience study of the PWMTF spending policy spillover compared against inflation, as measured by the consumer price index (CPI). ([Appendix 4](#)) Specifically, page two of the analysis illustrates that the deficit to inflation grows each year, unless sufficient deposits are made. The Committee discussed the materials provided. Don Richards, Budget/Fiscal Administrator explained there are four (4) revenue streams that are deposited into the PWMTF: constitutional severance taxes; statutory severance taxes; direct legislative appropriations; and transfers, or "spillover amount" from the PWMTF Spending Policy Reserve Account to the corpus of the PWMTF. The outcome of the inflation analysis depends upon which of the four (4) streams policymakers wish to inflation proof.

The Committee inquired about opportunities to enhance the rate of return on the State's investments and reduce investment manager fees. In response to the discussion of return, Ms. Gratsinger noted the statutory constraints on equity investments. Treasurer Gordon explained that the State pays approximately \$114 million in direct and indirect investment fees each biennium and discussed recent efforts to divest from certain managers based upon the returns produced in relation to the fees. He explained that some additional fixed income investments would be managed in-house in the near future.

Treasurer Gordon and Patrick Fleming, Chief Investment Officer for Wyoming, next discussed constraints on the Treasurer's Office, including staffing, technology, the usual accounting using cost basis compared to the industry standard of market basis. Mr. Fleming noted that due to some vacancies and the Governor's hiring freeze, the Treasurer's Office has just two full-time investment staff. The Committee requested a copy of a recent analysis comparing active and passive management performance net of fees, as discussed by Mr. Fleming.

RECENT LEGISLATION RELATED TO AND HISTORY OF THE SPENDING POLICY AMOUNTS

Don Richards, Budget/Fiscal Administrator, presented the flow of investment earnings from the PWMTF and Common School Permanent Land Fund (CSPLF) in relation to the spending policy amount before and after the statutory changes adopted by the Legislature in the 2015 General Session. Mr. Richards noted that the primary changes in the 2015 legislation included: the increase in the maximum value of the reserve accounts from seventy-five percent (75%) of the spending policy amounts to ninety percent (90%); the "guarantee" or "backflow" provision to support the annual investment earnings to the General Fund of two and one-half percent (2.5%) of the five-year market average; and the distribution of earnings between the first two and one-half percent (2.5%) and the five percent (5%) spending policy amount split equally between the Legislative Stabilization Reserve Account (LSRA) and the Strategic Investments and Projects Account (SIPA). ([Appendix 5](#))

Next, Mr. Richards discussed the establishment of the spending policy amounts (SPAs) in 2000 for FY 2001 through FY 2004, as fixed dollar amounts; the Legislature's revision of the SPA to a percentage of the five-year average market value in FY 2002 (initially 8%); and the reduction of that percentage to five percent (5%) of the five-year average market value beginning in FY 2004. He concluded his comments with a summary of appropriations to and from the spending policy reserve accounts since inception. ([Appendix 6](#))

STATE LOAN AND INVESTMENT BOARD'S INVESTMENT MANAGEMENT POLICY

Ms. Gratsinger and Josh Keavan, RVK, discussed the history of the definition of a "prudent investor" and the migration of investment requirements by states and foundations away from lists of acceptable investments toward a broad consideration of the merits of each investment as well as consideration of the full portfolio in terms of risk. The Committee asked the presenters if they believed there was conflict between the statutory maximum investment in equities and the notion of the prudent investor concept. Mr. Keavan responded that the limitation on equity investments is artificial and much more in-line with the legal list of acceptable investments.

Treasurer Gordon provided copies of the State Loan and Investment Board investment policies ([Appendix 7](#)) and noted two recent changes to the rules regarding investments in international equities and expansion of investments for local governments. In terms of the distribution of responsibilities and authorities, Treasurer Gordon explained that the state's investment consultant, RVK, provides

recommendations; the State Loan and Investment Board adopts target investment allocations; and the State Treasurer's Office executes the policy.

EQUITY, FIXED INCOME, AND ALTERNATIVE INVESTMENTS – COMPARISONS WITH OTHER STATES AND ENDOWMENT AND FOUNDATIONS UNIVERSE

Josh Keavan presented a comparison of equity investments, fixed income investments, and alternative investments with sovereign wealth funds, endowments, and foundations. ([Appendix 8](#)) Mr. Fleming discussed the Sharpe ratio as a measure of return per unit of risk and noted that Wyoming has less overall equity risk than its peers. Wyoming's portfolio is more conservative and performs better in periods with weak equity performance and worse than its peers in periods of strong equity performance. The goal of the portfolio should be to increase return without increasing the risk level.

Looking backward, Mr. Keavan observed that Wyoming's PWMTF investments have performed worse than its peer global sovereign wealth funds and attributed some of this lower performance to Wyoming's higher proportion of fixed income investments, noting that a major constraint on the portfolio is the statutory maximum fifty-five percent (55%) equity limitation. Mr. Keavan noted that the asset allocation of endowment and foundation peers have much less fixed income and a higher proportion of alternative investments. The Committee requested the percentage of equity investments in other, comparable states.

Concluding the discussion, Mr. Fleming noted that all asset classes look expensive on a risk adjusted basis.

POOL MANAGEMENT CONSIDERATIONS

Mr. Fleming explained the needs of various funds invested by the State Treasurer are different depending upon the uses of the funds and whether the fund is a permanent fund. The liquidity needs of funds differ. He suggested that a more tailored approach would be beneficial, and the Treasurer's Office is constrained by the accounting systems currently used by the Office. For example, the internal accounting system operates a cost basis, not a market basis, and the probability of error is significant when managing investments through multiple spreadsheets and antiquated systems. Treasurer Gordon stated that the Office is at its limit, and a major effort is underway to bring the Office up to speed on internal accounting.

The Committee discussed other states' approaches to investing and whether there were efficiencies realized when a single office invests pension assets and state assets. This approach differs from Wyoming's investment structure in which the State Treasurer is responsible for investment of state assets and the Wyoming Retirement Board is responsible for the investment of pension funds. Examples of both consolidated state asset management and bifurcated fund management were discussed.

STATE TREASURER'S INTERPRETATIVE POLICY ON REALIZED CAPITAL GAINS AND LOSSES

Treasurer Gordon summarized the interpretative policy on realized capital gains and losses implemented by former Treasurer Meyer by indicating that income is judged to include dividends, interest and capital gains. If there are net, realized capital losses in any period, no subsequent realized capital gains are distributed until the corpus is fully restored to offset the realized capital losses. He noted that since inception this interpretative rule applies to both permanent funds and the State Agency Pool, separately. The Committee and the Treasurer discussed the challenges with the application of this interpretation to the State Agency Pool as different funds may have different levels of deposits during period of realized

capital losses and realized capital gains and challenges that become apparent in an environment when the State Agency Pool corpus is declining in value rather than increasing. The State Treasurer indicated his reluctance to revisit the Meyer rule in the absence of discussions with the Legislature. He noted that through May, the State Agency Pool has net, realized capital losses of \$8 million and there are \$27 million in net, realized capital losses across all state funds.

REVIEW AND DISCUSSION OF FOUNDATION MODEL AND UNIFORM PRINCIPAL TRUST AND INCOME ACT

Betsy Anderson, State Treasurer's Counsel explained the Principal and Income Act (the Act). The Act was recently amended by the Legislature to provide a trustee discretion to distribute capital gains or retain them in the corpus for future beneficiaries, unless otherwise provided for in the trust documents. The State has been distributing capital gains for some time. Members of the Committee pointed out that some portion of the capital gains may be distributed back to the corpus and the definition of income and level of SPA would impact the distribution of investment earnings for current expenditures or to the corpus.

OTHER

The State Treasurer's Office provided several handouts ([Appendices 9 – 12](#)) generally relating to the Overview of State Investment Portfolio, but did not specifically discuss the materials.

The State Treasurer's Office also provided an interactive questionnaire for the Committee regarding the outlook of stocks, bonds, background on the Yale endowment and the spending policy. ([Appendix 13](#))

PUBLIC COMMENT

An opportunity for public comment was provided; no comments were received.

COMMITTEE DIRECTIVES

The Committee discussed moving the next meeting scheduled for Friday, September 16th to Wednesday, September 14th. In preparation for the Committee's September meeting, each member was asked to share requests or thoughts as noted below:

- A copy of the State Treasurer's interpretative policy on capital gains and losses
- State Treasurer's Office thoughts on whether various terms such as earnings, dividends, interest, income, and revenue should be defined in statute
- Opportunities to increase the corpus of the permanent funds so that a higher percentage of current revenues can be supported by steady investment income
- An analysis of a spending policy whereby the nominal return on portfolio minus an inflationary premium is the spending policy
- Primer on a pure total return model, including a Monte Carlo simulation of the risk of a downturn in any given year compared against an alternative model with a higher allocation to equities
- Better method to forecast investment earnings
- Further discussion about how to treat realized capital gains and losses, including other states' approaches
- Consider lifting or removing the statutory cap on investment in equities by permanent funds
- Clear comparison chart ([Appendix 4](#), page 2) that shows inflation proofing, with the revenue streams disaggregated

- Comparisons of other states and consideration of state investment organization (combined or separate from the Wyoming Retirement System) and oversight of investments by a board of professionals rather than elected officials
- Opportunities for more in-house investment with an equal or greater reduction in external manager's fees
- Options to ease cash management needs
- Identification of a sustainable spending policy, via examples
- Identification of reserve account size that provides certainty over an investment cycle of 4-7 years
- Opportunities to build the SIPA and LSRA
- Summary of appropriations in 2017-2018 from SIPA
- Development of a better understanding of the balance between the roles of the Legislature, Treasurer, and State Loan and Investment Board in developing and implementing state investment policy.

MEETING ADJOURNMENT

There being no further business, Chairman Perkins adjourned the meeting at 4:37 p.m.

Respectfully submitted,

Senator Drew Perkins, Chairman

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SELECT COMMITTEE ON CAPITAL FINANCING & INVESTMENTS *Summary of Proceedings*

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Committee Meeting Materials Index

Appendix	Agenda Item	Appendix Description	Appendix Provider
1	Committee Sign-In Sheet	Lists meeting attendees	Legislative Service Office
2	Committee Meeting Agenda	Provides an outline of the topics the Committee planned to address at meeting	Legislative Service Office
3	Overview of State Investment Portfolio, et al	Overview of State Investment Portfolio	RVK
4	Overview of State Investment Portfolio, et al	Experience Study of PMTF Spending Policy Spillover and how well it has Offset Inflation, 2002-2015	State Treasurer
5	Recent legislation regarding earnings and spending policy distributions	Spending policy flow charts	Legislative Service Office
6	History of spending policy, use of the reserve accounts and current encumbrances	LSO memo on: history of spending policies, use of reserve accounts and current encumbrances	Legislative Service Office
7	State Loan and Investment Board establishment of investment policy	State Loan and Investment Board Master Investment Policy and Sub-Policies, June 2, 2016	State Treasurer
8	Equity Investment Policy, Fixed Income Investment Policy, and Alternative Investments	Asset Class Reviews	RVK
9	Overview of State Investment Portfolio, et al	Investment performance analysis commentary	RVK
10	Overview of State Investment Portfolio, et al	Asset allocation, spending and the nature of fixed income	RVK
11	Overview of State Investment Portfolio, et al	Excerpts from the 2015 national association of college and university business officers – commonfund study of endowments	State Treasurer
12	Overview of State Investment Portfolio, et al	Investment outlook, June 2016	State Treasurer (author, Bill Gross, Janus Capital Group)

13	Equity Investment Policy, Fixed Income Investment Policy, and Alternative Investments	Interactive committee questionnaire	State Treasurer
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