

# SENATE BILL No. 1573

November 5, 2008, Introduced by Senators JANSEN and CLARKE and referred to the Committee on Appropriations.

A bill to amend 1965 PA 314, entitled "Public employee retirement system investment act," by amending sections 12d, 13, 19, 20d, 20j, and 20k (MCL 38.1132d, 38.1133, 38.1139, 38.1140d, 38.1140j, and 38.1140k), sections 12d, 13, 19, and 20d as amended by 2000 PA 307 and sections 20j and 20k as added by 1996 PA 485, and by adding section 19a; and to repeal acts and parts of acts.

**THE PEOPLE OF THE STATE OF MICHIGAN ENACT:**

1           Sec. 12d. (1) "National rating services" means Moody's  
2 investors service, inc.; Standard & Poor's ratings group; Fitch  
3 investors service inc.; Duff & Phelps credit rating corp.; or any  
4 other nationally recognized statistical rating organization as  
5 determined by the state treasurer.

6           (2) "Net earnings available for fixed charges" means net  
7 income after deducting operating and maintenance expenses, taxes  
8 other than federal and state income taxes, depreciation, and

1 depletion, but excluding extraordinary expenses appearing in the  
2 regular financial statements of the system.

3 (3) "Obligations" means bonds, notes, collateral trust  
4 certificates, convertible bonds, debentures, equipment trust  
5 certificates, conditional sales agreements, guaranteed mortgage  
6 certificates, pass-through certificates, participation  
7 certificates, mortgages, trust deeds, general obligation bonds,  
8 revenue bonds, or other similar interest bearing instruments of  
9 debt. Obligations may be secured or unsecured and may be publicly  
10 offered or privately placed.

11 (4) "Party in interest" means, as it relates to a system, any  
12 of the following:

13 (a) An investment fiduciary, counsel, or employee of the  
14 system.

15 (b) A person providing services to the system.

16 (c) The political subdivision sponsoring the system.

17 (d) An organization, any of whose members are covered by the  
18 system.

19 (e) A spouse, ancestor, lineal descendant, or spouse of a  
20 lineal descendant of an individual described in subdivision (a) or  
21 (b).

22 (f) An entity controlled by an individual or organization  
23 described in subdivisions (a) to (e).

24 (5) "Portfolio company" means an entity in which the  
25 investment fiduciary has invested or has considered investing  
26 system assets.

27 (6) **"PRIVATE EQUITY" MEANS AN ASSET CLASS CONSISTING OF EQUITY**

1 OR DEBT SECURITIES IN ENTITIES THAT ARE NOT PUBLICLY TRADED, WHICH  
2 MAY INCLUDE, BUT ARE NOT LIMITED TO, INVESTMENTS IN LEVERAGED  
3 BUYOUTS, VENTURE CAPITAL, GROWTH CAPITAL, DISTRESSED OR SPECIAL  
4 SITUATIONS, MEZZANINE CAPITAL, AND SECONDARY INVESTMENTS IN EQUITY  
5 OR DEBT INTERESTS.

6 Sec. 13. (1) The provisions of this act shall supersede any  
7 investment authority previously granted to a system under any other  
8 law of this state.

9 (2) The assets of a system may be invested, reinvested, held  
10 in nominee form, and managed by an investment fiduciary subject to  
11 the terms, conditions, and limitations provided in this act. An  
12 investment fiduciary of a defined contribution plan may arrange for  
13 1 or more investment options to be directed by the participants of  
14 the defined contribution plan. The limitations on the percentage of  
15 total assets for investments provided in this act do not apply to a  
16 defined contribution plan in which a participant directs the  
17 investment of the assets in his or her individual account, and that  
18 participant is not considered an investment fiduciary under this  
19 act.

20 (3) An investment fiduciary shall discharge his or her duties  
21 solely in the interest of the participants and the beneficiaries,  
22 and shall do all of the following:

23 (a) Act with the same care, skill, prudence, and diligence  
24 under the circumstances then prevailing that a prudent person  
25 acting in a similar capacity and familiar with those matters would  
26 use in the conduct of a similar enterprise with similar aims.

27 (b) Act with due regard for the management, reputation, and

1 stability of the issuer and the character of the particular  
2 investments being considered.

3 (c) Make investments for the exclusive purposes of providing  
4 benefits to participants and participants' beneficiaries, and of  
5 defraying reasonable expenses of investing the assets of the  
6 system.

7 (d) Give appropriate consideration to those facts and  
8 circumstances that the investment fiduciary knows or should know  
9 are relevant to the particular investment or investment course of  
10 action involved, including the role the investment or investment  
11 course of action plays in that portion of the system's investments  
12 for which the investment fiduciary has responsibility; and act  
13 accordingly. For purposes of this subsection, "appropriate  
14 consideration" includes, but is not limited to, a determination by  
15 the investment fiduciary that a particular investment or investment  
16 course of action is reasonably designed, as part of the investments  
17 of the system, to further the purposes of the system, taking into  
18 consideration the risk of loss and the opportunity for gain or  
19 other return associated with the investment or investment course of  
20 action; and consideration of the following factors as they relate  
21 to the investment or investment course of action:

22 (i) The diversification of the investments of the system.

23 (ii) The liquidity and current return of the investments of the  
24 system relative to the anticipated cash flow requirements of the  
25 system.

26 (iii) The projected return of the investments of the system  
27 relative to the funding objectives of the system.

1 (e) Give appropriate consideration to investments that would  
2 enhance the general welfare of this state and its citizens if those  
3 investments offer the safety and rate of return comparable to other  
4 investments permitted under this act and available to the  
5 investment fiduciary at the time the investment decision is made.

6 (f) Prepare and maintain written objectives, policies, and  
7 strategies with clearly defined accountability and responsibility  
8 for implementing and executing the system's investments.

9 (g) Monitor the investment of the system's assets with regard  
10 to the limitations on those investments pursuant to this act. Upon  
11 discovery that an investment causes the system to exceed a  
12 limitation prescribed in this act, the investment fiduciary shall  
13 reallocate assets in a prudent manner in order to comply with the  
14 prescribed limitation.

15 (4) An investment fiduciary may use a portion of the income of  
16 the system to defray the costs of investing, managing, and  
17 protecting the assets of the system **INCLUDING PROVIDING**  
18 **PROFESSIONAL TRAINING AND EDUCATION**; may retain investment and all  
19 other services necessary for the conduct of the affairs of the  
20 system; and may pay reasonable compensation for those services.  
21 Subject to an annual appropriation by the legislature, a deduction  
22 from the income of a state administered system resulting from the  
23 payment of those costs shall be made.

24 (5) The system shall be a separate and distinct trust fund and  
25 the assets of the system shall be for the exclusive benefit of the  
26 participants and their beneficiaries and of defraying reasonable  
27 expenses of investing the assets of the system. With respect to a

1 system, an investment fiduciary shall not cause the system to  
2 engage in a transaction if he or she knows or should know that the  
3 transaction is any of the following, either directly or indirectly:

4 (a) A sale or exchange or a leasing of any property from the  
5 system to a party in interest for less than the fair market value,  
6 or from a party in interest to the system for more than the fair  
7 market value.

8 (b) A lending of money or other extension of credit from the  
9 system to a party in interest without the receipt of adequate  
10 security and a reasonable rate of interest, or from a party in  
11 interest to the system with the provision of excessive security or  
12 at an unreasonably high rate of interest.

13 (c) A transfer to, or use by or for the benefit of, the  
14 political subdivision sponsoring the system of any assets of the  
15 system for less than adequate consideration.

16 (d) The furnishing of goods, services, or facilities from the  
17 system to a party in interest for less than adequate consideration,  
18 or from a party in interest to the system for more than adequate  
19 consideration.

20 (6) With respect to a system subject to this act, an  
21 investment fiduciary shall not do any of the following:

22 (a) Deal with the assets of the system in his or her own  
23 interest or for his or her own account.

24 (b) In his or her individual or any other capacity act in any  
25 transaction involving the system on behalf of a party whose  
26 interests are adverse to the interests of the system or the  
27 interest of its participants or participants' beneficiaries.

1 (c) Receive any consideration for his or her own personal  
2 account from any party dealing with the system in connection with a  
3 transaction involving the assets of the system.

4 (7) This section does not prohibit an investment fiduciary  
5 from doing any of the following:

6 (a) Receiving any benefit to which he or she may be entitled  
7 as a participant or participant's beneficiary of the system.

8 (b) Receiving any reimbursement of expenses properly and  
9 actually incurred in the performance of his or her duties for the  
10 system.

11 (c) Serving as an investment fiduciary in addition to being an  
12 officer, employee, agent, or other representative of the political  
13 subdivision sponsoring the system.

14 (d) Receiving agreed upon compensation for services from the  
15 system.

16 (8) Except for an employee of a system, this state, or the  
17 political subdivision sponsoring a system, when acting in the  
18 capacity as an investment fiduciary, an investment fiduciary who is  
19 qualified under section 12c(1)(b) shall meet 1 of the following  
20 requirements:

21 (a) Be a registered investment adviser under either the  
22 investment advisers act of 1940, title II of chapter 686, ~~54 Stat.~~  
23 ~~847, 15 U.S.C. USC~~ 80b-1 to 80b-21, or the uniform securities act,  
24 1964 PA 265, MCL 451.501 to 451.818.

25 (b) Be a bank as defined under the investment advisers act of  
26 1940, **15 USC 80B-1 TO 80B-21.**

27 (c) Be an insurance company qualified under section 16(3).

1 (9) An investment fiduciary shall not invest in a debt  
2 instrument issued by a foreign country that has been identified by  
3 the United States state department as engaging in or sponsoring  
4 terrorism.

5 (10) A system shall annually publish and make available to the  
6 plan participants and beneficiaries a list of all expenses paid by  
7 soft dollars.

8 Sec. 19. (1) An investment fiduciary may invest up to ~~5%~~10%  
9 of a system's assets in publicly or privately issued real estate  
10 investment trusts or in real or personal property otherwise  
11 qualified pursuant to section 15, 16, or 20c.

12 (2) In addition to investments authorized under subsection  
13 (1), an investment fiduciary of a system having assets of more than  
14 \$100,000,000.00 may do any of the following:

15 (a) Invest in, buy, sell, hold, improve, lease, or acquire by  
16 foreclosure or an agreement in lieu of foreclosure, real or  
17 personal property or an interest in real or personal property.

18 (b) Develop, maintain, operate, or lease the real or personal  
19 property referred to in subdivision (a).

20 (c) Form **OR INVEST IN** 1 or more limited partnerships,  
21 corporations, limited liability companies, trusts, or other  
22 organizational entities for which liability of an investor cannot  
23 exceed the amount of the investment under the laws of the United  
24 States or of any state, district, or territory of the United States  
25 **OR FOREIGN COUNTRY. THE LIMITED PARTNERSHIP, CORPORATION, LIMITED**  
26 **LIABILITY COMPANY, TRUST, OR OTHER ORGANIZATIONAL ENTITY MAY INVEST**  
27 **IN, BUY, SELL, HOLD, DEVELOP, IMPROVE, LEASE, OR OPERATE REAL OR**

1 **PERSONAL PROPERTY, OR ORIGINATE A MORTGAGE OR INVEST IN AN ANNUITY**  
2 **SEPARATE ACCOUNT THAT INVESTS IN REAL OR PERSONAL PROPERTY** to hold  
3 title to, improve, lease, manage, develop, maintain, or operate  
4 real or personal property whether currently held or acquired after  
5 the effective date of the amendatory act that added this  
6 subdivision. An entity formed ~~pursuant to~~ **UNDER** this subdivision  
7 has the right to exercise all powers granted to the entity by the  
8 laws of the jurisdiction of formation, including, but not limited  
9 to, the power to borrow money in order to provide additional  
10 capital to benefit and increase the overall return on ~~property~~ **THE**  
11 **INVESTMENT** held by the entity.

12 (d) Invest in investments otherwise qualified pursuant to  
13 subsection (1).

14 (3) Except as otherwise provided in this section, the  
15 aggregate investments made under subsection (2) shall not exceed 5%  
16 10% of the assets of the system. The purchase price of an  
17 investment made under this section shall not exceed the appraised  
18 value of the real or personal property.

19 (4) If the investment fiduciary of a system is the state  
20 treasurer, investments described in subsection (1) or (2) may  
21 exceed ~~5%~~ 10% of the assets of the system.

22 (5) An investment qualified under this section in which the  
23 underlying asset is an interest in real or personal property  
24 constitutes an investment under this section for the purpose of  
25 meeting the asset limitations contained in this act. This  
26 subsection applies even though the investment may be qualified  
27 elsewhere in this act. Notwithstanding this subsection, an

1 investment fiduciary may designate a real estate investment trust  
2 which satisfies the requirements of section 14(2) as an investment  
3 qualified under this section or as an investment in stock under  
4 section 14.

5 SEC. 19A. (1) AN INVESTMENT FIDUCIARY OF A SYSTEM HAVING  
6 ASSETS OF LESS THAN \$250,000,000.00 MAY INVEST NOT MORE THAN 5% OF  
7 THE SYSTEM'S ASSETS IN PRIVATE EQUITY. HOWEVER, IF THE SYSTEM HAS  
8 ASSETS OF LESS THAN \$250,000,000.00, THE INVESTMENTS SHALL BE MADE  
9 THROUGH A FUND OF FUNDS VEHICLE.

10 (2) AN INVESTMENT FIDUCIARY OF A SYSTEM HAVING ASSETS OF  
11 \$250,000,000.00 OR MORE MAY INVEST NOT MORE THAN 10% OF THE  
12 SYSTEM'S ASSETS IN PRIVATE EQUITY.

13 (3) AN INVESTMENT FIDUCIARY OF A SYSTEM HAVING ASSETS OF  
14 \$1,000,000,000.00 OR MORE MAY INVEST NOT MORE THAN 15% OF THE  
15 SYSTEM'S ASSETS IN PRIVATE EQUITY.

16 (4) IF THE INVESTMENT FIDUCIARY IS THE STATE TREASURER,  
17 INVESTMENTS DESCRIBED IN THIS SECTION SHALL NOT BE SUBJECT TO A  
18 PERCENTAGE OF THE TOTAL ASSETS LIMITATION.

19 (5) AS USED IN THIS SECTION, "FUND OF FUNDS" MEANS AN  
20 INVESTMENT FUND THAT USES AN INVESTMENT STRATEGY OF HOLDING A  
21 PORTFOLIO OF OTHER INVESTMENT FUNDS RATHER THAN INVESTING DIRECTLY  
22 IN SHARES, BONDS, OR OTHER SECURITIES.

23 Sec. 20d. (1) An investment fiduciary of a system having  
24 assets of less than \$250,000,000.00 may invest not more than 5% of  
25 the system's assets in investments not otherwise qualified under  
26 this act, whether the investments are similar or dissimilar to  
27 those specified in this act.

1           (2) An investment fiduciary of a system having assets of  
2 \$250,000,000.00 or more may invest not more than 10% of the  
3 system's assets in investments described in subsection (1).

4           (3) An investment fiduciary of a system having assets of  
5 \$1,000,000,000.00 or more may invest not more than 15% of the  
6 system's assets in investments described in subsection (1).

7           (4) An investment fiduciary of a system who is the state  
8 treasurer may invest not more than ~~20%~~25% of the system's assets  
9 in investments described in subsection (1).

10           (5) If an investment described in subsection (1) is  
11 subsequently determined to be permitted under another section of  
12 this act, then the investment shall no longer be included under  
13 this section.

14           (6) This section shall not be used to exceed a percentage of  
15 total assets limitation for an investment provided in any other  
16 section of this act.

17           Sec. 20j. (1) Subject to qualification elsewhere in this act,  
18 an investment fiduciary may invest in any of the following:

19           (a) A derivative that hedges positions of a nonderivative  
20 component of a portfolio that clearly reduces a defined risk.

21           (b) A derivative that replicates the risk/return profile of an  
22 asset or asset class, provided the asset or asset class is  
23 permitted in other sections of this act.

24           (c) A derivative that rebalances the country or asset class  
25 exposure of a portfolio.

26           (d) A derivative in which the investment fiduciary has  
27 examined the price, yield, and duration characteristics in all

1 market environments both at the time of investment and on an  
2 ongoing basis.

3 (e) A commingled or pooled investment fund that uses  
4 derivatives, if the fund's use of derivatives is consistent with  
5 the guidelines outlined in this section.

6 (f) Over-the-counter derivatives if, in the case of an over-  
7 the-counter security, a minimum of 2 competing bids or offers are  
8 obtained. All counter party risk in over-the-counter derivative  
9 transactions shall be examined at the time of investment and on an  
10 ongoing basis.

11 (2) The aggregate market value of the underlying security,  
12 future, or other instrument or index made under this section shall  
13 not exceed ~~15%~~ 30% of the assets of the system. For purposes of the  
14 asset limitation in this section only, "derivatives" does not  
15 include:

16 (a) Asset backed pools, mortgage backed pools, or  
17 collateralized mortgage obligations that are otherwise qualified  
18 under this act and are no more exposed to prepayment risk or  
19 interest rate risk than the underlying collateral including planned  
20 amortization classes and sequential-pay collateralized mortgage  
21 obligations.

22 (b) Convertible bonds, convertible preferred stock, rights or  
23 warrants to purchase stock or bonds or notes or partnership  
24 interests, floating rate notes, zero coupon securities, stripped  
25 principal securities, or stripped interest securities, which items  
26 are otherwise qualified under this act.

27 (c) Exchange-listed derivatives trading on a daily basis and

1 settling in cash daily or having a limited and fully defined risk  
2 profile at an identified, fixed cost, including futures contracts  
3 and purchased options.

4 (d) Currency forwards trading on a daily basis and settling in  
5 cash daily or having a limited and fully defined risk profile at an  
6 identified, fixed cost.

7 (3) Notwithstanding any other provision of this act to the  
8 contrary, an investment fiduciary shall not invest in derivatives  
9 for the purpose of leveraging a portfolio or shorting securities as  
10 a sole investment.

11 Sec. 20k. (1) Notwithstanding a percentage of total assets  
12 limitation for an investment provided in any other section of this  
13 act, an investment fiduciary may invest not more than 20% of a  
14 system's assets in foreign securities. Except as otherwise provided  
15 in this act, an investment fiduciary shall not do any of the  
16 following:

17 (a) Invest in more than 5% of the outstanding foreign  
18 securities of any 1 issuer.

19 (b) Invest more than 5% of a system's assets in the foreign  
20 securities of any 1 issuer.

21 (2) Investments in foreign securities under this section shall  
22 be made only by investment fiduciaries described in section 13(8)  
23 who have demonstrated expertise in investments of that type.

24 **(3) AN INVESTMENT FIDUCIARY WHO IS THE STATE TREASURER MAY**  
25 **INVEST MORE THAN 20% OF THE SYSTEM'S ASSETS IN INVESTMENTS**  
26 **DESCRIBED IN SUBSECTION (1).**

27 Enacting section 1. Section 13a of the public employee

1 retirement system investment act, 1965 PA 314, MCL 38.1133a, is  
2 repealed.