MINUTES

MONTANA SENATE
56th LEGISLATURE - REGULAR SESSION

COMMITTEE ON BUSINESS AND INDUSTRY

Call to Order: By **CHAIRMAN JOHN HERTEL,** on January 8, 1999 at 9:00 A.M., in Room 410 Capitol.

ROLL CALL

Members Present:
Sen. John Hertel, Chairman (R)
Sen. Mike Sprague, Vice Chairman (R)
Sen. Dale Berry (R)
Sen. Vicki Cocchiarella (D)
Sen. Bea McCarthy (D)
Sen. Glenn Roush (D)
Sen. Fred Thomas (R)

Members Excused: None.

Members Absent: None.

Staff Present: Bart Campbell, Legislative Branch
Mary Gay Wells, Committee Secretary

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:
Hearing(s) & Date(s) Posted: SB 23, 1/4 /1999
Executive Action: SB 23; SB 26; SB 51

{Tape : 1; Side : A; Approx. Time Counter : 0.7}

HEARING ON SB 23

Sponsor: SENATOR FRED THOMAS, SD 31, STEVENSVILLE

Proponents: Mark Barry, Montana State Fund
Carroll South, Executive Dir., Board of Investments
Patrick Heffernan, MT. Logging Assoc.
George Wood, MT Self Insurers Assoc.
Jacqueline Lenmark, American Insurance Assoc.

Opponents: None

__Opening Statement by Sponsor:__ **SENATOR FRED THOMAS, SD 31, STEVENSVILLE** presented **SB 23** to the Committee. His opening statements are **EXHIBIT(bus05a01).** The original bill was written with a restriction of 20%. **SENATOR THOMAS** suggested an amendment that would put this restriction at 25% **EXHIBIT(bus05a02).**

__Proponents' Testimony__: **Mark Barry, Senior Vice President, Administration and Finance, State Fund.** We rise in support of this bill. The State Fund insures approximately 24,000 businesses in Montana. We insure them for their Workers Compensation insurance coverage. The reason for this Constitutional Amendment is primarily because our assets are considered public monies. As public monies, we are required in the Constitution to limit our investments to fixed securities. That is government bonds, T-bills, etc. This allows the voters of Montana to allow us to invest a portion of our assets in stocks. He then presented four points concerning **SB 23. EXHIBIT(bus05a03) Mr. Barry** presented two graphs **EXHIBIT(bus05a04)** and **EXHIBIT(bus05a05)** on investment returns from FY 91 through FY 98 and total rates of return versus benchmarks. Our goal is not only to maximize returns for our policy holders but that it is also able to absorb the fluctuations in the market because these two vehicles do not correlate as far as the rate of return.

Carroll South, Executive Director, Board of Investments. The Board of Investments is responsible for investing all state money. The State Fund is one of our larger customers. At the end of the last fiscal year, the State's portfolio was over $7.5 billion dollars--a combination of trust funds, pension funds, insurance funds and idle cash in various state accounts. I would like to talk from a couple of graphs **EXHIBIT(bus05a06)** and **EXHIBIT(bus05a07).** Historically, there are records going back to the early 1900's comparing fixed income returns to equity returns. Although it varies from one year to the next, over the last 70 some years equities have returned anywhere from 2 to 3% more per year than fixed income investments. The primary reason for this is capital appreciation. When you buy a bond with a $10 million par and hold it for 30 years, you know at the end of 30 years you get the $10 million and that is it. You have received interest along the way but it doesn't appreciate. Whereas stocks generally over a long period of time do. The first graph is factual. This is a graph of the state common stock performance vis-a-vis its long term bond performance. We have 23 years of official records and during the period of time our custodial banks have actually calculated the total rate of return. We do not do that because it is part of the requirements in the investment world that you have an objective party do your total rates of return. The total rates of return reflected here represent interest and dividends as well as capital appreciation of the initial investment. The stocks dramatically in the last 23 years have outperformed the bonds and from 1994 on the difference is significant. Obviously the lines don't mean a whole lot but I would like to put some numbers to these and give you an example as to what would have happened had someone invested $50 million in both of these portfolios 23 years ago. Again the total rates of returns are always compounded because it assumes you re-invest your dividends; that is the way the pension funds and the insurance company works. The trusts don't work that way because you spend the income. Therefore, you would have $900 million more now because not only of the rates of return itself, but the compounding. The compounding effect is incrementally great when the returns are high. Obviously the more money the State Fund makes on its investment, the less it has to charge its customers to pay the bills. The second graph is a factual graph and indicates what the Board of Investments has tried to do since 1981. Pensions have been investing in equities since 1975--three years after the new Constitution was adopted. It permitted those investments in pensions. The Board of Investments has determined that historically as well as going forward, equities will provide a greater return than fixed income. From 1981 to 1998, this graph represents what the Board of Investments has done with the pension portfolios. In 1981, 16% of the pension portfolios were in equities. At that time, the only equity was the common stock pool. In 1998, 53% of the pension portfolios are in equities and that is a very diverse kind of equity which includes S&P 500 stock, international stock, real estate, etc. We support this bill for good investment purposes and a better rate of return on State money.

Patrick Heffernan, Montana Logging Association. We rise in support of this bill. Many of our members who own and operate family-owned timber harvesting business are insured with the State Fund. The State Fund has greatly improved their service over the last few years. There is a tremendous amount of competition now in the Work Comp sector where several years ago there wasn't any competition. This bill is important because it helps the State Fund remain competitive with these other entities entering into the Work Comp arena. We recommend a "Do Pass".

George Wood, Executive Secretary, Montana Self Insurers Assoc. The Self Insurers Assoc. represents Plan One, Montana Employers. We don't represent insurers. We think this is a prudent piece of legislation. It will allow a more business-like management. The passage of this bill will give them one more tool to do what you expect them to do. We recommend a "Do Pass".

Jacqueline Lenmark, American Insurance Assoc. I do represent insurance companies--companies that write Worker's Compensation insurance under Plan Two. We also support this legislation. It is a very strong policy of my Assoc. to support strong, competitive, three-way systems with strong, competitive state funds. We think this will give the State Fund one more way to insure its fiscal stability and we urge a "Do Pass".

Opponents' Testimony: None

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Questions from Committee Members and Responses:

SENATOR VICKI COCCHIARELLA asked **SEN. THOMAS** who deferred the question to **Mr. South** to look at the first State Fund graph **(EXHIBIT 4).** The pink line is below the blue line and then notice the Board of Investments graphs for TRS **(EXHIBIT 6).** She was concerned about the accuracy of one or the other as they seemed to contradict each other. And the bottom line was what was the likely possibility that these trends would go the other way. **Mr. South** responded that there is a likelihood that in any given year, bonds will perform better than equities. He had the actual return year by year for both and the Montana Common Stock Pool in 1983 was 60%. In 1982 it was -11.5%. So there are minuses and pluses, but overall and historically, equities will outperform fixed income. With equities you get the growth of the company; you don't get that with a bond. **SEN. COCCHIARELLA** then asked how they would manage and protect the State Fund if the trend went the other way. **Mr. South** replied that the portfolio is properly diversified so that all the eggs are not in one basket. Also, you should not put all the eggs in one stock. The Common Stock Pool is currently at about $2 billion and has 120 different companies in it. So the Pool is very diversified. So if one company falls flat on its face, others make up for it. So you diversify not only by your asset allocations: so much in cash, bonds, stocks; but you also diversify within each class.

SENATOR MIKE SPRAGUE asked **Mr. South** to help clarify the above explanation. **SEN. SPRAGUE** then asked for a rough sketch of how diversification is planned. **Mr. South** responded that in the case of the pensions, they try to get between 50% and 60% in equities. This would be a broad range of equities. The goal now is 10% of the pensions in international equities. There is from 1% to 2% in alternative equities which include venture capital and leverage buyouts. There is 2% to 3% of the pensions in cash which is the short-term investment pool. That pool in itself is well diversified. This is a fixed unit pool. **SEN. SPRAGUE** asked about the capital risk factor. Internet stocks are going wild with no justification. How would the Board of Investments look at something like that? **Mr. South** stated that basically there are different philosophies of investment in equities and the Board want to combine value with growth. Value neutral funds are looking for underpriced companies. Growth mutual funds are looking for companies that may be slightly overpriced but have a great future. They try to combine these two philosophies. They want value plus growth in the companies that they invest in.

{Tape : 1; Side : A; Approx. Time Counter : 25.3}

Closing by Sponsor:

SEN. THOMAS closed and said that the State Chamber of Commerce could not be here today but they were in support of this bill. The amendment would be to include the State Compensation Insurance Fund and allow them to invest up to 25% of their funds in private corporate capital stock. This would allow them to make more on their investments and in turn allow premiums to be kept down or reduced with these additional funds. We need this to go to the public in the year 2000 and for them to vote favorably for this bill. I hope that each of you can support this bill.

{Tape : 1; Side : A; Approx. Time Counter : 34.6}

EXECUTIVE ACTION ON SB 26

Motion/Vote: SEN. MCCARTHY moved that SB 26 DO PASS. Motion carried unanimously. 7-0

EXECUTIVE ACTION ON SB 51

Motion/Vote: SEN. ROUSH moved that SB 51 DO PASS. Motion carried unanimously. 7-0

EXECUTIVE ACTION ON SB 23

Motion/Vote: SEN. COCCHIARELLA moved that SB 23 BE AMENDED. Motion carried unanimously. 7-0

Motion/Vote: SEN. MCCARTHY moved that SB 23 DO PASS AS AMENDED. Motion carried unanimously. 7-0

ADJOURNMENT

Adjournment: 9:45 A.M.

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SEN. JOHN HERTEL, Chairman

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MARY GAY WELLS, Secretary

JH/MGW

EXHIBIT(bus05aad)