Agenda Item 6B
March 4, 2014
Action

MEMORANDUM

February 28, 2014

TO: County Council

FROM: Robert H. Drummer, Senior Legislative Attorney

SUBJECT: **Action:** Expedited Bill 15-14, Personnel – Board of Investment Trustees – Consolidated Retiree Health Benefits Trust Board of Trustees – Investments – Amendments

Government Operations and Fiscal Policy Committee recommendation (3-0): enact the Bill as introduced.

Expedited Bill 15-14, Personnel – Board of Investment Trustees – Consolidated Retiree Health Benefits Trust Board of Trustees – Investments - Amendments, sponsored by the Council President at the request of the County Executive, was introduced on February 4. A public hearing and a Government Operations and Fiscal Policy Committee worksession were both held February 25.

Bill 15-14 would:

(1) repeal the requirement that investments made by the Board of Investment Trustees and the Consolidated Retiree Health Benefits Board of Trustees retain U.S. indicia of ownership;
(2) repeal the prohibition on investments in County related bonds by the Board of Investment Trustees and the Consolidated Retiree Health Benefits Board of Trustees;
(3) repeal the restriction on real estate investment by the Consolidated Retiree Health Benefits Board of Trustees; and
(4) generally amend the law regarding the Employees' Retirement System, Retirement Savings Plan, the Deferred Compensation Plan, and the Consolidated Retiree Health Benefits Trust Fund.

Background

The Uniform Management of Public Employee Retirement Systems Act (UMPERSA) is a uniform model act published by the National Conference of Commissioners on Uniform State Laws in 1997. The model act contains provisions that would govern the establishment and management of a public employee pension trust, including principles governing the investment and management of trust funds by the trustees. A summary of UMPERSA is at ©16-18. This model act has not been enacted in its entirety in Maryland. However, the General Assembly did enact Chapter 146 of the 2005 Laws of Maryland (codified at State Personnel & Pensions Article §40-101), which requires all local jurisdictions establishing a public pension system after July 1, 2005 to adhere to the principles of UMPERSA addressing the investment and management of funds. This law also requires each existing local pension system to certify to the Joint Committee on Pensions of the Maryland General Assembly that it adheres to the UMPERSA principles addressing the investment and management of funds or explain any deviations.

Expedited Bill 27-07, Personnel – Retirement – Investment Authority, enacted on December 4, 2007 and signed into law on December 17, 2007, removed the restrictive list of investments that the Board could use in order to comply with the fiduciary rules of UMPERSA. Bill 27-07 did not remove all of the restrictions on investments.

The Boards of the Montgomery County Employee Retirement Plans and the Montgomery County Consolidated Retiree Health Benefits Trust are currently precluded from making investments maintaining indicia of ownership of assets outside the jurisdiction of the U.S. courts. Since investment opportunities are increasingly located outside of the United States, many without maintaining United States indicia of ownership within the jurisdiction of the courts of the U.S, current law constrains the pool of investments available to the Employee Retirement Plans and Consolidated Retiree Health Benefits Trust. This restriction may unnecessarily limit the returns that can be generated by these entities.

Restricting the Boards from making these investments may hinder their ability to fulfill their fiduciary duty. Similarly, the Employee Retirement Plans and Consolidated Retiree Health Benefits Trust are currently prohibited from investing in County-related bonds, which precludes participation in investments with certain investment managers. The Consolidated Retiree Health Benefits Trust is also prohibited from making investments in real estate funds if more than 10% of such fund's assets comprise real estate in Montgomery County; this precludes participation in investments with a wide variety of real estate investment managers.

The goal of the Bill is to provide the Boards with the flexibility to make investments with indicia of ownership outside of the United States courts, investments in County-related bonds, and County-related real estate, as consistent with their fiduciary duties.

Public Hearing

The only speaker, Linda Herman, BIT Executive Director, supported the Bill on behalf of the Executive and the Boards. See ©23.

GO Committee Worksession

The Government Operations and Fiscal Policy Committee reviewed the Bill at a worksession on February 25. Linda Herman, BIT Executive Director and Amy Moskowitz, Associate County Attorney represented the Executive Branch. The Committee reviewed the Bill and discussed its purpose. The Committee (3-0) recommended approval of the Bill as introduced pending any new issues raised at the public hearing scheduled for later that day.

Issues

1. Should the Boards be permitted to make investments maintaining indicia of ownership of assets outside the jurisdiction of the U.S. courts?

Maryland, the District of Columbia, Virginia, Anne Arundel County, Howard County, Baltimore County, and Fairfax County do not prevent their pension boards from making investments maintaining indicia of ownership of assets outside the jurisdiction of the U.S. courts. See the County Attorney memorandum at ©19-20. Recently, the County Board of Investment Trustees considered 2 different investments with private equity firms that could not have been made because of this restriction. See the Linda Herman memorandum at ©21-22. Removing this restriction would permit the Boards to better fulfill their fiduciary duty without creating additional risk. **Committee recommendation (3-0):** repeal the restriction on making investments maintaining indicia of ownership of assets outside the jurisdiction of the U.S. courts.

2. Should the Boards be permitted to invest in County-related bonds?

Maryland, Virginia, West Virginia, Howard County, Baltimore County, Prince George's County, and Fairfax County do not prevent investments in State or County bonds. This restriction prevents the County Boards from investing in many commingled bond funds where the manager does not honor restrictions on investments from individual investors. See the Linda Herman memorandum at ©21-22. Removing this restriction would permit the Boards to better fulfill their fiduciary duty without creating additional risk. **Committee recommendation (3-0):** repeal the restriction on investing in County-related bonds.

3. Should the Boards be permitted to invest in real estate funds with more than 10% of the properties located in the County?

This restriction also prevents the County Retiree Health Benefits Board from investing in many commingled real estate funds where the manager does not honor restrictions on investments from individual investors. See the Linda Herman memorandum at ©21-22. This restriction has already been removed for the Board of Investment Trustees. Removing this restriction would permit the Board to better fulfill their fiduciary duty without creating additional risk. **Committee recommendation (3-0):** repeal the Retiree Health Benefits Board's restriction on investing in funds with more than 10% County real estate.

This packet contains:

F:\LAW\BILLS\1415 BIT And Consolidated Retiree Amendments\Action Memo.Doc

Expedited Bill No. 15-14
Concerning: Personnel - Board of Investment Trustees - Consolidated Retiree Health Benefits Trust Board of Trustees – Investments - Amendments
Revised: January 16, 2014 Draft No. 1
Introduced: February 4, 2014
Expires: August 4, 2015
Enacted: ________
Executive: ________
Effective: ________
Sunset Date: None
Ch. _____, Laws of Mont. Co. ________

COUNTY COUNCIL FOR MONTGOMERY COUNTY, MARYLAND

By: Council President at the request of the County Executive

AN EXPEDITED ACT to:

(1) repeal the requirement that investments made by the Board of Investment Trustees and the Consolidated Retiree Health Benefits Board of Trustees retain U.S. indicia of ownership;
(2) repeal the prohibition on investments in County related bonds by the Board of Investment Trustees and the Consolidated Retiree Health Benefits Board of Trustees;
(3) repeal the restriction on real estate investment by the Consolidated Retiree Health Benefits Board of Trustees; and
(4) generally amend the law regarding the Employees' Retirement System, Retirement Savings Plan, the Deferred Compensation Plan, and the Consolidated Retiree Health Benefits Trust Fund.

By amending
Montgomery County Code
Chapter 33, Personnel and Human Resources
Sections 33-59, 33-60, 33-125, 33-145, 33-160 and 33-162

Boldface	*Heading or defined term.*
Underlining	*Added to existing law by original bill.*
[Single boldface brackets]	*Deleted from existing law by original bill.*
Double underlining	*Added by amendment.*
[[Double boldface brackets]]	*Deleted from existing law or the bill by amendment.*
* * *	*Existing law unaffected by bill.*

The County Council for Montgomery County, Maryland approves the following Act:

Sec. 1. Sections 33-59, 33-60, 33-125, 33-145, 33-160 and 33-162 are amended as follows:

33-59. Board of investment trustees.

* * *

(b) *Membership.*

* * *

(4) The following 6 trustees must be appointed by the Executive and confirmed by the Council:

(A) An active County employee who is a vested member of the retirement system and the Merit System, and not a member of a collective bargaining unit. A 3-year term for this trustee ends on March 1 of every third year after the trustee is confirmed by the Council.

(B) A retired County employee who is a member of the retirement system. Before appointing this trustee, the Executive must consider, and should select from, a list of 3 to 5 individuals recommended by the Montgomery County Retired Employees' Association. The Executive must notify the Council when nominating an individual not recommended by the Association. A 3-year term for this trustee ends on March 1 of every third year after the trustee is confirmed by the Council.

(C) Two persons recommended by the Council who are knowledgeable in pensions, investments, or financial matters. A 3-year term for these trustees ends on March 1 of every third year after each trustee is confirmed by the Council.

(D) Two individuals knowledgeable in pensions, investments, or financial matters. Before nominating these trustees, the Executive must consider, and should select from, individuals recommended by citizens or countywide citizens' groups. An individual recommended by a citizens' group need not be a member of the group. The Executive must notify the Council when nominating an individual not recommended by a citizens' group. A 3-year term for these trustees ends on March 1 of every third year after each trustee is confirmed by the Council.

(5) A trustee appointed under paragraph [(3)] (4) continues to serve after the trustee's term ends until the Council confirms a successor, but the term for each position is not affected by any holdover. A trustee who, after appointment and before the end of a term, is no longer qualified for the trustee's position is removed from the Board by operation of law.

* * *

(l) In this Section, "retirement system" means the Employees' Retirement System, [or] the Retirement Savings Plan, or the Deferred Compensation Plan under Article IX.

33-60. The board of investment trustees-Powers and duties.

* * *

(b) *Agents for transfer of property.*

* * *

[(6) Except as authorized by executive regulation adopted under method (3) that is substantially equivalent to federal ERISA regulations on maintenance of indicia of ownership of plan assets, the board must maintain the indicia of ownership of the assets of the retirement system within the jurisdiction of the district courts of the United States.]

(c) *Authorized investments.*

* * *

[(3) The board or an investment manager must not invest any retirement system asset in any bond, note, or debt instrument issued by:

(A) The County;

(B) Any political subdivision within the County;

(C) Any agency supported or financed wholly or partly by taxes levied by the County Council; or

(D) Any agency supported by bond issues underwritten by the County.]

* * *

33-125. Powers and duties of the Board.

* * *

(b) *Agents for transfer of property.*

* * *

[(6) The Board must maintain the indicia of ownership of the assets of the retirement savings plan within the jurisdiction of the district courts of the United States.]

* * *

33-145. Powers and duties of the board.

* * *

(c) *Agents for transfer of property.*

* * *

[(6) The Board must maintain the indicia of ownership of the assets of the deferred compensation plan within the jurisdiction of the district courts of the United States, except as authorized in regulations adopted under method (3) that are substantially equivalent to federal regulations under the Employee Retirement and Income Security Act (ERISA) regarding indicia of ownership of plan assets.]

* * *

33-160. Board of Trustees.

* * *

(f) *Officers*. The Board must select a chair, vice chair, and secretary from the Board's members.

(1) The chair must preside at meetings of the Board and may take administrative action, including executing an instrument, on behalf of the Board. A person may rely in good faith on an act of the chair as legally valid.

(2) The vice chair must perform the duties and exercise the powers of the chair when the chair is [absent from the County or disabled] <u>unavailable</u>, or the Board determines is otherwise unable to perform the duties of the chair.

(3) The secretary must record the proceedings and actions of the Board and may certify a document or action of the Board. A person may rely in good faith on the secretary's certification as proof of the document or action.

* * *

33-162. Trust Fund management.

* * *

(c) *Transfer Agents.*

* * *

[(6) The Board must maintain the indicia of ownership of the Trust Fund's assets within the jurisdiction of the United States federal courts, except as authorized in regulations that the Executive adopts under method (2). Those regulations must be substantially equivalent to federal regulations under the Employee Retirement Income Security Act (ERISA) regarding indicia of ownership of plan assets.]

(d) *Authorized investments.*

* * *

[(2) The Board or any investment manager must not invest in real property, including securities based on ownership or other interests in real property, unless the investment is a pooled investment in which the Board has no power to manage the real property. A pooled investment must not invest more than 10 percent of its assets in real property located in the County. This 10 percent limit applies to the market value of the total assets on the preceding June 30. If the market value of investments in real property in the County exceeds the 10-percent limit as a result of market forces, the Board or the investment manager need not sell an existing equity investment. The Board may obtain valuations and take appropriate steps to comply with this 10-percent limit.]

[(3)] (2) * * *

[(4) The Board and any investment manager must not invest any Trust Fund asset in any bond, note, or debt instrument issued by:

(A) the County;

(B) a political subdivision in the County; or

(C) an agency supported by bond issues underwritten by the County.

However, the Board or any investment manager may invest plan assets in bonds, notes, and debt instruments of any of these entities if the investment is held indirectly through a mutual fund or other pooled, investment vehicle and complies with any limit in the Internal Revenue Code.]

* * *

Sec. 2. Expedited Effective Date.

The Council declares that this legislation is necessary for the immediate protection of the public interest. This Act takes effect on the date on which it becomes law.

Approved:

Craig L. Rice, President, County Council — Date

Approved:

Isiah Leggett, County Executive — Date

This is a correct copy of Council action.

Linda M. Lauer, Clerk of the Council — Date

LEGISLATIVE REQUEST REPORT

Expedited Bill 15-14
Personnel - Board of Investment Trustees - Consolidated Retiree Health Benefits Trust Board of Trustees – Investments - Amendments

DESCRIPTION: The Bill would repeal the requirement that investments made by the Board of Investment Trustees for the Montgomery County Employee Retirement Plans and the Board of Trustees for the Montgomery County Consolidated Retiree Health Benefits Trust maintain the indicia of ownership of assets within the jurisdiction of the courts of the U.S. The bill would also repeal other categorical restrictions on investments, including County-related bonds and County-related real estate, and make technical changes.

PROBLEM: The Boards of the Montgomery County Employee Retirement Plans and the Montgomery County Consolidated Retiree Health Benefits Trust are currently precluded from making investments maintaining indicia of ownership of assets outside the jurisdiction of the U.S. courts. Since investment opportunities are increasingly located outside of the United States, many without maintaining United States indicia of ownership within the jurisdiction of the courts of the U.S, current law constrains the pool of investments available to the Employee Retirement Plans and Consolidated Retiree Health Benefits Trust. This restriction may unnecessarily limit the returns that can be generated by these entities. Restricting the Boards from making these investments hinders their ability to fulfill their fiduciary duty, as the Uniform Management of Public Employee Retirement Systems Act (UMPERSA) mandates that all categorical restrictions on types of investments be eliminated. Similarly, the Employee Retirement Plans and Consolidated Retiree Health Benefits Trust are currently prohibited from investing in County-related bonds, which precludes participation in investments with certain investment managers. The Consolidated Retiree Health Benefits Trust is also prohibited from making investments in real estate funds if more than 10% of such fund's assets comprise real estate in Montgomery County; this precludes participation in investments with a wide variety of real estate investment managers.

GOALS AND OBJECTIVES: The goal of the Bill is to provide the Boards with the flexibility to make investments with indicia of ownership outside of the United States courts, investments in County-related bonds, and County-related real estate, as consistent with their fiduciary duties.

The Bill also makes other clarifying changes such as providing that a retiree member of the Board of Investment Trustees may be a member of the Deferred Compensation Plan and that the vice chair of the Board of Trustees for the Consolidated Retiree Health Benefits Trust assumes the duties of the chair when the chair is unavailable.

COORDINATION: The Board of Investment Trustees, Board of Trustees, and the County Attorney's Office have reviewed this Bill.

FISCAL IMPACT: Office of Management and Budget

ECONOMIC IMPACT: Department of Finance

EVALUATION: N/A

EXPERIENCE ELSEWHERE: Numerous other governmental retirement plans, including the State of Maryland Retirement and Pension System, Virginia Retirement System and D.C. Retirement System, have no similar requirement that investments maintain the indicia of ownership of assets within the jurisdiction of the U.S. courts. Neither the Maryland State Retirement and Pension System nor Virginia Retirement System have a prohibition against investing in State-related bonds.

SOURCE OF INFORMATION: Linda Herman and Bradley Stelzer, Board of Investment Trustees, Board of Trustees
Amy Moskowitz, Office of the County Attorney
Morgan Lewis, outside legal counsel for the Board of Investment Trustees

APPLICATION WITHIN MUNICIPALITIES: N/A

PENALTIES: N/A

OFFICE OF THE COUNTY EXECUTIVE
ROCKVILLE, MARYLAND 20850

Isiah Leggett
County Executive

MEMORANDUM

December 19, 2013

TO: Craig Rice, Council President

FROM: Isiah Leggett, County Executive

SUBJECT: Expedited Bill to Amend the County's Retirement Law

I am attaching for the Council's consideration a bill that would amend the County's law to allow the Employee Retirement Plans and Consolidated Retiree Health Benefits Trust to delete a provision which requires the Boards overseeing the investment of the Trust Funds to maintain the indicia of ownership of assets within the jurisdiction of the district courts of the United States. The bill would also delete other categorical restrictions on investments and make technical changes.

The County Code currently requires the Employee Retirement Plans (ERP) and Consolidated Retiree Health Benefits Trust (CRHBT) to maintain the indicia of ownership of assets within the jurisdiction of the courts of the United States. (Sections 33-60, 33-125, 33-145, and 33-162). These provisions of the County Code mirror the Employee Retirement Income Security Act (ERISA) which governs private retirement plans, but not the ERP. The Board of Investment Trustees for the ERP and the Board of Trustees for the CRHBT (collectively, "Boards") have been advised by outside legal counsel that it is viewed as an acceptable practice by plans subject to ERISA to make investments with indicia of ownership outside of the U.S. provided that documents relating to the investment are held in the U.S. under the untested theory that this satisfies the requirement that the courts of the U.S. maintain jurisdiction of the assets. The outside counsel for the Boards has advised them that a better approach for the ERP and CRHBT would be to remove the requirement that investments maintain U.S. indicia of ownership rather than to rely on "acceptable practice." Outside legal counsel also noted that such a provision is unusual in governmental retirement plans. Numerous other governmental retirement plans, including the Maryland State Retirement and Pension System, Virginia Retirement System, and D.C. Retirement Board, have no similar requirement that investments maintain the indicia of ownership of assets within the jurisdiction of the U.S. courts.

Due to the increasingly global nature of investment opportunities, the bill under consideration is important, since it would remove the requirement that investments for the ERP and CRHBT maintain indicia of ownership of assets within the jurisdiction of the courts of the U.S. and allow the Boards to pursue investments with favorable return potential without doubt that the "acceptable practice" continues to be sufficient. The changes included in the bill also serve to improve the Boards' ability to perform their fiduciary duty, as the Uniform Management of Public Employee Retirement Systems Act (UMPERSA) mandates that all categorical restrictions on types of investments be eliminated due to the limitations these restrictions place on the trustee's ability to perform their fiduciary duties in the investment of retirement plan funds and the potential loss of investment income. The Council previously took action in Bill 27-07 to eliminate other categorical restrictions on investments from the Code.

The County Code also currently contains categorical restrictions on the ERP's and CRHBT's ability to invest in County-related bonds (33-60 and 33-162) and the CRHBT's ability to make real estate fund investments if more than 10% of such fund's investments are located in the County (33-162) ("County-related real estate investments"). The prohibition against investing in County-related bonds cannot be adhered to by certain investment managers as their fiduciary duty requires them to pursue the best investment opportunities on a risk/return basis without restriction. This restriction limits the Boards' ability to perform their fiduciary duty and, therefore, to adhere to UMPERSA. It is important to note that the Boards currently do not have authority to make direct investments in securities, as 33-60(c)(1) and 33-162(d)(1) require that all investments be made through an investment manager. Under the proposed legislation, there would be no changes to the requirement to use an investment manager, meaning that only investment managers – not the Boards directly – could purchase County-related bonds. Other local jurisdictions such as Virginia and Maryland do not restrict investment by their retirement systems in State-related bonds. Also, prior legislation removed the restriction on the Board of Investment Trustees' ability to make County-related real estate investments for the ERP; removing the same restriction for the Board of Trustees for the CRHBT brings parity to the Boards' ability to pursue real estate investments.

The Bill also makes several other technical changes such as clarifying that a retiree member of the Board of Investment Trustees may be a member of the Deferred Compensation Plan and that the vice chair of the Board of Trustees for the Consolidated Retiree Health Benefits Trust assumes the duties of the chair when the chair is unavailable.

Thank you for your prompt consideration of this bill.

IL:lh

Attachments

Fiscal Impact Statement
Council Bill XX-13
Board of Investment Trustees – County Retirement Plans
Board of Trustees – Consolidated Retiree Health Benefits Trust

1. Legislative Summary.

   This bill would amend the Montgomery County Code by removing requirements that investments made by the Boards overseeing the County's Retirement Plans and the Consolidated Retiree Health Benefits Trust (CRHBT) retain U.S. indicia of ownership. The bill would also delete other categorical restrictions on investments, including County-related bonds and real estate located in the County, and make technical changes.

2. An estimate of changes in County revenues and expenditures regardless of whether the revenues or expenditures are assumed in the recommended or approved budget. Includes source of information, assumptions, and methodologies used.

   Implementation of this bill would not impact County revenue. County expenditures could be impacted if the bill resulted in the ability to generate higher investment returns, which would reduce the required County contribution to the Retirement Plans and the CRHBT. The extent or degree of the impact is unquantifiable. The assumption is that there is an opportunity cost to limiting available investment options.

3. Revenue and expenditure estimates covering at least the next 6 fiscal years.

   Not applicable

4. An actuarial analysis through the entire amortization period for each bill that would affect retiree pension or group insurance costs.

   Not applicable

5. Later actions that may affect future revenue and expenditures if the bill authorizes future spending.

   Not applicable

6. An estimate of the staff time needed to implement the bill.

   Not applicable

7. An explanation of how the addition of new staff responsibilities would affect other duties.

   Not applicable

8. An estimate of costs when an additional appropriation is needed.

   Not applicable

9. A description of any variable that could affect revenue and cost estimates.

   Not applicable

10. Ranges of revenue or expenditures that are uncertain or difficult to project.

    Not applicable

11. If a bill is likely to have no fiscal impact, why that is the case.

Implementation of this bill would not impact County revenue. County expenditures could be impacted if the bill resulted in the ability to generate higher investment returns, which would reduce the required County contribution to the Retirement Plans and the CRHBT. While the extent or degree of the impact is unquantifiable, it is believed that there is an opportunity cost to limiting available investment options.

12. Other fiscal impacts or comments.

    Not applicable

13. The following contributed to and concurred with this analysis:
    Linda Herman and Bradley Stelzer, Montgomery County Employee Retirement Plans; and Corey Orlosky, Office of Management and Budget

Jennifer A. Hughes
Jennifer A. Hughes, Director
Office of Management and Budget

12/12/13
Date

Economic Impact Statement
Bill xx-13
Board of Investment Trustees – County Retirement Plans
Board of Trustees – Consolidated Retiree Health Benefits Trust

Background:

This legislation would:

- amend the requirements of the County retiree member of the Board of Investment Trustees.
- amend the requirement that investments made by the Board of Investment Trustees must retain U.S. indicia of ownership.
- amend the requirement that investments made by the Consolidated Retiree Health Benefits Board of Trustees must retain U.S. indicia of ownership.
- amend the Employees' Retirement System to delete the prohibition of investments in County related bonds.
- amend the Consolidated Retiree Health Benefits Trust to delete the prohibition of investment in Montgomery County real estate.
- amend the Consolidated Retiree Health Benefits Trust to delete the prohibition of investments in County related bonds.
- generally amend the law regarding the Employees' Retirement System, Retirement Savings Plan and the Deferred Compensation Plan.
- generally amend the law regarding the Consolidated Retiree Health Benefits Trust Fund.

1. The sources of information, assumptions, and methodologies used.

The source of information is from the staff of the Montgomery County Employee Retirement Plans. Assumptions and methodologies are not applicable.

2. A description of any variable that could affect the economic impact estimates.

Not applicable. Bill xx-13 would have no economic impact because the proposed legislation is a technical change that removes the requirement that investments made by the Board of Investment Trustees for the County's Retirement Plans and the Board of Trustees for the Consolidated Retiree Health Benefits Trust retain a U.S. indicia of ownership. The Bill also deletes other categorical restrictions on investments, including County-related bonds and real estate located in Montgomery County. The Bill also makes other technical changes relating to membership of the Board of Investment Trustees and duties of officers on the Board of Trustees. No economic impact results from these technical changes since they do not affect employment, spending, savings or other economic variables.

Economic Impact Statement
Bill xx-13
Board of Investment Trustees – County Retirement Plans
Board of Trustees – Consolidated Retiree Health Benefits Trust

3. **The Bill's positive or negative effect, if any on employment, spending, saving, investment, incomes, and property values in the County.**

   Not applicable. See #2 above. Bill xx-13 would have no economic impact.

4. **If a Bill is likely to have no economic impact, why is that the case?**

   See #2 above. The proposed legislation removes the requirement that investments made by the Board of Investment Trustees for the County's Retirement Plans and the Board of Trustees for the Consolidated Retiree Health Benefits Trust retain a U.S. indicia of ownership. The Bill also deletes other categorical restrictions on investments, including County-related bonds and real estate located in Montgomery County. The legislation also makes other technical changes relating to membership of the Board of Investment Trustees and duties of officers on the Board of Trustees. No economic impact results from these changes.

5. **The following contributed to and concurred with this analysis**: Linda Herman and Brad Stelzer of the Board of Investment Trustees and David Platt and Rob Hagedoorn, Finance;

Joseph F. Beach, Director
Department of Finance

12/5/13
Date

Uniform Law Commissioners
The National Conference of Commissioners on Uniform State Laws

SUMMARY

Uniform Management of Public Employee Retirement Systems Act

More than $1 trillion in assets are managed in the United States in retirement systems for public employees of state and local government. A mixture of state law governs these systems, unlike private retirement systems which are governed primarily by federal law, the Employee Retirement Income Security Act (ERISA). State law has not kept up with modern investment practices so that trustees for these systems are very frequently not be able to maximize return for the level of risk that is appropriate to these systems. This means less money to pay retirement benefits than would be the case if trustees could use modern portfolio theory. (More on modern portfolio theory, later.)

In 1997 the Uniform Law Commissioners have promulgated the Uniform Management of Public Employee Retirement Systems Act (UMPERSA) to remedy the deficiency. It will provide legal rules that permit public employee retirement systems to invest their funds in the most productive and secure manner. And these advantages can be obtained with a minimum of regulatory interference. How does UMPERSA work?

ALL ASSETS HELD IN TRUST

Except for certain insurance-based assets, all assets of a retirement system are held in trust and the trustee has the independent, exclusive authority to invest and manage those assets. The trustee is defined as the person with the ultimate authority to manage a retirement system or to invest or manage its assets. By declaring that all retirement system assets are held in trust, UMPERSA assures that public employees are guaranteed the highest standard of conduct in the management and investment of assets for retirement that the law can establish. A trustee is the highest fiduciary, carries the greatest burdens of care, loyalty and utmost good faith for the beneficiaries to whom he or she is responsible.

As well as ordinary trustees' powers, a trustee under UMPERSA has the power to establish an administrative budget and to employ the services necessary to administer the trust. The trustee may delegate functions that "a prudent trustee or administrator acting in like capacity and familiar with those matters could properly delegate under the circumstances." This delegation rule, which reverses the common law rule about delegation of trust functions, is important with respect to the trustee's investment obligations.

PRUDENT INVESTMENT RULES

UMPERSA follows the Uniform Prudent Investor Act in its articulation of prudent investment rules. These rules provide trustees with the great advantage of modern portfolio theory. When the trustee is responsible for investment of the assets of a public employee retirement system, he or she must invest as a prudent investor invests his or her own assets. Prudent investment is a fiduciary duty. A prudent investor takes all factors into account in considering investment decisions, such as general economic conditions, effects of inflation or deflation, expected total return from income and appreciation of capital, and the role that every investment fills in the entire portfolio. There is a positive obligation to diversify investments, unless special circumstances indicate that it is not prudent to do so. Diversification is the best method for reducing risk of loss. In return for these obligations, the trustee obtains the power to invest in any property or

16

investment consistent with UMPERSA.

Although a trustee under UMPERSA may invest in assets other than interest-bearing instruments and real estate, the prudent investment rules do not promote unreasonable risk-of-loss or speculative investment. The trustee must make a careful risk-return analysis in light of the objectives of the retirement system, including the income needs of that system. The availability of a broader range of investments and diversification means risk can be safely and significantly managed with the prospect of much greater return.

Since most of the public employee retirement systems are backed by state and local governments, if they fail to generate the income to pay retirement benefits, the taxpayer inevitably assumes the burden. Thus prudent investment reduces taxpayer risk, as well.

As a corollary to prudent investment obligations, the trustee's performance in investment is measured by the performance of the entire portfolio, not just the performance of individual investments. Also, performance is measured in light of the facts and circumstances when investment decisions are made. Hindsight is ruled out.

TRUSTEE LIABILITY

A trustee or other fiduciary who breaches a duty imposed by UMPERSA is personally liable for any loss or for any profit made through use of trust assets. No agreement may exonerate a trustee or fiduciary from liability. The retirement system or the fiduciary may insure against such losses.

REQUIRED DISCLOSURES

UMPERSA requires each retirement system to provide three information resources. A "summary plan description" is required, as are subsequent updates when the system changes the plan. The summary plan description is a brief disclosure of the benefits the plan provides, how one qualifies for benefits, and how a member may become disqualified. Each system must publish "annual disclosure of financial and actuarial status" in detail. This is a comprehensive compilation of financial and actuarial information. And last, an "annual report" must be published. The "annual report" is a brief summary of the "annual disclosure of financial and actuarial status."

All three must be available at the retirement system's principal offices for public inspection. The administrator must honor requests for copies, but may charge a reasonable fee for supplying them.

The administrator must send copies of the "summary plan description" to new participants in a retirement system within three months after they join. Updates must be sent out at least seven months after the fiscal year in which the plan changes have been made. A complete revised "summary plan description" with all prior changes incorporated must be sent to participants at least every five years. The "annual report" must be sent to participants within seven months of the end of the fiscal year which is reported.

UMPERSA contemplates the creation of an agency as a central repository of information on public employee retirement systems. Disclosures of the "summary plan description", subsequent changes, the"annual disclosure of financial and actuarial status" and the annual report must be filed with the designated agency.

ENFORCEMENT

A public employer, participant, beneficiary or fiduciary may bring equitable action in a court for relief from a violation of UMPERSA or breach of a duty. The agency may also bring injunctive relief against a violation of UMPERSA.

17

CONCLUSION

UMPERSA will provide for improved investment returns for public employee retirement systems. It will guarantee important information to public employers, trustees and participants about the administration of these systems. It provides clear liability and enforcement rules. State and local governments, trustees and fiduciaries, participants and the taxpayer, who must pay for financial deficiencies in such systems, all stand to gain from the adoption of UMPERSA. Every state should adopt it as soon as possible.

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18

OFFICE OF THE COUNTY ATTORNEY

Isiah Leggett *County Executive*	Marc P. Hansen *County Attorney*

MEMORANDUM

TO: Bob Drummer

FROM: Amy S. Moskowitz

DATE: February 24, 2014

RE: Other Jurisdictions-Trust Investments

You asked whether other neighboring jurisdictions contain any statutory provisions regarding indicia of ownership of trust assets within the jurisdiction of the courts of the United States and investment of assets in its own bonds.

Indicia of Ownership in the United States

The following jurisdictions do not have any statutory provisions requiring indicia of ownership of trust assets within the jurisdiction of the courts of the United States:

1. State of Maryland
2. District of Columbia
3. State of Virginia
4. Anne Arundel County
5. Howard County
6. Baltimore County
7. Fairfax County

Investment in County/State Bonds

The following jurisdictions do not have any statutory prohibition of investing trust assets in County/State bonds:

1. State of Maryland
2. State of Virginia
3. State of West Virginia

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4. Howard County
5. Baltimore County
6. Prince George's County
7. Fairfax County

The following jurisdictions contain restrictions on investment in bonds:

1. The District of Columbia prohibits investment in its bonds unless the Board has no discretionary authority for the investment decision.
2. Anne Arundel County prohibits investment in County bonds if it would be considered a prohibited transaction under the Internal Revenue Code.

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BOARD OF INVESTMENT TRUSTEES

BOARD OF TRUSTEES

MEMORANDUM

February 24, 2014

To: Robert Drummer, Senior Legislative Attorney

From: Linda A. Herman, Executive Director

Subject: Bill #15-14

The Boards overseeing the investment programs for the County's retirement plans and the retiree health benefits trust are requesting this legislation to remove the requirement that investments for the Trusts maintain indicia of ownership of assets within the jurisdiction of the courts of the U.S. and allow the Boards to pursue investments with favorable return potential without doubt that the "acceptable practice" continues to be sufficient. The investment programs for the Trust funds include strategic asset allocations to private funds, including private equity, private real assets and hedge funds. Allocation to these market sectors provides the Trusts with the opportunity to invest both domestically and globally in the funds that offer the best risk adjusted return. During the last twelve months, Board staff reviewed two such opportunities, both were private equity firms domiciled outside of the U.S., one a technology firm located in Israel and the other a German private equity firm. After the Boards' Staff, and the consultant, completed their due diligence on the firms, the decision was made not to invest in one of the funds and the other fund was capacity constrained so we were not able to obtain an allocation. Had we been able to invest in the fund that was selected, the requirement that the investment maintain U.S. indicia of ownership would have prohibited us from making the investment as we would not be willing to rely on the "untested theory" that most ERISA plans rely on. In addition, the Boards, as fiduciaries over the nearly $4 billion in Trust assets, are requesting this change to ensure that the Trusts are afforded the same investment opportunities as other local jurisdictions with which they compete to obtain an investment in these funds.

The County Code also currently contains categorical restrictions on the Trusts limiting their ability to invest in County-related bonds and, for the retiree health benefits trust, to make real estate fund investments if more than 10% of such fund's investments are located in the County. In 2013, the Board overseeing the investment program for the County's $3.4 billion defined benefit retirement plan, hired a consultant to assist Board Staff in sourcing and evaluating direct investment opportunities within the opportunistic or hedge fund sector. These opportunities are usually available via a commingled vehicle, wherein the investment manager establishes the investment guidelines for the vehicle, not the investor, as is the case of a separate account. The commingled vehicles cannot adhere to the requirements of individual investors, such as the County's Trust Funds, as their fiduciary duty requires them to pursue the best investment opportunities on a risk/return basis without restriction. Therefore, restrictions such as the

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ones contained in the County Code limit the investment opportunities for the Trust Funds. The Board has approved the investment in two hedge fund commingled vehicles pending the passage of Bill #15-14. Without the passage of this legislation, the investments cannot be made.

TESTIMONY FOR EXPEDITED BILL 15-14, COUNTY'S RETIREMENT LAW

Good afternoon, for the record, I am Linda Herman, Executive Director of the Montgomery County Employee Retirement Plans, the Board of Investment Trustees which oversees the assets of the County's three retirement plans, and the Board of Trustees of the Consolidated Retiree Health Benefits Trust which oversees the assets of the OPEB Trust Fund. I am here today on behalf of the County Executive and the Boards to testify in support of Bill 15-14, Chapter 33 – Retirement & Investments.

The proposed Bill will amend the County's law to remove certain restrictions related to the investments made by the Boards on behalf of the Employee Retirement Plans (ERP) and Consolidated Retiree Health Benefits Trust (CRHBT). The County Code currently requires the Trust Funds to maintain the indicia of ownership of assets within the jurisdiction of the courts of the United States. Due to the increasingly global nature of investment opportunities, the bill under consideration is important, since it will allow the Boards to pursue investments with favorable return potential without doubt that the "acceptable practice" that has been used in the past continues to be sufficient. The changes included in the bill also serve to improve the Boards' ability to perform their fiduciary duty, as the Uniform Management of Public Employee Retirement Systems Act (UMPERSA) mandates that all categorical restrictions on types of investments be eliminated due to the limitations these restrictions place on the trustee's ability to perform their fiduciary duties in the investment of retirement plan funds and the potential loss of investment income. The Council previously took action in Bill 27-07 to eliminate other categorical restrictions on investments from the Code.

The County Code also currently contains categorical restrictions on the ERP's and CRHBT's ability to invest in County-related bonds and the CRHBT's ability to make real estate fund investments if more than 10% of such fund's investments are located in the County. The prohibition against investing in County-related bonds cannot be adhered to by certain investment managers as their fiduciary duty requires them to pursue the best investment opportunities on a risk/return basis without restriction. This restriction limits the Boards' ability to perform their fiduciary duty and, therefore, to adhere to UMPERSA.

The Bill also makes several other technical changes such as clarifying that a retiree member of the Board of Investment Trustees may be a member of the Deferred Compensation Plan and that the vice chair of the Board of Trustees for the Consolidated Retiree Health Benefits Trust assumes the duties of the chair when the chair is unavailable.

We look forward to working with the Council in its deliberations on this legislation.